Trademark licences survive bankruptcy

THE CASE:
Mission Product Holdings Inc v Tempnology, LLC
The Supreme Court of the US
20 May 2019

Aaron M Kaufman explores the treatment of trademark licence rights in bankruptcy proceedings

On 20 May 2019, the Supreme Court of the US (SCOTUS) rendered its decision in the *Mission Product Holdings* case,[1] ruling that a bankrupt licensor could not use its bankruptcy as a weapon to rescind its non-debtor licensee's trademark rights.

According to the court, the licensor's rejection of the trademark licence in bankruptcy had the same effect as a "breach" outside of bankruptcy.

According to SCOTUS, because a breaching licensor would have no right to rescind or terminate the licence outside of bankruptcy, there was no basis under bankruptcy law to treat rejection as terminating or rescinding the underlying licence.

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IP as defined in the bankruptcy code

The *Mission Product* ruling represents SCOTUS' most recent decision to address the intersection of IP and bankruptcy law. Bankruptcy law impacts how IP assets are handled in a number of critical ways. For one, "property of the estate" in the bankruptcy context includes "all legal or equitable interests of the debtor in property as of the commencement of the case"[2] This would include any intellectual property. The Bankruptcy Code[3] provides its own definition of "intellectual property", which contains at least one glaring omission.[4] The definition does not include "trademarks" or any reference to the Lanham Act. Legislative history suggests that this omission was intentional.[5]

As discussed below, the omission of "trademarks" from the definition of "intellectual property" ultimately did not compel different treatment for "trademark" licences upon their rejection. As discussed below, in her concurring opinion, Justice Sotomayor noted that the majority's decision "leaves Congress with the option to tailor a provision for trademark licences, as it has repeatedly in other contexts".[6]

Tempnology's business failure

To understand SCOTUS' decision in *Mission Product Holdings*, some context is needed. Tempnology, the debtor in the underlying bankruptcy case, manufactured and held trademarks related to its portfolio of towels, socks, headbands and related accessories marketed under the "Coolcore" and "Dr Cool" brands.[7]

Tempnology had entered into a co-marketing and distribution agreement with Mission Product Holdings, conferring upon Mission distribution rights and licences to use its trademarks for marketing and distribution. The parties' relationship soured after Mission hired Tempnology's former president, which lead to a scenario where Mission maintained exclusive rights to use the debtor's trademarks and related IP during a two-year "wind down" period. When the debtor was unable to terminate the wind-down period early, it turned to bankruptcy as a potential weapon.

In 2015, Tempnology filed a chapter 11 bankruptcy petition and immediately moved to reject all agreements and licences with Mission. The bankruptcy court and First Circuit Court of Appeals both held that the debtor had the right to reject these licences, as "executory" contracts, and that the Bankruptcy Code's omission of "trademarks" from the definition of "intellectual property" meant that "section 365(n) does not apply to Mission's right to be the exclusive distributor of Debtor's products, or to its trademark licence." In other words, the bankruptcy court held (and the First Circuit agreed) that Mission's trademark and distribution rights did not survive the rejection because trademarks were not "intellectual property" as the term is defined under the Bankruptcy Code. In so ruling, the First Circuit acknowledged its departure from the Seventh Circuit's ruling in *Sunbeam Prods, Inc v Chicago Am Mfg, LLC* – a 2012 decision that was considered the majority view up until the First Circuit's ruling.[8]

To support its reasoning, the First Circuit inferred that, by omitting "trademark" from the statutory definition of "intellectual property," Congress intended to cut off the rights of non-debtor trademark licensees in the event of rejection in bankruptcy. Because the Bankruptcy Code protects "intellectual property" licensees under section 365(n) of the Bankruptcy Code,[9] the First Circuit concluded that trademark licensees were not entitled to these same protections and, thus, must not have any rights when their licences are rejected in bankruptcy.

The decision

For those following oral arguments in the *Mission* case, the ruling may have seemed inevitable in hindsight. The ramifications of "vaporising" contractual rights by rejecting them seemed too risky. Thus, it may have come as no surprise at all when Justice Kagan issued the court's 8-1 decision, concluding that rejection of a contract under section 365(g) of the Bankruptcy Code does not mean that contract is "vaporised". As the court presented the issue in its decision:

> "What is the effect of a debtor's (or trustee's) rejection of a contract under section 365 of the Bankruptcy Code? The parties and courts of appeals have offered us two starkly different answers. According to one view, a rejection has the same consequence as a contract breach outside bankruptcy: It gives the counterparty a claim for damages, while leaving intact the rights the counterparty has received under the contract. According to the other view, a rejection (except in a few spheres) has more the effect of a contract rescission in the non-bankruptcy world: Though also allowing a damages claim, the rejection terminates the whole agreement along with all rights it conferred. We hold that both section 365's text and fundamental principles of bankruptcy law command the first, rejection-as-breach approach."[10]

