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June 18, 2019

Supreme Court Shields Trademark License From Licensor's Rejection in Bankruptcy Court

The U.S. Supreme Court's recent decision in [Mission Product Holdings, Inc. v. Tempnology, LLC](#), 139 S. Ct. 1652 (2019) that a trademark licensor's rejection of a trademark license does **not** terminate the licensee's right to use the licensed mark is likely to have a major impact on trademark licensors and licensees. Trademark licensors and licensees must consider this decision and draft their agreements to include how their relations will be governed in the event of a licensor bankruptcy.

The issue in *Mission Product* focused on whether or not a licensee could continue to use a trademark pursuant to the license agreement following the licensor's rejection of the agreement under sections 365(a) and (n) of the Bankruptcy Code. The Court resolved a circuit split on this issue by affirming the reasoning of the U.S. Court of Appeals for the Seventh Circuit in *Sunbeam Products, Inc. v. Chicago American Manufacturing, LLC*, 686 F.3d 372 (7th Cir. 2012), which held that rejection of a trademark license constitutes a prepetition breach of the license agreement but does not otherwise terminate the licensor's and licensee's rights and obligations under the license agreement.

Background

In *Mission Product*, the licensor, Tempnology, manufactured clothing and accessories designed to stay cool when used during exercise, which sold under the name "Coolcore." Tempnology granted Mission Product, among other things, a nonexclusive license to use the Coolcore trademark in the United States and elsewhere. Before the expiration of Mission Product's license, Tempnology filed for relief under Chapter 11 of the Bankruptcy Code. Tempnology moved under section 365(a) of the Bankruptcy Code to reject the license agreement as an executory contract and the bankruptcy court approved the rejection. The parties agreed that the rejection would allow Tempnology to stop performing under the license agreement and allow Mission Product to assert a prepetition damage claim. Tempnology also argued that its rejection of the license agreement also terminated Mission Product's rights to use the Coolcore marks.

Tempnology based its argument on a negative inference it drew from the fact that, over the years, the U.S. Congress had adopted provisions in section 365 of the Bankruptcy Code that allowed the other party in a rejected contract to continue exercising its contractual rights. Tempnology pointed to section 365(n), which provides that if the licensor of certain specified intellectual property rights (such as patents, copyrights and four other types of intellectual property) rejects the license, the licensee can continue to use the patented technology as long as it makes the payments required under the license even though section 365(n) expressly excludes trademark licenses. 11 U.S.C. § 365(n). Tempnology argued that a negative inference should be drawn that Congress intended for trademark licenses to terminate upon rejection, which would thereby terminate the right of the licensee to use the licensed mark.

The Supreme Court's Decision

The Supreme Court, writing through Justice Elena Kagan, rejected Tempnology's arguments by first relying on the language in section 365(g) that a rejection constitutes a breach and not a rescission. While a breaching debtor can stop performing its remaining obligations under the license, it cannot rescind the license. The Court went on to note that the section 365(n) provision allowing a licensee to continue using licensed intellectual property other than trademarks was a reaction by Congress in 1988 to a seminal U.S. Court of Appeals for the Fourth Circuit

decision that held that a patent licensor's rejection of an executory contract had the effect of revoking the grant of a patent license. See *Lubrizol Enterprises v. Richmond Metal Finishers*, 756 F.2d 1043 (4th Cir. 1985). The Supreme Court in *Mission Product* explained that "Congress's repudiation of *Lubrizol* for patent contracts does not show any intent to *ratify* that decision's approach for almost all others. Which is to say that no negative inference arises." 139 S. Ct. at 1655. Stated simply, the inclusion of certain express protections for identified contract counterparties should not be interpreted as a negative inference that Congress intended to withhold such protections with respect to contracts not specifically identified.

The Court also rejected Tempnology's arguments based on a trademark licensor's need to monitor and exercise quality control over licensed goods and services. Under U.S. trademark law, trademarks can be licensed only on condition that the licensor engages in quality control to ensure that the trademark is being used in conformance with its quality standards. A license without quality control is termed a "naked license" under trademark law. Trademark law considers a naked license to be an abandonment of the trademark, which results in the loss of the mark. Tempnology argued that if rejection does not terminate the license, the debtor-licensor would need to choose between expending scarce resources on quality control or forgoing expending such resources, thereby risking diminution in value of its intellectual property. The Court observed that these concerns, while possibly serious, "would allow the tail to wag the Doberman." The Court explained that the ability to reject a contract under section 365 allows a debtor to avoid future obligations under the contract, but it does not exempt the debtor from all burdens that generally applicable law imposes on the licensor.

Implications

The *Mission Product* decision is important because it removes the uncertainty faced by trademark licensors and licensees in the event of a bankruptcy filing by a licensor or licensee. The decision further avoids the need to use expensive and complex steps, such as placing licensed marks in a special purpose entity, to avoid negative effects of a licensor's bankruptcy.

Nonetheless, *Mission Product* does not resolve the jeopardy of bankruptcy for trademarks, where the license is rejected and contains no provisions for quality control or maintenance of registrations, both of which are in the interest of both licensors and licensees. Since the license remains in effect after rejection, the license terms will still govern. Depending on the provisions, the result might not be retention of the license by the licensee or the necessary protection of the trademarks. For example, irrespective of the Court's holding as to what the Bankruptcy Code allows, license terms might provide, in case of a breach by the licensor (which, we now know by statute, is what a bankruptcy rejection constitutes), that the licensee forfeit its rights or that parties terminate the license at the option of either party. Alternatively, the terms might allow the license to continue but may impose duties on parties to maintain the trademark rights. The critical point is that license terms regulate the licensor-licensee relationship and the duties of both sides, even post-petition rejection under *Mission Product*.

Drafting specific terms if the parties want the license to continue with a minimum of bankruptcy jeopardy after rejection remains of the utmost importance after *Mission Product*. For example, if the parties intend that trademark rights will be fully maintained after insolvency of one of the parties or a license is rejected in bankruptcy, the licensor can be required in the license to provide a written affirmation that it will continue with its quality control requirements—or even transfer trademarks by assignment to the licensee. Similarly, license provisions should provide a mechanism to ensure that trademarks are maintained, potentially with license fees used to pay for renewals. While license provision details may vary in individual cases, it is important that both parties consider their objectives in the event of bankruptcy and set forth terms to protect and maintain the trademarks or terminate the license agreement.

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