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SUPREME COURT RESOLVES TRADEMARK TREATMENT FOLLOWING REJECTION IN BANKRUPTCY

Earlier this week, the U.S. Supreme Court issued its decision in *Mission Product Holdings, Inc. v. Tempnology, LLC*, finally answering the long-awaited question as to whether a debtor-licensor's rejection of a trademark contract deprived the licensee of its right to use the trademark. The Court concluded that rejection of a trademark licensing agreement operates only as a breach, allowing the trademark user to continue to use the trademark post-rejection to the extent permitted under applicable state law. The ruling resolved a split among the First Circuit Court of Appeals and the Seventh Circuit Court of Appeals on what the International Trademark Association identified as "the most significant unresolved issue in trademark licensing."

BACKGROUND

Section 365 of the Bankruptcy Code permits a debtor to "assume" or "reject" most executory contracts to which the debtor is a party, enabling the debtor to assume a contract that is favorable and reject a contract that is not. Rejection of a contract "constitutes a breach of such contract" and creates an unsecured claim against the estate for damages resulting from the non-performance. Typically, unsecured claims are unlikely to be paid in full.

The primary issue at stake in *Mission* emanates from the case of *Lubrizol Enterprises, Inc. v. Richmond Metal Finishers, Inc.*, a 1985 case decided by the Fourth Circuit Court of Appeals. In that case, the debtor sought to reject a metal coating process technology license it had granted to Lubrizol. The Fourth Circuit approved the contract rejection and stated that, as the result of that rejection, Lubrizol was entitled to an unsecured claim but no other rights, including those rights Lubrizol would have maintained after a non-bankruptcy breach. Given the substantial ramifications to technology users, *Lubrizol* was viewed with great disfavor by the intellectual property community.

As a direct result of the *Lubrizol* opinion, Congress passed an amendment to section 365 that protected non-debtor licensees of patents and certain other intellectual property from stripping those rights in a bankruptcy case through rejection. However, the new provision, section 365(n), was silent with respect to trademarks.

Following the enactment of 365(n), a number of courts were asked to address the effect of a debtor's rejection of a trademark license in a bankruptcy case. The court responses were not consistent, with two distinct interpretations ultimately emerging. According to one interpretation, rejection of a trademark agreement has the same consequence as a breach of contract outside of bankruptcy in that the user of the trademark has a claim for damages but the user's rights under applicable non-bankruptcy law are otherwise left intact. Thus, a trademark user would be permitted to continue the use the trademark post breach if permitted to do so under applicable non-bankruptcy law. According to the other interpretation, since Congress failed to specifically include trademarks in the definition of intellectual property subject to 365(n), Congress intended that trademark licensees should lose their core trademark rights upon rejection of the contract by the debtor licensor. That result effectively rescinded the contract, leaving the trademark licensee with nothing but an unsecured claim against the debtor's bankruptcy estate.

MISSION

Tempnology, LLC was a company specializing in the production of sports apparel designed to remain at cool temperatures when worn during physical exercise. Tempnology and Mission Product Holdings, Inc. entered into an agreement pursuant to which Tempnology granted Mission, among other things, a nonexclusive and non-transferrable license to use the debtor's trademarks. Years after the agreement was entered into, Tempnology's financial condition deteriorated and it filed for bankruptcy under chapter 11 of the Bankruptcy Code. During the chapter 11 case, Tempnology sought to reject the Mission trademark agreement as part of its effort to reorganize and sought a declaratory judgment seeking to confirm that Mission was no longer entitled to use the trademarks that were being rejected. Mission opposed Tempnology's motion.

The parties contentions in the dispute were familiar. Tempnology's primary argument was that Mission lost all user trademark rights when Tempnology rejected the trademark agreement. In contrast, Mission argued that bankruptcy law only created a breach, with the ramifications of that breach governed by applicable state law. Following rulings by two lower courts, the Court of Appeals for the First Circuit ruled in favor of Tempnology. That decision was appealed to the Supreme Court.

The Supreme Court reviewed the two competing views noted above and concluded that the same consequences follow a trademark rejection in bankruptcy as a breach of that contract outside of bankruptcy. In preserving state law rights, "Section 365 reflects a general bankruptcy rule: The estate cannot possess anything more than the debtor itself did outside of bankruptcy." And while Congress created specific exceptions as to the applicability of section 365 rejection (such as the intellectual property protection in 365(n)), the Court found that no negative inference arises where Congress failed to modify the generally applicable law. Simply, rejection of a trademark contract is treated as a breach of such contract. As such, Mission was entitled to continue to use the trademark as provided by applicable state law.

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TAKEAWAYS

The Supreme Court's decision resolved, once and for all, the long-standing dispute as to the effect of the rejection on a trademark license. That is a positive development for trademark licensees. Trademark holders should recognize, however, that the Supreme Court's ruling does not provide licensees with unconditional use of a trademark post-rejection. Parties must review applicable non-bankruptcy law to define the scope of their rights.

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