

PUBLICATION

Supreme Court Resolves Circuit Split to Hold that a Licensee's Trademark Rights Survive Following Rejection of the License in Bankruptcy

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On May 20, 2019, the Supreme Court resolved a significant issue of trademark and bankruptcy law that was decades in the making. Until then, a Circuit split with no gray area dictated one of two outcomes when a trademark licensor files bankruptcy, and either the bankruptcy trustee (or debtor-in-possession) rejects a trademark license: do the trademark licensee's rights terminate as a result of the rejection, or do they survive? In *Mission Product Holdings Inc. v. Tempnology, LLC*, No. 17-1657 U.S. (May 20, 2019), the Supreme Court held that rejection of the trademark license agreement constitutes a breach of the contract, but it does not rescind it and does not terminate the licensee's rights. In so holding, the Supreme Court rejected the position taken by The Fourth Circuit nearly 35 years ago in *Lubrizol Enterprises Inc. v. Richmond Metal Finishers Inc.*, 75 F.2d 103 (4th Cir. 1985), and it sided with the more recent position adopted by the Seventh Circuit in *Sunbeam Products Inc. v. Chicago American Manufacturing LLC*, 686 F.3d 372 (7th Cir. 2012).

In *Mission Product*, Tempnology, LLC manufactured clothing designed to stay cool when exercising, which it marketed under the name "Coolcore." In 2012, Tempnology granted a non-exclusive license to Mission Product Holdings to use the Coolcore mark in the United States and around the world. The trademark license agreement was set to expire in July of 2016, but Tempnology filed a petition for Chapter 11 bankruptcy relief before the license expired. As a debtor-in-possession, Tempnology sought to "reject" the trademark license agreement as an "executory contract" under Section 365(a) of the Bankruptcy Code to free itself of any further obligations under that agreement.

The Bankruptcy Code gives the estate's trustee (or debtor-in-possession) the option to "assume or reject an executory contract," subject to approval by the Court. The trademark license agreement in *Mission Product* was an "executory contract" because performance by both sides remained outstanding. The license was both an asset (the licensor's right to the licensee's future performance) and a liability insofar as the licensor had ongoing obligations (such as its duty to monitor and exercise quality control over the goods and services sold under the mark). To facilitate reorganization, the power to assume or reject executory contracts allows the trustee (or debtor-in-possession) the ability to evaluate whether the contract is a good deal and then exercise its business judgment when deciding whether to assume or reject.

The Supreme Court held that "rejection" of the trademark license agreement as an executory contract does not result in a rescission of the contract, and to reach that conclusion, the Court noted that the "[Bankruptcy] Code's principal provisions of rejection . . . does much of the work." Under the Code, rejection "constitutes a breach of [an executory] contract," deemed to occur "immediately before the date of the filing of the petition." Breach in the bankruptcy context means the same thing that it means in contract law, and the application here is that the trademark licensor could stop performing and the licensee could assert a pre-petition claim in the bankruptcy for damages associated with the licensor's non-performance. The licensor and the licensee agreed with that much of the application, but they disagreed on whether rejection of the trademark license terminates the licensee's rights. The Court ruled in favor of the licensee, explaining that the licensor can stop performing its remaining obligations but it cannot rescind the license already conveyed, "[s]o the licensee can continue to do whatever the license authorizes."

Since "rejection is a breach" and not a rescission, the Court gave an example of the consequence of a party's breach outside of the bankruptcy context. If a dealer leases a photocopier to a law firm and breaches that lease by deciding to stop servicing the machine, the law firm has a choice: it can keep making its payments to retain the right to use the photocopier and sue the dealer for its nonperformance, or it can return the machine based on the dealer's breach and also sue for nonperformance. Importantly, that choice remains with the law firm; the dealer cannot terminate the law firm's right to use the photocopier based on the dealer's failure to perform its servicing obligations. If the dealer were to file for bankruptcy and reject the lease, the dealer could stop servicing the photocopier and the law firm would have the same choice: continue making payments for use of the copier and assert a pre-petition claim for failure to service the copier, or return the copier and still assert a pre-petition claim for failure to service the copier.

The trademark licensor argued that if it did not monitor and exercise quality control over the goods and services sold under the trademark, then the value of the mark would naturally decline and may eventually invalidate the trademark altogether. By having to choose between expending scarce resources on quality control or risk losing a valuable asset, the debtor argued that either choice would impede its ability to reorganize and undermine a fundamental purpose of the Bankruptcy Code. The Court observed that the Bankruptcy Code "aims to make reorganizations possible," but "it does not permit any and everything that might advance that goal." Moreover, the licensor's quality control obligations stem from Lanham Act Section 5, and nothing about the ability to reject an executory contract exempts the debtor from its legal obligations as a property owner.

Going forward, trademark licensees now have certainty that their rights will not terminate as a result of the rejection of the license in bankruptcy. At the same time, licensees must remain mindful that they still have to hold up their end of the bargain and continue fulfilling their obligations under the license. Since rejection does not equate to rescission, the contract remains in place for both parties.

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