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CLIENT ALERT

# U.S. Supreme Court Holds that a Debtor Licensor's Rejection of a Trademark License Does Not Deprive the Non-Debtor Licensee of Rights to Use the Licensed Trademark

June 4, 2019


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On May 20, 2019, the U.S. Supreme Court resolved a circuit split in its highly anticipated decision in *Mission Product Holdings v. Tempnology*.[1] In an 8-1 decision authored by Justice Kagan, the Court held that when a trademark licensor becomes bankrupt, the debtor licensor's rejection of the trademark license does not rescind the non-debtor licensee's existing rights to use the licensed trademark, and the non-debtor licensee retains any rights it would have under nonbankruptcy law following a breach of the agreement.

**Background**

This case involved Tempnology, LLC entering into a licensing agreement with Mission Product Holdings Inc., giving Mission Product exclusive rights to distribute COOLCORE-trademarked products in the United States.[2] The case arose from Tempnology's 2015 Chapter 11 bankruptcy, which led Tempnology to "reject" its licensing agreement with Mission Product under § 365(a) of the Bankruptcy Code and therefore declare that Mission Product's rights to use the COOLCORE trademark were terminated.

1 *Mission Product Holdings*, *Inc. v. Tempnology LLC*, No. 17-1657 (U.S. May 20, 2019).

2 *Mission Product Holdings*, No. 17-1657 slip op. at 1-2.

In *Mission Product*, the initial bankruptcy court ruling found that the termination of the license agreement revoked Mission Product's right to use the COOLCORE marks. A Bankruptcy Appellate Panel overturned this ruling following the reasoning of a prior ruling from the Seventh Circuit Court of Appeals, which held that a rejection of a license in bankruptcy constitutes a breach by the debtor, but does not eliminate the rights that the contract had already conferred on the non-breaching party.[3] In reversing the Bankruptcy Appellate Panel decision, the First Circuit Court of Appeals determined that a trademark owner in bankruptcy had the ability to terminate a licensing agreement based on (i) an argument of negative inference that the lack of an express inclusion of "trademarks" in the protections afforded by § 365(n) of the Bankruptcy Code (which allows a non-debtor licensee of licensed "intellectual property" to retain its rights under such contract for the duration of the contract, as it may be extended as long as it continues to make royalty payments, among other things) and (ii) the special features of trademark law.[4] The First Circuit held that trademarks were necessarily not covered by § 365(n) because they were not listed in the Bankruptcy Code definition of "intellectual property." The First Circuit also agreed with Tempnology's argument that trademark law uniquely requires mark owners to monitor and exercise quality control over the use of their marks. As such, requiring a bankrupt licensor to continue allowing the use of the mark forces the debtor licensor to spend limited resources on ensuring quality control and thus impedes the purpose of the reorganization under Chapter 11.

The Supreme Court overturned the First Circuit and sided with the Seventh Circuit's reasoning in *Sunbeam Products*. *Mission Product* hinged on the Supreme Court's interpretation of the outcome of a "rejection" of an executory contract. The Court held that a "rejection" of an executory contract results in a breach by the debtor party, but not a termination of the rights previously granted thereunder. As such, any rights conferred to the non-debtor party prior to the rejection would remain despite the breach.

**Decision**

Justice Kagan authored the majority opinion, which was joined by Justices Breyer, Roberts, Alito, Thomas, Ginsburg, and Kavanaugh. Justice Sotomayor filed a concurring opinion and Justice Gorsuch filed a dissenting opinion.

In its decision, the Court reversed the decision of the First Circuit Court of Appeals, which previously found in favor of Tempnology. Writing for the majority, Justice Kagan affirmed that debtors that have filed for bankruptcy cannot terminate previously granted rights by merely rejecting a contract, including in the case of a trademark license.

The Court first addressed whether the case was moot. Tempnology argued that because its license agreement to Mission Product had expired by its terms, and Tempnology had liquidated with all of the bankruptcy estate's assets having been distributed, there was no ability for a court to provide relief, and therefore, the case should be dismissed regardless of the

3 *Sunbeam Products, Inc. v. Chicago Am. Mfg., L.L.C.*, 686 F. 3d 372, 376-7 (CA7 2012).

4 *In re Tempnology, LLC*, 879 F.3d 389 (2018).

merits. The Court disagreed and found that Mission Product had valid claims for lost profits from its inability to use the COOLCORE marks and could still seek to unwind prior distributions to obtain relief from the estate of Tempnology. In doing so, the Court held that "[i]f there is any chance of money changing hands . . ." then the mootness doctrine will not prevail.[5] This holding may be the definitive death knell for the doctrine of "equitable mootness" in the bankruptcy context, which has become less favored by courts in recent years.

The majority opinion goes on to make clear that, largely based upon the Court's interpretation of § 365(g) of the Bankruptcy Code, a "rejection" of an executory contract constitutes a breach of contract by a debtor, rather than a termination, and no exception to this interpretation is warranted because the executory contract at issue is a trademark license agreement. The Court couched this finding in a general bankruptcy rule: the estate of a debtor cannot possess anything more than the debtor itself possessed outside of bankruptcy. The Court noted that outside of bankruptcy, unless a contract has language expressly stating otherwise, if one party breaches a contract, the breaching party cannot rescind any rights it previously granted to the non-breaching party unless the non-breaching party chooses to terminate the contract as a result of the breach. Justice Kagan used the example of a copier leased by a law firm. Outside of bankruptcy, if the copier supplier breaches its lease of the copier, the law firm can either choose to continue paying fees and keep leasing the copier, or it can terminate and end the lease. The Court found that these same principles equally apply to any rejected executory contract, including a trademark license agreement. The Court acknowledged that while a debtor licensor can stop performing its remaining obligations under an executory contract by way of rejection, it does not allow for the rescission of previously conveyed rights. This reasoning endorses the "rejection-as-breach" rule and repudiates the "rejection-as-rescission" interpretation of § 365.[6] It is important to note that the Court makes clear that the above findings apply to all executory contracts, regardless of whether they are trademark licenses.

