

Keywords: Trademarks; Chapter 11 Bankruptcy;

General: The rejection of a trademark license debtor-licensor does not deprive the licensee of its rights to use the trademark. All rights that would ordinarily survive a contract breach outside bankruptcy remain in place.

Mission Product Holdings, Inc. v. Tempnology, LLC
587 U. S. ____ (2019) Supreme Court No. 17-1657
Decided May 20, 2019

I. Facts

Mission Product Holdings, Inc., entered into a contract with Tempnology, LLC, which gave Mission a non-exclusive license to use Tempnology’s trademarks (“Coolcore”) and an exclusive license to distribute certain Coolcore products in the United States. Tempnology filed for Chapter 11 bankruptcy and asked the bankruptcy court to allow it to “reject” the licensing agreement. Section 365(a) of the bankruptcy code enables a debtor to “reject any executory contract” – meaning a contract that neither party has finished performing. It further provides that rejection “constitutes a breach of such contract.” 11 U.S.C. §365(g). The bankruptcy court approved Tempnology’s rejection of the licensing agreement, giving Mission a pre-petition claim against the estate for damages resulting from the debtor’s nonperformance. Tempnology also argued that its rejection of the contract also terminated the rights it had granted Mission to use the Coolcore trademarks. It based this argument on a negative inference that several provisions in 35 U.S.C. §365 state that a counterparty to specific kinds of agreements may keep exercising contractual rights after a debtor’s rejection, including Section 365(n) relating to some types of intellectual property licenses: if the debtor-licensor rejects the agreement, the licensee can continue to use the property (typically, a patent), so long as it makes whatever payments the contract demands. Tempnology pointed out that neither Section 365(n) nor any similar provision covers trademark licenses, so, it reasoned, in that sort of contract a different rule must apply: The debtor’s rejection must extinguish the rights that the agreement had conferred on the trademark licensee. The bankruptcy court agreed and revoked Mission’s right to use the Coolcare marks.

The bankruptcy appellate panel reversed, relying instead on a decision from the Seventh Circuit and Section 365(g)’s statement that rejection “constitutes a breach” to hold that rejection does not terminate rights that would survive a breach of contract outside bankruptcy. That is, outside bankruptcy, the breach of an agreement does not eliminate rights the contract had already conferred on the non-breaching party so neither could a rejection of an agreement in bankruptcy have that effect. Accordingly, the panel found that Mission could continue to use the Coolcore trademarks.

The First Circuit rejected the panel’s judgment and reinstated the bankruptcy court’s decision, endorsing the inference drawn from Section 365(n). The Supreme Court granted certiorari to resolve the division between the First and Seventh Circuits.

II. Issues

Does the rejection of a contract by a debtor-licensor deprive the licensee of its rights to use a licensed trademark?

III. Discussion

No. The Supreme Court noted the Circuit split in answering the question of what is the effect of a debtor's (or trustee's) rejection of a contract under Section 365 of the Bankruptcy Code. The view of the Seventh Circuit is that a rejection has the same consequence as a contract breach outside bankruptcy: it gives the counterparty a claim for damages, while leaving intact the rights the counterparty has received under the contract. According to the First Circuit, a rejection (except in a few spheres) has more the effect of a contract rescission in the non-bankruptcy world: though also allowing a damages claim, the rejection terminates the whole agreement along with all rights it conferred. In examining these positions, the Court looked to the Bankruptcy Code.

Section 365(a) gives a debtor the option, subject to court approval, to “assume or reject any executory contract,” while section 365(g) describes what rejection means: rejection “constitutes a breach of [an executory] contract,” deemed to occur “immediately before the date of the filing of the petition.” The Court equated a rejection with a breach and since “breach” is neither a defined nor a specialized bankruptcy term, the Court noted that it means in the Code what it means in contract law outside bankruptcy. The Court then went on to determine the meaning of breach outside of bankruptcy.

The Court provided an example of a breach of an agreement and noted that the non-breaching party has two choices: to continue to comply with the terms of the contract or to refuse to perform further, with the rights to any damages that accompany the choice. However, the Court noted that the choice lies with the non-breaching party.

The Court returned to Sections 365(a) and (g) and stated that they speak broadly, to “any executory contract[s],” including licensing agreements involving trademarks. The licensor not only grants a license, but provides associated goods or services during its term; the licensee pays continuing royalties or fees. If the licensor breaches the agreement outside bankruptcy (again, barring any special contract term or state law), everything described in the Courts example applies. In particular, the breach does not revoke the license or stop the licensee from doing what it allows and because rejection constitutes a breach under Section §365(g), the same consequences follow in bankruptcy. The Court reasoned that the debtor can stop performing its remaining obligations under the agreement, but the debtor cannot rescind the license already conveyed. Therefore, the licensee can continue to do whatever the license authorizes.

This result reflects a general bankruptcy rule that the estate cannot possess anything more than the debtor itself did outside bankruptcy, i.e., a debtor's property does not shrink by happenstance of bankruptcy, but it does not expand, either. Therefore, if the not yet debtor was subject to a counterparty's contractual right (e.g., to use a trademark), so too is the trustee or debtor once the bankruptcy petition has been filed. The Court reasoned that by insisting that the same counterparty rights survive rejection as survive breach, the rule prevents a debtor in bankruptcy from recapturing interests it had given up.

The Court also addressed Tempnology's main argument to the contrary relating to the negative inference of Section 365(n) that licensees of some intellectual property – but not trademarks – retain contractual rights after rejection. The Court noted that the reading by Tempnology offers no account of how to read Section 365(g) and also improperly treats the provisions Tempnology cites as narrowly tailored exceptions instead of responses to discrete problems that emerged over time. The Court highlights that Section 365(n) was enacted to reverse a Fourth Circuit finding relating to patent (and some other intellectual property) licenses similar to the holding by the First

Circuit for the present matter. Since Section 365(n) does not cover trademark licensing agreements, the Court found that these agreements, along with most other contracts, fall within Section 365(g)'s general rule.

The Court held that the debtor-licensor's rejection cannot revoke the trademark license, thus reversing the judgment of the Court of Appeals and remanded the case for further proceedings consistent with the opinion.

IV. Conclusion

A debtor's rejection of an executory contract under Section 365 of the Bankruptcy Code has the same effect as a breach of that contract outside bankruptcy and such an act cannot rescind rights that the contract previously granted.