U.S. Supreme Court Clarifies Application of Trademarks in Bankruptcy Proceedings

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Mission Product Holdings Inc. v. Tempnology, LLC

The U.S. Supreme Court recently clarified the protections of bankruptcy law and how they interact with trademark licenses. In this case, the Petitioner, Mission Product Holdings, licensed certain trademarks from Tempnology. During the license, Tempnology declared bankruptcy and rejected the trademark license under Section 365 of the Bankruptcy Code.

In a bankruptcy case, the debtor is allowed to reject executory contracts. Section 365(g) provides that any such rejection constitutes a breach by the debtor, but what that means is not specifically defined by the Bankruptcy Code. Tempnology argued that rejection must be termination of the contractual rights previously granted (in effect rescission), in part relying on §365(h), (i) and (n), which expressly provide non-debtor counterparties to specifically defined classes of contracts may retain certain contractual rights even after those contracts are rejected by a debtor in bankruptcy. Tempnology also argued that forcing a debtor to continue to monitor the goods sold and the licensor’s conduct or risk losing the trademark would harm the ability to reorganize.

Here, the Court found that even if the rejection was a breach by Tempnology, the licensor cannot breach the license agreement to revoke the already granted license. The Court found that Tempnology’s rejection only meant that Tempnology did not have to continue any of its unfulfilled obligations under the license agreement, and that if it caused Mission harm, Mission could assert a pre-petition claim for damages. But, the Court found that allowing Mission to use the trademark was not an ongoing obligation of Tempnology; rather, it was more akin to a property right granted at the time of the license. If Tempnology had ongoing obligations aside from purely allowing Mission to use the trademark, it could use rejection to void those obligations and let Mission choose whether it wanted to continue using the mark anyway. The Court further explained that to find any differently would violate the general rule that a debtor's property cannot increase or decrease as a result of declaring bankruptcy, and taking back the trademark license would in effect increase the debtor's property.

The Court was unconvinced that it should treat rejection as rescission of the contract, despite the fact that certain Section 365 of the Bankruptcy Code expressly carves out certain rights that survive rejection. The Court found that the exceptions did not inform how the trademark license should be treated and that, if anything, subsection (n)'s specific provision for the survival of patent licenses, should be seen as a general application that trademark licenses should also survive rejection. The Court further found that while Tempnology may be correct that the rescission approach to rejection would make a debtor's reorganization easier, nothing requires that all possible steps be taken to make a debtor's job easier.

This case is notable not only for clarifying the treatment of trademark licenses in bankruptcy—resolving a circuit split and overruling the Fourth Circuit's heavily criticized 1985 decision in *Lubrizol Enterprises Inc. v. Richmond Metal Finishers Inc.*, 756 F.2d 1043 (4th Cir. 1985) but also in how it analogizes the trademark license as a conveyed property right, not an ongoing contract. As a practical matter, this holding does not make it impossible to draft a license in such a way to cancel the use during bankruptcy, but does mean a debtor-licensor can't use rejection to rescind all trademark licenses. Drafting a license in such a way to provide more important ongoing obligations on behalf of the debtor-licensor that could be stopped may allow for rescission, or put the licensee in a position that rescission becomes preferable.

If you have questions about the implications of this case on a bankruptcy proceeding or how a bankruptcy proceeding may affect trademark licenses, please contact a member of Foster Pepper's Creditors' Rights & Bankruptcy or Intellectual Property group.