



Trademark Owners Cannot Use Bankruptcy Law to Revoke Trademark Licenses

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On May 20, 2019, the U.S. Supreme Court ruled in an 8-1 decision that a bankrupt debtor and trademark licensor cannot rescind the licensee's rights to use its trademark by rejecting the license agreement in bankruptcy. See *Mission Product Holdings Inc. v. Tempnology, LLC*, 587 U.S. _____ (2019). In reaching its decision, the Supreme Court resolved a split between the Court of Appeals for the First and Seventh Circuits as to "whether the debtor-licensor's rejection of that contract deprives the licensee of its rights to use the trademark." The Court held that it does not and explained that "rejection [of an executory contract in bankruptcy] breaches a contract but does not rescind it. And that means all the rights that would ordinarily survive a contract breach, including those conveyed here [such as continued use of a licensed trademark], remain in place."

In *Mission Product Holdings*, the debtor (Tempnology, LLC or "Debtor") "manufactured clothing and accessories designed to stay cool when used in exercise." The Debtor marketed its products under the "Coolcore" brand name. In 2012, the Debtor entered into a contract with Mission Product Holdings, Inc. ("Licensee") granting it, among other things, a non-exclusive license to use Coolcore trademarks. Before the expiration of that agreement, however, the Debtor filed its petition for relief under Chapter 11 of the Bankruptcy Code and, shortly thereafter, sought bankruptcy court approval to reject its agreement with the Licensee pursuant to 11 U.S.C. §365(a).

Section 365(a) of the Bankruptcy Code allows a trustee (or, as applicable here, a debtor-in-possession), with the court's approval, to either assume or reject an "executory contract." While not defined in the Bankruptcy Code, an executory contract is generally defined as one where "performance remains due to some extent on both sides." This provision of the Bankruptcy Code is designed to afford debtors the opportunity to shed burdensome obligations and eliminate any requirement for future performance or, if the agreement's terms are favorable to a debtor's estate, to assume (or assume and assign) the agreement and continue performing according to its terms. If an executory contract is rejected, the Bankruptcy Code specifies that the "rejection constitutes...a breach of such contract." 11 U.S.C. § 365(g). Bankruptcy courts generally approve the debtor's decision of whether to assume or reject executory contracts under the business judgment rule.

In *Mission Product Holdings*, both the Debtor and Licensee agreed that due to the rejection (1) the Debtor could stop performing its obligations under the licensing agreement, and (2) the Licensee could assert a pre-petition general unsecured claim in the bankruptcy proceeding for damages resulting from the Debtor's breach (a claim on account of which the Licensee would likely see little to no recovery). Significantly, however, the parties could not agree on whether the Licensee could continue to use the licensed marks after rejection, and the Debtor sought a declaratory judgment on the matter.

The Debtor's argument that the Licensee could no longer use its trademarks was based on the negative inference that because trademark license agreements were not included in Section 365's identification of specific agreements where the counterparty may continue to exercise its use rights after rejection (such as with patent licenses for example), the rejection of a trademark license must terminate the contractual rights granted under the license. The bankruptcy court agreed with the Debtor and held that rejection of the agreement terminated the Licensee's ability to continue to use the trademark.

On appeal, the Bankruptcy Appellate Panel reversed, following the Seventh Circuit's ruling in *Sunbeam Products, Inc. v. Chicago American Manufacturing, LLC*, 686 F.3d 372 (7th Cir. 2012), and held that because the rejection constituted a breach under Section 365, it could not terminate rights that would have survived a breach of contract outside of bankruptcy. Thereafter, the Court of Appeals for the First Circuit reversed the Bankruptcy Appellate Panel, holding that the rejection in fact terminated the Licensee's rights under the agreement.

In a victory for trademark licensees, the Supreme Court reversed the First Circuit's decision (thereby affirming the Seventh Circuit's previous *Sunbeam* decision), pointing out that both Section 365's plain text and fundamental principles of bankruptcy law command the "rejection-as-breach" rather than the "rejection-as-rescission" approach. The Court explained that rejection "gives the counterparty a claim for damages, while leaving intact the rights the counterparty has received under the contract." The "rejection-as-breach" rule ensures that a debtor in bankruptcy cannot recapture interests it already relinquished. Furthermore, because the term "breach" is not defined in the Bankruptcy Code, effects of a breach are determined by non-bankruptcy law. The Court noted that outside of bankruptcy, "breach [of a license agreement by the licensor] does not revoke the license or stop the licensee from doing what it allows." Consequently, the Court adopted the "rejection-as-breach" approach thereby permitting licensees of rejected license agreements to continue to use a debtor's trademark, provided that both the licensee and its use of the trademark comply with the terms of the license.

The Supreme Court was unpersuaded by the Debtor's argument that, if a licensee was permitted to continue to use a debtor's trademark post-rejection "the debtor will have to choose between expending scarce resources on quality control and risking the loss of a valuable asset," thereby impeding the Debtor's ability to reorganize and undermining a fundamental purpose of the Bankruptcy Code. While acknowledging the Debtor's dilemma, the Court rejected the notion that a trademark specific dilemma could justify the Debtor's proposed construction, which would affect "nearly every executory contract" and "would allow the tail to wag the Doberman." The Court noted that although the Bankruptcy Code is designed to make reorganizations possible, "it does not permit anything and everything that might advance that goal."

Although the full impact of the *Mission Product Holdings* opinion remains to be seen, it constitutes a win for trademark licensees dealing with financially distressed licensors and gives licensees greater assurance that, absent contractual or statutory law providing otherwise, rejection of a trademark license agreement in bankruptcy will not impede the licensee's continued use of the trademark.

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