

Supreme Court: Rejection of a Trademark License by a Bankrupt Licensor Doesn't Terminate the License

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What happens if you are a trademark licensee and your licensor files for bankruptcy protection?

Can the licensor unilaterally terminate your license and prohibit you from using the license – even if you're in the middle of a long-term contract and you are complying with the deal? Many licensors have been doing this, using the bankruptcy courts to extricate themselves from

unprofitable or unsatisfactory licensing agreements. But on May 20, 2019, in *Mission Product Holdings, Inc. v. Tempnology, LLC*, the United States Supreme Court held that a trademark licensor who files bankruptcy during the term of the contract cannot use the Bankruptcy Code to terminate the license before it expires. In other words, the licensor's rejection of a trademark license in bankruptcy is a breach of contract, not a termination of the license. The upshot is that the Supreme Court has recognized the right of trademark licensees to continue to use the trademark for the life of their contract.

Mission Product Holdings, Inc. v. Tempnology, LLC

Tempnology, LLC manufactured athletic clothing and other apparel designed to stay cool during exercise. Its products were sold under the brand "Coolcore." Several years before filing bankruptcy, Tempnology contracted with Mission Product Holdings, Inc. The agreement made Mission the exclusive distributor of certain Coolcore-branded products in the United States and granted Mission a non-exclusive, worldwide license to use the Coolcore trademarks. Ten months before the agreement was set to expire, Tempnology filed for bankruptcy protection under Chapter 11.

In Chapter 11, a debtor seeks to reorganize its debts while it continues to operate. Once in bankruptcy, as part of its reorganization efforts, Tempnology sought to reject its contract with Mission under Section 365 of the Bankruptcy Code. When a company files for bankruptcy, Section 365 allows it, subject to court approval, to accept or reject certain contracts. If a debtor rejects a contract, the other party to the contract can file a claim against the debtor's bankruptcy estate for damages. But if the debtor fails to reorganize and the estate has insufficient assets, the other party may recover nothing. Moreover, damages may not suffice for a trademark licensee who wants to continue to use the license.

Nevertheless, the bankruptcy court allowed Tempnology to reject its contract with Mission, meaning it could

stop performing its obligations under the contract. Tempnology then sought a declaratory judgment that the rejection terminated Mission's ability to continue using the Coolcore trademarks, even though the license granted under the agreement would not expire until the following year. Once again, the bankruptcy court sided with Tempnology and held that Mission could no longer use the Coolcore trademarks. This cut off Mission's ability to use the Coolcore trademarks and freed Tempnology to sign a new licensing agreement with someone else.

The Supreme Court's Decision

After two appeals, the case came before the United States Supreme Court. The Supreme Court noted that Section 365 states that rejection of an executory contract is a breach of contract. Outside of bankruptcy, a breach of contract does not rescind or void the contract. That being the case, the Supreme Court held that neither should a breach void a contract inside bankruptcy. In other words, the rules of contract law do not get jettisoned by the filing of a bankruptcy petition. Because rejection in bankruptcy does not void the contract, rejection also does not eliminate those rights already conferred under the contract to the non-breaching party. In a trademark license agreement, this means that a rejection does not terminate the license conferred to the licensee when the agreement was formed. It merely allows the breaching debtor-licensor to terminate whatever performance obligations they had under the contract.

The Supreme Court noted that this result is consistent with the Bankruptcy Code's limitations on a debtor's ability to unwind pre-bankruptcy transactions. Bankruptcy courts typically will only invalidate property transfers in the shadow of bankruptcy where the debtor received insufficient value or sought to favor one creditor over others. The holding also follows the general rule that the debtor's bankruptcy estate possesses no greater rights than those the debtor possessed when it entered bankruptcy. As a result, despite the rejection, Mission continued to have a contractual right to use the Coolcore trademarks until the license agreement expired.

Conclusion

Trademark licensees can rest a little easier knowing their licenses cannot be terminated unilaterally in bankruptcy. Before signing a trademark licensing agreement, a licensee should consider the risk of bankruptcy by the licensor and consult counsel for advice in drafting terms to protect its rights.

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