Generally speaking, when a company files for bankruptcy protection under the Bankruptcy Code, the trustee or the debtor-in-possession may "reject" leases, licences and other executory contracts, leaving the non-debtor counterparty with its remedies under non-bankruptcy law.[11]

In 1985, in a case known as *Lubrizol Enters, Inc v Richmond Metal Finishers, Inc,* the Fourth Circuit allowed a debtor licensor to reject a non-exclusive patent licence for a metal coating process.[12] The rejection of this patent licence left the licensee without effective recourse. To avoid this "unfair result" following *Lubrizol,* Congress enacted section 365(n) of the Bankruptcy Code to protect most non-debtor IP licensees. But the omission of "trademark" from the statutory definition of intellectual property, left many to ponder what ramifications the omission would have when a debtor rejects a "trademark" licence.

In support of the "rejection-as-breach" approach, the court recognised that the filing of a bankruptcy case establishes a bankruptcy estate comprising all of the debtor's rights and assets as they existed before the filing, and that "[t]he estate cannot possess anything more than the debtor itself did outside bankruptcy."[13]

According to the court, the alternative "rejection-as-rescission" approach adopted by the First Circuit was tantamount to an avoidance power. It would allow a licensor to roll back a transaction merely because it was burdensome on the debtor and "subvert everything the code does to keep avoidances cabined".[14]

The court thus concluded that rejection should be handled in bankruptcy exactly as a breach would be handled outside of bankruptcy. That is, whatever rights non-bankruptcy law applies to the particular dispute would be available in the event of a rejection in bankruptcy.

The court further rejected Tempnology's argument that the "general rule" would "swallow the exceptions".[15] When the special provisions governing rejection in certain cases – eg, section 365(h), (i) and (n) – were read in the context of their respective legislative history, the court was satisfied that all such provisions were enacted" to reinforce or clarify the general rule that contract rights survive rejection".[16]

Finally, the court rejected First Circuit's and Tempnology's "negative inference" argument – ie, omission of trademark from the definition of "intellectual property" meant that Congress intended to cut off all trademark licensees' rights upon the rejection of their licences. The court efficiently disposed of this logic as follows:

> "That section's special provisions, as all agree, do not mention trademarks; and the general provisions speak, well, generally. So Tempnology is essentially arguing that distinctive features of trademarks should persuade us to adopt a construction of section 365 that will govern not just trademark agreements, but pretty nearly every executory contract. However serious Tempnology's trademark-related concerns, that would allow the tail to wag the Doberman."[17]

The court recognised that this ruling, and the "resulting balance" between a debtor's desire to shed burdensome contracts and the need to protect non-debtor contract counterparties may leave struggling businesses without the ability to meaningfully reorganise. To the extent such a problem existed, the court explained such problem arises from the complex balancing of interests under section 365, not from any oversight or omission by Congress.

Justice Sotomayor wrote a concurring opinion, noting simply that if this result was not what Congress intended in omitting "trademarks" from the definition of "intellectual property", it would be up to Congress to consider amendments.

Justice Gorsuch dissented on the basis of mootness, concluding that there was no live case or controversy given that the licence was now terminated under its own terms, and Mission Product had not pled a viable theory of recovery beyond the lost licence rights (which were now terminated).

Footnotes

1. *Mission Product Holdings, LLC v Temnology, LLC nka Old Cold LLC*, 587 US, Case No 17-1657 (2019).
2. 11 USC § 541(a)(1).
3. As used in this article, the "Bankruptcy Code" refers to title 11 of the US Code. See 11 USC §§ 101 et Seq (2019). All references to "section" shall mean sections within the "Bankruptcy Code" unless otherwise noted.
4. 11 USC § 101(35A).
5. See S Rep No 100-505, at 5-6 (1988), reprinted in 1988 US CCAN 3200, 3204 ("[T]he bill does not address the rejection of executory trademark, trade name, or service mark licences by debtor-licensors.").
6. Concurring Op at 2.
7. *Mission Prod Holdings, Inc v Tempnology, LLC (In re Tempnology, LLC)*, 879 F.3d 389, 392-93 (1st Cir 2018).
8. 686 F.3d 372 (7th Cir 2012).
9. 11 USC § 365(n).
10. Op at 7-8.
11. 11 USC §§ 365(a), 1107(a); see *NLRB v Bildisco & Bildisco*, 465 US 513, 531-32, 104 S Ct 1188, 79 L Ed 2d 482 (1984).
12. See generally *Lubrizol Enters, Inc v Richmond Metal Finishers, Inc (In re Richmond Metal Finishers, Inc),* 756 F.2d 1043 (4th Cir 1985).
13. Op at 11. (Citations omitted).
14. Op at 11-12.
15. Op at 12.
16. Op at 13.
17. Op at 15-16.

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