



## AR&E TRADEMARK LAW ALERT: SUPREME COURT HOLDS TRADEMARK LICENSE CANNOT BE RESCINDED IN BANKRUPTCY IN MISSION PRODUCT HOLDINGS INC. V. TEMPNOLOGY, LLC

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(May 22, 2019), On May 20, 2019, the U.S. Supreme Court strengthened trademark licenses by holding that a bankrupt debtor's right to reject certain contracts under Section 365(a) of the Bankruptcy Code does not permit the debtor to rescind trademark licenses. See *Mission Product Holdings, Inc. v. Tempnology, LLC*, 587 U.S. \_\_\_ (2019).

The Court ruled in favor of trademark licensee Mission Product Holdings Inc., which had a license from clothing designer Tempnology. When Tempnology filed for Chapter 11 bankruptcy, it sought to rescind its license to Mission. Mission objected under Section 365(n) of the Bankruptcy Code, which stated that a "licensee of a right to intellectual property" could choose to retain its licensed rights, so long as it was not in breach (e.g., paying its Royalty obligations). Tempnology argued that "intellectual property" was defined in the Bankruptcy Code to include trade secrets, patents, and copyrights, but it did not include "trademarks." The Bankruptcy Court ruled with Tempnology, and extinguished the license. *In re Tempnology, LLC*, 541 B.R. 1 (Bankr. D.N.H. 2015).

The Bankruptcy Appellate Panel reversed the decision relying on the decision in *Sunbeam Products, Inc. v. Chicago A. Mfg., LLC*, 686 F. 3d 372, 376–377 (7th Cir. 2012). The Panel focused heavily on the statement in Section 365(g) that rejection of a contract "constitutes a breach." Therefore, while a rejection converts a debtor's unfulfilled obligations to a pre-petition damages claim, it does not terminate the contract or extinguish the licensee's rights. *Mission Products Holdings, Inc. v. Tempnology, LLC*, 589 B.R. 809 (B.A.P. 1st Cir. 2016).

The Court of Appeals for the First Circuit then rejected the Appellate Panel's view, and reinstated the lower court decision, reasoning that the trademark owner's inability to monitor and exercise quality control over goods associated with the mark jeopardizes the continued validity of its own rights. *Mission Products Holdings, Inc. v. Tempnology, LLC*, 879 F.3d 389 (1st Cir. 2018).



The Supreme Court granted certiorari to address the question of whether a rejection has the same consequences as a contract breach, or if the rejection terminates the entire agreement, effectively rescinding the contract altogether. The Supreme Court took the former view and reversed the First Circuit, agreeing with the Seventh Circuit's rejection-as-breach approach. The decision effectively gives each party distinct options, similar to those in typical breach of contract cases. The debtor-licensor, upon filing for bankruptcy, may choose to continue its contracts or reject its obligations, repudiating any further performance of its duties. The licensee may keep up its side of the agreement, continuing to pay for the use of the trademark while also having the opportunity to seek damages for the breach. The licensee may also choose to walk away from the agreement and sue for the resulting damages. The termination of the trademark license is entirely at the hands of the licensee. *Mission Product Holdings, Inc. v. Tempnology, LLC*, 587 U.S. \_\_\_ (2019).

The Court explained that the rejection-as-breach rule ensures that a debtor is subject to its counterparty's contractual rights even after the bankruptcy petition is filed. The rule prevents a debtor in bankruptcy from recapturing interests it had given up through contract. In its rejection of Tempnology's argument that trademarks were specifically left out of Section 365, the Court pointed out that Congress has enacted the provisions in that section when needed to enforce or clarify the general rule that contractual rights survive rejection. For example, following the Fourth Circuit's decision in *Lubrizol Enterprises v. Richmond Metal Finishers*, 756 F. 2d 1043 (1985) to adopt the same rule for patent licenses that the First Circuit erroneously applied in this case, Congress sprang into action to enact Section 365(n). This section reversed *Lubrizol* and ensured the continuation of patent licensees' rights.

Ultimately, the Court declined to distinguish trademarks from other types of intellectual property licenses covered under Section 365. The implications for trademark law are significant. Parties contemplating reliance on a licensed mark for building a business will now have more comfort that their rights will not be pulled by an unexpected bankruptcy by the licensor.

However the Court left certain important questions unanswered though, which may be presented in future cases. For example, if the bankrupt licensor no longer provides actual control over the nature and the quality of the use by the licensee, the Court did not address whether the result may invalidate the trademark under the rules against "naked licensing." Future trademark licenses should include detailed provisions attempting to address issues



such as this.

We will continue to follow developments in the law of trademark licensing as it applies to bankruptcy. In the meantime, should you have any questions, please feel free to contact one of our lawyers.

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