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Brand Protection

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Supreme Court to Decide Fate of Trademark Licenses in Bankruptcy

Mission Product Holdings, Inc. v. Tempnology, LLC n/k/a Old Cold LLC

U.S. Supreme Court: Petition for writ of certiorari granted October 26, 2018

The U.S. Supreme Court has agreed to hear a case that could settle a decades-old debate surrounding the fate of trademark licenses in bankruptcy. The Supreme Court granted Mission Product Holdings' petition for a writ of certiorari from the First Circuit's decision in *Mission Product Holdings, Inc. v. Tempnology, LLC.* Mission requests that the Supreme Court settle a split between the First and Fourth Circuits, on the one hand, and the Seventh Circuit, on the other, as to whether the rejection of a license in bankruptcy terminates a licensee's right to use licensed trademarks (the First and Fourth Circuits' rule) or simply constitutes a breach, which may not preclude the licensee's continued trademark exploitation (the rule in the Seventh Circuit).

The Supreme Court's decision will matter to licensees that have invested in manufacturing, marketing, distributing and selling products incorporating licensed trademarks. These businesses stand to lose their investment and anticipated returns from the licensed rights when the licensor files bankruptcy. While licensees can typically assert a claim for damages, these calculations sometimes fail to capture the full economic loss. Rejection claims often receive only cents on the dollar in a bankruptcy case, while preservation of the licensee's rights after a rejection can help maintain the full revenue stream from the trademark to the licensee.

Background

Online apparel company Mission and athletics textiles company Tempnology entered into a Co-Marketing and Distribution Agreement in 2012, which, in part, granted Mission "a non-exclusive, worldwide (except for certain countries in East Asia) license to use Tempnology's trademarks on the Tempnology products Mission distributed …." Tempnology's DR. COOL and COOLCORE marks for athletic towels, socks and headbands were covered by the agreement.

But when Tempnology filed for bankruptcy in 2015, it rejected the agreement under Section 365(a) of the U.S. Bankruptcy Code, which allows a debtor-in-possession "subject to the court's approval, [to] assume or reject any executory contract or unexpired lease of the debtor." Mission sought to protect its rights by invoking Section 365(n) of the Bankruptcy Code, which empowers a nondebtor/licensee of rights to "intellectual property" under a rejected contract with the debtor/licensor "to retain [the licensee's] rights … under such contract and under any agreement supplementary to such contract, to … intellectual property … as such rights existed immediately before the case commenced…" Section 101(35A) of the Bankruptcy Code, in turn, defines "intellectual property" to include trade secrets, patents, patent applications, plant varieties, copyrights and mask works for semiconductor chip products—but leaves out trademarks. This omission has led many courts to conclude that the intellectual property rights a licensee can safeguard exclude any interest in trademarks.

Once excluded from this special statutory protection, a licensee's ability to continue using a licensed trademark after license rejection by a debtor/licensor depends on what rule the bankruptcy court follows. In *Tempnology*, the Bankruptcy Court for the District of New Hampshire determined that Mission could not continue using the trademark after the license's rejection in bankruptcy. The *Tempnology* court adopted the Fourth Circuit's approach from *Lubrizol Enterprises, Inc. v. Richmond Metal Finishers, Inc.*, a 1985 decision holding that a licensee of a rejected trademark license cannot continue using the trademark because the rejection equates to a license termination. In fact, Congress adopted Section 365(n) of the Bankruptcy Code in 1988 to counter the effect of *Lubrizol* on licensees. But Congress' apparent omission of trademarks from Section 365(n)'s coverage left trademark licensees subject to judicial determination of the consequences when a debtor/licensor rejects the license.

On appeal, the Bankruptcy Appellate Panel for the First Circuit disagreed with the *Tempnology* bankruptcy court. Instead, the BAP adopted the reasoning of the Seventh Circuit's significant 2012 decision in *Sunbeam Prods, Inc. v. Chicago Mfg., LLC*, holding that rejection constitutes only a contractual breach—and not a termination. Applying *Sunbeam*, the BAP held that rejection of Mission's license "did not vaporize Mission's trademark rights under the Agreement" and "[w]hatever post-rejection rights Mission retained in the Debtor's trademark and logo [were] governed by the terms of the Agreement and applicable non-bankruptcy law."

