

Publication

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Client Alert: Supreme Court Holds Bankruptcy Cannot Nullify License Agreement

The U.S. Supreme Court's recent decision in *Mission Product Holdings Inc. v. Tempnology, LLC* clarifies that a bankruptcy debtor cannot unilaterally revoke its trademark licensee's right to use a licensed mark pursuant to a trademark license agreement. Rather, the Court held that a debtor's rejection of any executory contract – including a trademark license – under Section 365 of the Bankruptcy Code has the same effect as a breach of that contract outside bankruptcy. The case resolves a decades-long debate as to how trademark licenses are treated in bankruptcy, and provides reassurance to brand licensees that a licensor's bankruptcy will not disrupt their business with respect to the licensed brand rights.

Section 365 of the United States Bankruptcy Code generally provides that a debtor "may assume or reject any executory contract or unexpired lease of the debtor" and that such rejection "constitutes a breach of such contract." 11 U.S.C. §§ 365(a) and 365(g). Pursuant to that provision, after filing for Chapter 11 bankruptcy, Tempnology, LLC – with the federal bankruptcy court's approval – rejected a license agreement between it and Mission Product Holdings Inc. that granted the latter a non-exclusive license to use Tempnology's COOLCORE trademark. While the parties agreed that the rejection constituted a breach of their agreement, they disputed whether it revoked Mission's license to use the

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COOLCORE trademark. Tempnology sought a declaratory judgment from the federal bankruptcy court confirming its view that rejection terminated the right to use the mark.

The federal bankruptcy court held that because Section 365(n) of the Bankruptcy Code (which establishes special rejection rules for “intellectual property”) did not specifically reference “trademarks,” rejection of a trademark license by a debtor-licensor extinguishes the trademark rights that the agreement had conferred on the trademark licensee.[1] The bankruptcy appellate panel reversed, relying heavily on a decision of the United States Court of Appeals for the Seventh Circuit about the effects of rejection on trademark licensing agreements.[2] However, the United States Court of Appeals for the First Circuit then rejected the panel’s and the Seventh Circuit’s views, arguing that allowing the license to survive would require ongoing monitoring obligations, which was precisely the type of ongoing burden the Bankruptcy Code intended to alleviate. As a result, it reinstated the bankruptcy court’s decision terminating Mission’s license to use COOLCORE.

The U.S. Supreme Court granted *certiorari* to resolve the division between the federal appeal courts. The question before the Supreme Court, therefore, came down to whether a debtor-licensor’s rejection of a trademark license agreement acts as a termination of the agreement, thereby depriving the licensee of its rights to use the trademark. In an 8-1 decision, the Court held that it does not. “A rejection 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, remain in place.”[3] The Court reasoned that the bankruptcy estate cannot possess stronger termination rights than the debtor itself did outside of bankruptcy. Thus, the limitations on the debtor’s property (i.e., the license) outside of bankruptcy equally apply inside of bankruptcy. Otherwise,

termination of the license would constitute an expansion of the debtor's rights through an "avoidance" action that fails to meet the standards set forth in the Bankruptcy Code. The Court concluded that the Code was, therefore, designed to treat a breach in bankruptcy no different than a breach outside of bankruptcy. As a result, the Court held that Tempnology's rejection of the license agreement was equivalent to a breach of contract, entitling Mission to continue using the licensed trademark in accordance with the terms of the license agreement.

The decision settles a long disputed point of bankruptcy and intellectual property law and underscores the importance of trademark license construction and drafting.

Should you have any questions concerning any of these issues, do not hesitate to contact Lee Eulgen (312.269.8465, leulgen@nge.com), Jessica Rissman Cohen (312.269.5272, jcohen@nge.com), or another member of Neal Gerber Eisenberg's Intellectual Property group, or Nick Miller (312-269-5654, nmiller@nge.com) of our Financial Restructuring practice.

[1] *In re Tempnology, LLC*, 541 B.R.1 (Bkrtcy Ct. NH 2015).

[2] *See In re Tempnology, LLC*, 559 B.R. 809, 820-823 (Bkrtcy App. Panel CA1 2016); *Sunbeam Products, Inc. v. Chicago Am. Mfg. LLC*, 686 F. 3d 372, 376-377 (7th Cir. 2012). Additional discussion the Seventh Circuit's 2012 decision can be found here.

[3] *Mission Product Holdings Inc. v. Tempnology, LLC*, 587 U.S. ____ at 1 (2019).

