

## Supreme Court Settles Circuit Split on Treatment of Trademark Licenses Following Rejection in Bankruptcy

May 21, 2019

On May 20, 2019, the U.S. Supreme Court issued a significant decision in *Mission Product Holdings, Inc. v. Tempnology, LLC*, holding that the rejection of a trademark license by a debtor-licensor under Section 365 of Chapter 11 of the U.S. Bankruptcy Code operates not as a rescission of the license but as a breach of the license agreement and, following any such rejection, the licensee can continue to use the licensed trademarks in accordance with the license agreement.

The Court's decision resolves a split between federal circuit courts that has long been the source of confusion as to the rights of a trademark licensee in the event of a licensor's bankruptcy, in part because a trademark licensee could not avail itself of the protections of Section 365(n). More recently, there had been a growing trend among certain courts to provide trademark licensees with protections against such risk (see, e.g., *In re Exide Technologies*, 607 F.3d 957 (3d Cir. 2010); *Sunbeam Products, Inc. v. Chicago American Manufacturing, LLC*, 686 F.3d 372 (7th Cir. 2012); *In re Crumbs Bake Shop, Inc.*, No. 14-24287 (Bankr. D.N.J. Oct. 31, 2014)), however other courts had not afforded such protections (*In re Tempnology, LLC*, 879 F. 3d 389 (2018)). In *Mission*, the Court has clearly put trademark licensees on surer footing in the event their licenses are rejected in bankruptcy.

However, practitioners will need to give careful consideration to the following implications of the decision:

- Whether the Court's decision grants a trademark licensee more expansive post-rejection rights and remedies than those possessed by licensees of other types of intellectual property under Section 365(n).
- The treatment of other forms of executory intellectual property agreements post-rejection such as covenants not to sue to the extent they do not qualify as a "license" for the purposes of Section 365(n) and trademark coexistence agreements.
- The incremental benefits, if any, in pursuing traditional strategies to mitigate the bankruptcy vulnerability of a trademark licensor (e.g., taking a security interest in the licensed trademarks or placing the licensed trademarks in a special purpose entity isolated from any bankruptcy filing).
- The extent to which any specific contract term in a license agreement or any state law could restrict the right of a trademark licensee to continue using the licensed trademarks post-rejection.
- Finally, given that the Court purported to extend its reasoning to executory contracts generally, the extent to which the decision will have applicability beyond trademark and other forms of intellectual property licenses in bankruptcy.

A more detailed discussion of the facts and holding of the *Mission* decision is provided below.

### Background

Mission Product Holdings, Inc. was a licensee of Tempnology, LLC under a co-marketing and distribution agreement which provided Mission with exclusive distribution rights to certain of Tempnology's cooling accessories and a non-exclusive license to use Tempnology's trademarks to sell these products. After Tempnology filed a petition for Chapter 11 bankruptcy, it moved to reject a number of its contracts, including its agreement with Mission. The bankruptcy court allowed Tempnology to reject the agreement and concluded that because Section 365(n) does not apply to trademarks, Tempnology could terminate

Mission's rights to use Tempnology's trademarks. The Bankruptcy Appellate Panel reversed the bankruptcy court, relying on the Seventh Circuit's *Sunbeam* decision (*In re Tempnology, LLC*, 559 B.R. 809, 820-823 (Bkrcty. App. Panel CA1 2016)). On appeal, the First Circuit agreed with the bankruptcy court, and overturned the Bankruptcy Appellate Panel's decision (*In re Tempnology, LLC*, 879 F. 3d 389 (2018)), which created a circuit split between the First Circuit and Seventh Circuit regarding the treatment of trademark licenses following their rejection in bankruptcy. The Supreme Court granted Mission's petition for certiorari to resolve this circuit split.

