

Supreme Court Holds Trademark Licenses Survive Bankruptcy

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In an 8-1 decision on May 20, 2019, the Supreme Court of the United States held in *Mission Product Holdings Inc. v. Tempnology, LLC* that a debtor's rejection of a trademark license under Section 365 of the Bankruptcy Code amounts to a breach of the license agreement and the licensee retains the rights to the licensed marks for the remainder of the license term.

The opinion, authored by Justice Elena Kagan, concisely resolved a circuit split, stating:

"The question is whether the debtor-licensor's rejection of that contract deprives the licensee of its rights to use the trademark. We hold 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."

Slip Op. at 1. The only dissent, authored by Justice Neil Gorsuch, asserted that the petition for *certiorari* should have been dismissed as improvidently granted. In the dissenter's view, the Court could not grant effective relief.

Under Section 365 of the Bankruptcy Code, a debtor is permitted to "reject any executory contract." 11 U.S.C. § 365(a). A contract is executory if performance remains due to some extent on both sides. Section 365 of the Bankruptcy Code further provides that "the rejection of an executory contract or unexpired lease of the debtor constitutes a breach of such contract or lease." 11 U.S.C. § 365(g).

In this case, the debtor, Tempnology, LLC, filed for Chapter 11 bankruptcy and rejected a trademark license it had previously granted to Mission Product Holdings, Inc. Tempnology argued in the Bankruptcy Court that the rejection of the contract also terminated the rights it had granted to Mission to use its trademarks. Mission disagreed, asserting that the rejection amounted to a breach of the trademark license and, outside of bankruptcy, the breach of an agreement does not eliminate rights the contract had already conferred on the non-breaching party (Mission). So, neither could a rejection of an agreement in bankruptcy have that effect.

The Bankruptcy Court ruled in favor of the debtor, the Bankruptcy Appellate Panel reversed and then the Court of Appeals for the First Circuit rejected the Panel's view. Instead, the majority reasoned that special features of trademark law counsel against allowing a licensee to retain rights to a mark after the licensing agreement's rejection. Under that body of law, the majority stated, the trademark owner's "[f]ailure to monitor and exercise [quality] control" over goods associated with a trademark "jeopardize[s] the continued validity of [its] own trademark rights."

This created a circuit split because a similar case in the Seventh Circuit, *Sunbeam Products, Inc. v. Chicago Am. Mfg., LLC*, 686 F.3d 372 (7th Cir. 2012), held the opposite, finding "[o]utside of bankruptcy, a licensor's breach does not terminate a licensee's right to use [the licensed] intellectual property."

The Supreme Court sided with the reasoning of the Seventh Circuit.

The Supreme Court began its analysis with the text of the statute. Relying on traditional principles of contract law, the Court ascribed no special meaning to the term "breach" in Section 365 of the Bankruptcy Code. Instead, it chose to apply the "established meaning" of the word. In doing so, the Court adopted the view that "a rejection has the same consequence as a contract breach outside of bankruptcy: It gives the counterparty a claim for damages, while leaving

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intact the rights the counterparty has received under the contract." Slip Op. at 11.

The Court then reasoned that "[t]he estate cannot possess anything more than the debtor itself did outside of bankruptcy." Slip Op. at 14. "The debtor can stop performing its remaining obligations under the agreement. But the debtor **cannot rescind the license already conveyed**. So the licensee can continue to do whatever the license authorizes." *Id.* (emphasis added).

Tempnology's main argument relied on a negative inference in the statute. Section 365(n) of the Bankruptcy Code provides that licensees of some intellectual property—but not trademarks—retain contractual rights after rejection. The Court dismissed this argument as "pay[ing] too little heed to the main provisions governing rejection and too much to subsidiary ones." Slip Op. at 15. The Court pointed out that the enactment of § 365(n) arose due to a patent license dispute that Congress sought to statutorily correct; however, Justice Kagan concluded that "Congress's repudiation . . . for patent contracts does not show any intent to ratify that decision's approach for almost all others." Slip Op. at 16.

The decision marks a victory for trademark licensees as it cements the rights of licensees of trademarks regardless of the rejection of the agreement in bankruptcy. It will also enhance the negotiating leverage of licensees in bankruptcy cases and make it more difficult for debtors to reorganize.

If you have any questions about the impact of this ruling, please contact the authors or your Miller Canfield attorney.