The Court also addressed the fact that the rejection-as-rescission interpretation essentially circumvents the Bankruptcy Code's limits on avoidance actions. By interpreting rejection as a rescission of rights, rejection essentially becomes a de facto avoidance and allows a debtor to unwind a transaction without meeting the normal express requirements for avoidance actions (like fraudulent conveyances) set forth in Chapter 5 of the Bankruptcy Code.

The Court rejected Tempnology's negative inference argument based on the non-inclusion of trademarks in the definition of "intellectual property" in the Bankruptcy Code, which is utilized in § 365(n). The Court found that there was insufficient evidence that Congress specifically enacted § 365(n) to protect certain parties, but not others. While the Court agreed that § 365(n) did not apply to trademark licenses, there was nothing about § 365(n) that would prevent a trademark licensee from enjoying the protections of § 365(g).[7]

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5 *Id.* at 6.

6 *Id.* at 11.

7 *Id*. at 12.

The Court further rejected the argument that distinct features of trademark law, which require mark owners to perform quality control, would run counter to the reorganization policies of Chapter 11 of the Bankruptcy Code because they would impede the debtor licensor's ability to reorganize by making it "choose between expending scarce resources on quality control and risking the loss of a valuable asset."[8] The Court noted that, by Tempnology's own argument, § 365 applies to all types of executory contracts and never specifically addresses trademark licenses. The Court reasoned that construction of § 365 should treat trademark license agreements the same as all other executory contracts, with only those contracts that fall into discrete provisions in § 365 treated differently. The Court noted that allowing Tempnology's trademark concerns to dictate the interpretation of § 365 would "allow the tail to wag the Doberman."[9] The Court also noted that even if the Bankruptcy Code favors reorganizations, "Section 365 does not grant the debtor an exemption from all the burdens that generally applicable law—whether involving contracts or trademarks—imposes on property owners."[10]

In a concurring opinion, Justice Sotomayor agreed with the Court's interpretation of §§ 365(a) and (g), and the determination that there is no specific aspect of trademark law that compels the acceptance of the special features argument.[11] However, Justice Sotomayor highlighted two potentially significant features of the *Mission Product* holding. First, Justice Sotomayor noted that the Court left open the baseline inquiry of whether the licensee's rights would necessarily survive a breach under nonbankruptcy law. Second, Justice Sotomayor noted that because trademark licenses are not included in the definition of "intellectual property" and thus are not covered by § 365(n), they would also not be subject to the additional obligations in that section. Justice Sotomayor observed "that trademark licensee's rights and remedies are more expansive in some respects than those possessed by licensees of other types of intellectual property."[12] Justice Sotomayor left it to Congress to address the differences in treatment resulting from the Court's holding.

In his dissent, Justice Gorsuch asserted that the Court should not have heard the case on the basis that Mission Product did not make a claim that would result in damages, and the matter therefore was moot.[13]

### Implications

This decision resolves the long-debated circuit split between rejection-as-breach and rejection-as-rescission interpretations of § 365 and provides trademark licensees with certainty that their rights under trademark licenses cannot be rescinded in the event of a licensor bankruptcy. By taking this position and expressly agreeing that § 365(n) does not

[8] *Id*. at 14.

[9] *Id*. at 15-16.

[10] *Id*. at 16.

[11] *Id.* at 1 (Sotomayor, J., concurring).

[12] *Id.* at 2.

[13] *Id.* at 1 (Gorsuch, J., dissenting).

apply to trademark licenses, the Court has made moot so-called "§ 365(n) clauses" (clauses in trademark licenses that have the licensor expressly acknowledge that the licensed trademarks will be treated as "intellectual property" for the purposes of § 365(n)).

While this decision may have resolved the circuit split, as Justice Sotomayor points out, it will be necessary to analyze non-bankruptcy law to determine the scope of a non-debtor licensee's rights post-rejection. On its face, rejection-as-breach still leaves powerful tools for trademark licensors to effectively prohibit uses of its trademark in bankruptcy. Unlike other intellectual property licenses, in most cases a licensor has extensive approval rights over the use of the trademark as a condition to the use of the licensed trademark. By simply refusing to exercise its approval rights (whether in breach of its obligations, or because the licensor has been granted the sole discretion to do so under the terms of the license), a debtor licensor can still effectively halt a non-debtor licensee's ability to use a trademark even though the grant of trademark rights remains in effect. Non-debtor licensees can combat this by stipulating that a licensor's failure to respond to an approval request in a certain period means that the request is "deemed approved," but most licensors are wont to agree to these types of clauses, regardless of their risk of bankruptcy.

Also as pointed out by Justice Sotomayor, the Court's interpretations of § 365(n) and § 365(g) ironically provides trademark licensees with more rights than the licensee of any other intellectual property right in bankruptcy. Given this interpretation, it would likely behoove Congress to finally add trademarks to the definition of "intellectual property" in § 365(n) to resolve this disparity.

Finally, and significantly for other bankruptcy appellate cases, the Court's determination that Mission Product's litigation was not moot despite the fact that the Tempnology estate's assets had been distributed, may mean further bankruptcy appellate litigation in the future, as the concept of "equitable mootness" has likely gone completely by the wayside.

If you have any questions regarding this client alert, please contact the following attorneys or the Willkie attorney with whom you regularly work.


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