## Supreme Court Opinion

Under both Section 365's text and fundamental principles of bankruptcy law, the Court held that "rejection of a contract—any contract—in bankruptcy operates not as a rescission but as a breach."<sup>1</sup> The Court noted that Sections 365(a) and (g) speak broadly, to "any executory contract[s]" and licensing agreements involving trademarks or other property, including the Tempnology-Mission contract, are executory contracts. According to the Court, under Section 365(g), "the rejection of an executory contract[ ] constitutes a breach of such contract."<sup>2</sup> Following the Seventh Circuit *Sunbeam* decision, the Court concluded that a breach by a licensor outside of bankruptcy (assuming no special contract term or state law) "does not revoke the license or stop the licensee from doing what [the license] allows."<sup>3</sup> The Court reasoned that the same result should apply in bankruptcy since a rejection constitutes a breach and concluded that the debtor cannot rescind a license already conveyed, although the debtor is no longer obligated to perform its obligations under the agreement. Meanwhile, the licensee may continue to act in any manner authorized by the license. Accordingly, the Court held "that construction of Section 365 means that the debtor-licensor's rejection cannot revoke the trademark license."<sup>4</sup>

Tempnology argued that the provisions of Sections 365(h), (i) and (n), which provide specific exceptions in which certain executory contracts may be retained notwithstanding their rejection, must mean that the effect of rejection is more than a breach. According to Tempnology, if this were not the case, the general rule of Section 365 would be "swallowed" by such exceptions.<sup>5</sup> For example, Section 365(n) generally serves to mitigate an intellectual property licensee's exposure to the risk of the licensor's bankruptcy by allowing the licensee to treat the license as terminated or to elect to retain certain of its rights under the license. Trademarks are excluded from the definition of "intellectual property" as used in Section 365(n) and therefore some courts have reasoned by negative inference that a trademark licensee's rights to licensed trademarks are vulnerable if a trademark licensor in bankruptcy elects to reject the trademark license under Section 365(a).

The Court rejected Tempnology's argument. The Court confirmed that Section 365(n) does not apply to trademark licensing agreements, however, the Court also concluded that because such agreements fall within Section 365(g)'s general rule, the fact that Section 365(n) does not apply to trademark licenses does not mean that the rejection of trademark licenses should be treated differently than the rejection of other executory contracts. In particular, the Court noted that "Congress did nothing in adding Section 365(n) to alter the natural reading of Section 365(g)—that rejection and breach have the same

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<sup>1</sup> *Mission Prod. Holdings, Inc. v. Tempnology, LLC*, No. 17-1657, 2019 WL 2166392, at \*5 (U.S. May 20, 2019).

<sup>2</sup> *Id.* at \*3.

<sup>3</sup> *Id.* at \*6.

<sup>4</sup> *Id.* at \*9.

<sup>5</sup> *Id.* at \*7 (citing Brief for Respondent 19).

results.”<sup>6</sup> Given that trademark license agreements are generally considered executory contracts that fall under Section 365(g), the Court held that a debtor-licensor’s rejection of a trademark license agreement cannot revoke the license granted thereunder. However, the Court also noted that the provisions of Sections 365(h), (i) and (n) are not redundant of Section 365(g), rather the Court provided that each provision “sets out a remedial scheme embellishing on or tweaking the general rejection-as-breach.”<sup>7</sup>

Justice Sotomayor, in a concurring opinion, agreed with the Court in rejecting Tempnology’s arguments and that Congress’ adoption of Section 365(n) does not change the Court’s interpretation of Section 365(g). At the same time, however, Justice Sotomayor highlighted in her concurrence that the Court’s holding confirms in some respects that a trademark licensee’s post-rejection rights and remedies are more expansive as compared to those of other intellectual property licensees under Section 365(n) and noted that Congress may choose to specifically address the treatment of trademark licenses in future legislation to the extent such trademark licensees are treated differently from other intellectual property licensees.

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<sup>6</sup> *Id.* at \*7.

<sup>7</sup> *Id.* at \*7, n.2.

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