First Circuit Decision

On further appeal, the First Circuit affirmed the *Tempnology* bankruptcy court and rejected the BAP's decision. In effect, the appeals court adopted the *Lubrizol* rule from the Fourth Circuit to the exclusion of *Sunbeam* from the Seventh Circuit, explaining its choice in part by focusing on a licensor's continuing duty to "monitor and exercise control over" the use of its trademark by a licensee in order to maintain the licensor's rights in the trademark. The court reasoned that applying *Sunbeam* would have allowed "Mission to retain the use of [Tempnology's] trademarks in a manner that would force [Tempnology] to choose between performing executory obligations [such as policing the trademark's ongoing use] arising from the continuance of the license or risking the permanent loss of its trademarks." The First Circuit applied the Fourth Circuit's *Lubrizol* rule because it disagreed with the Seventh Circuit's "unstated premise" in *Sunbeam* that "it is possible to free a debtor from any continuing performance obligations under a trademark license even while preserving the licensee's right to use the trademark."

Before the Supreme Court

At Mission's request, the U.S. Supreme Court granted certiorari to consider "[w]hether, under § 365 of the Bankruptcy Code, a debtor-licensor's 'rejection' of a license agreement—which 'constitutes a breach of such contract' 11 U.S.C. §365(g)—terminates rights of the licensee that would survive the licensor's breach under applicable non-bankruptcy law."

In its petition, Mission argues that the First Circuit's decision underscores a split of authority among the circuits that "demands the [Supreme Court's] review," and that the First Circuit's ruling "contravenes the text and purpose of the Bankruptcy Code" and "reinstates much of the confusion *Lubrizol* caused."

Tempnology countered in its reply brief that "the First Circuit properly recognized that trademarks are different from other intellectual property rights, and that the Bankruptcy Code's strong policy of permitting a debtor to free itself of ongoing obligations under a contract as embodied in section 365(a) and the right to reject such obligations applies to the burden of policing trademarks—something to which the Seventh Circuit had given shorter shrift."

The IP Community Weighs In for Licensees

In an amicus brief filed on July 11, the International Trademark Association argued for nondebtor licensees. INTA urged the Supreme Court to "adopt the *Sunbeam* approach because it enhances the value of trademark licenses and promotes the stability of the trademark system."

A second brief, filed by seven law professors, also supported licensees. The professors criticized the First Circuit's holding because it "will allow debtor/licensors to unwind a variety of settled transfers of property rights" by rejecting trademark licenses.

The Supreme Court is likely to hear the case later this winter and issue its decision by late June.

In the Meantime, Licensees Can:

(1) Negotiate a first-priority security interest in favor of the licensee in the reversionary rights of the licensor and their proceeds in order to secure the licensee's claims for damages upon any rejection of the license in a licensor bankruptcy. This collateral right would give the licensee the ability to reap the benefits of royalties from any new trademark exploitation by the licensor after rejection. This strategy may deter a licensor from terminating in order to seek a better return under a new, more remunerative license.

(2) Insert a choice-of-law provision applying Seventh Circuit law to the issue. That said, the law of any circuit (other than the First and Fourth circuits) may give a licensee a chance at maintaining its trademark license rights even after rejection of the license in the licensor's bankruptcy. Of course, this strategy will likely be short-lived; assuming the Supreme Court rules on the issue in *Tempnology*, the high court's interpretation will become the law throughout the country.

Related Professionals

For more information, please contact:

Melanie J. Howard	mhoward@loeb.com
Daniel D. Frohling	dfrohling@loeb.com
Walter H. Curchack	wcurchack@loeb.com
William M. Hawkins	whawkins@loeb.com

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