



# Supreme Court Agrees to Address Uncertainty About Trademark Licenses in Bankruptcy Cases

01.07.2019 | By [Christopher D. Hughes](#)

Pursuant to 11 U.S.C. § 365, a debtor or bankruptcy trustee has the option, subject to court approval, of electing one of the following three alternatives with respect to an executory contract: (a) assuming the contract, (b) assuming and assigning the contract to a third party, or (c) rejecting the contract. Assumption of the contract, or assumption and assignment results in the agreement remaining in effect post-bankruptcy. A rejection of the contract is treated as a breach of the agreement by the debtor and, in effect relieves the debtor (as well as the non-debtor party) from post-bankruptcy obligations. In the event of a rejection, the non-bankrupt party's remedies are limited to a claim for damages resulting from rejection. (11 U.S.C. § 502 (g).)

When a bankrupt licensor rejects an intellectual property license agreement, the licensee faces the possibility of having its rights cut off after rejection. Section 365(n) of the Bankruptcy Code provides licensees of intellectual property with the option to elect to treat rejection of the licensing provisions either as a termination of the licensing agreement, or instead to retain the use/access to the covered intellectual property. Such retention is as is without any right to future enhancements or upgrades, provided that the licensee pays any royalty payments required by the contract. The statute was enacted in response to the decision in *Lubrizol Enterprises, Inc. v. Richmond Metal Finishers, Inc.*, 756 F.2d 1043 (4th Cir. 1985) which held that rejection of a technology licensing agreement resulted in the licensee's loss of the right to continue to use the subject metal coating process technology owned by the debtor.

The problem faced by *trademark* licensees as opposed to licensees of other intellectual property, however, is the language of 11 U.S.C. § 365(n). The Bankruptcy Code's definition of intellectual property in 11 U.S.C. § 101(35A) states that the term means certain enumerated items. Those categories listed in the statute are

trade secrets, plant varieties, patent applications, inventions, processes, designs or plants protected under Title 35, works of authorship protected under Title 17 and protected mask works under chapter 9 of Title 17. As defined, intellectual property does not include trademarks. Courts have held that, as a result, the licensee does not retain trademark rights following rejection by the debtor licensor. See, e.g., *Raima UK Ltd. v. Centura Software Corp.* (*In re Centura Software Corp.*), 281 B.R. 660, 662 (Bankr. N.D. Cal. 2002).

Despite the fact that § 365(n) is inapplicable to trademark licenses, some courts, most notably the Seventh Circuit Court of Appeals in *Sunbeam Prods. Inc. v. Chicago Am. Mfg., LLC*, 686 F.3d 372 (7th Cir. Ill. 2012), have protected trademark licensees by holding that the licensee's right to continue to use the trademark survives rejection of such a license by the bankrupt licensor. This approach is based on the position that rejection is not equivalent to a rescission or termination of the license agreement, but merely constitutes a breach, and that a breach by the licensor does not prevent the licensee from continuing to use the trademark.<sup>1</sup>

The First Circuit split with the Seventh Circuit in the decision earlier this year in *Mission Products Holdings, Inc. v. Tempnology LLC* (*In re Tempnology LLC*), 879 F. 3d 389 (1st Cir. 2018). In holding that a trademark licensee's rights in the trademark do not survive rejection of the parties' contract, the court noted that trademark licenses are not listed in the definition of intellectual property in 11 U.S.C. § 101(35A) nor does the statute include any catchall or residual clause that could extend to trademarks. The court noted that Congress included an express reference to a relatively obscure property (mask work protected under chapter 9 of title 17) and would have identified a much more obvious category like trademarks had it intended to extend the intellectual property exception to trademarks. The court recognized that while certain rights may survive rejection and that rejection does not vaporize a right and courts may have the authority to recognize unwritten limitations on the effect of a rejection under 11 U.S.C. § 365, trademarks are not appropriate candidates for such a judicially recognized exception because the effective licensing of a trademark requires the licensor to monitor and control quality of goods sold to the public under the trademark without which the validity of the owner's rights could be jeopardized resulting in a potential abandonment of the trademark. The result would be that the debtor in bankruptcy would be forced to choose between performing executory obligations relating to continuance of the license or risking the loss of its trademarks, a choice a rejecting debtor should not be compelled to make.

On October 26, 2018, the United States Supreme Court granted a petition for certiorari in the *Tempnology* case. (*Mission Product Holdings, Inc. v. Tempnology, LLC, nka Old Cold LLC*, Case No. 17-1657. The Supreme Court agreed to decide whether, under 11 U.S.C. § 365, a debtor-licensor's rejection of a license agreement, which constitutes a breach of the contract pursuant to 11 U.S.C. § 365(g) terminates rights of the licensee that would survive the licensor's breach under applicable non-bankruptcy law. A Supreme Court decision on that issue would resolve the split between the circuits on whether a trademark licensee can continue to use a trademark after rejection of the license by the licensor in bankruptcy. The licensee likely will argue that the fact that the Bankruptcy Code's failure to expressly provide for the continuation of trademark licensee rights does not alter the fact that, as the court in *Sunbeam* held, a rejection under section 365(g) is merely a breach by the licensor and a breach by a trademark licensor does not terminate the licensee's right to use intellectual property. In other words, the licensee's rights should not be terminated but the licensee's remedy for unfulfilled obligations is limited to a damage claim in the bankruptcy case. Conversely, the bankruptcy estate probably will rely on the statutorily based arguments made by the First Circuit that recognizing a continued right to use a licensed trademark would subvert the bankrupt debtor's recapture of licensed trademark rights on rejection of a license agreement contrary to Congressional intent.

<sup>1</sup> The Eighth Circuit in *Lewis Bros. Bakeries Inc. v. Interstate Brands Corp. (In re Interstate Bakeries Corp.)*, No. 11-1850, 2014 U.S. App. LEXIS 10537 (8th Cir. Mo. June 6, 2014) recognized another basis for preserving the licensee's rights notwithstanding a licensor bankruptcy. To the extent that the license agreement has been substantially performed by both parties at the time of bankruptcy, the license agreement is no longer executory and would not be subject to rejection under 11 U.S.C. § 365. As the Eighth Circuit noted, in order to be executory, both parties must have material, outstanding obligations. The trademark license in the *Lewis Bros. Bakeries, Inc.* was entered into as part of a sale of the debtor's Bitternut and Sunbeam bread operations and assets in Illinois. The asset purchase agreement provided for the perpetual, royalty-free, assignable, transferable, exclusive license to use the trademarks associated with the sold operations pursuant to the terms of a license agreement between the debtor and the buyer. The Eighth Circuit held that, under the circumstances in the case including language in both agreements, the asset purchase agreement and the trademark license agreement should be considered together as a single, integrated contract. The court concluded that the contracts at issue were not executory because the seller already had substantially performed its obligations under the integrated agreements. The assets already were sold to the buyer and the purchase price had been paid in full to the debtor. As a result, although the court didn't address the effect of the licensee's ongoing duties to maintain quality standards with respect to the goods sold under the licensed trademarks, the court held that licensee's rights survived.