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For more information,
contact:

Sarah R. Borders
+1 404 572 3596
sborders@kslaw.com

Jeffrey R. Dutson
+1 404 572 2803
jdutson@kslaw.com

Leia Clement Shermohammed
+1 404 572 4668
lshermohammed@kslaw.com

King & Spalding

Atlanta
1180 Peachtree Street, NE
Atlanta, Georgia 30309-3521
Tel: +1 404 572 4600

US Supreme Court Concludes Debtors May Not Terminate Trademark Rights of Licensees by Rejection in Bankruptcy, Resolving Circuit Split

On May 20, 2019, the U.S. Supreme Court held that rejection of a trademark license does not automatically terminate the licensee's right to use the trademark, settling a decades-old question at the intersection of intellectual property and bankruptcy law.¹

BACKGROUND

In 2012, Mission Product Holdings entered into an agreement with Tempnology, LLC that granted Mission a non-exclusive license to use Tempnology's trademarks worldwide.² Prior to the agreement's expiration, Tempnology filed for Chapter 11 bankruptcy and sought to reject the agreement with Mission under section 365(a) of the Bankruptcy Code.³ After the bankruptcy court approved the rejection, Tempnology sought a declaratory judgment confirming that the rejection terminated Mission's right to use the trademarks.⁴ The bankruptcy court agreed, holding that Mission's right to use Tempnology's trademarks was terminated as a result of Tempnology's rejection of the agreement.⁵

The Bankruptcy Appellate Panel (the "BAP") for the First Circuit reversed, holding that rejection equates only to a contractual breach and does not constitute a termination of the agreement.⁶ The U.S. Court of Appeals for the First Circuit then rejected the BAP's conclusions and reinstated the bankruptcy court's decision.⁷

THE CIRCUIT SPLIT

The Supreme Court's decision settles a circuit split between the First and Fourth Circuits, on one hand, and the Seventh Circuit, on the other, as to whether a debtor-licensor's rejection of a trademark license terminates a



licensee's right to use licensed trademarks.⁸ The split traces back to the Fourth Circuit's 1985 holding in *Lubrizol Enterprises v. Richmond Metal Finishers* that a debtor-licensor's rejection of an executory license pursuant to section 365 automatically terminates a licensee's rights under a patent license.⁹ In response to the *Lubrizol* decision, Congress amended the Bankruptcy Code to provide that a non-debtor licensee of a patent, copyright, or trade secret may retain its rights to intellectual property even if the license is rejected by the debtor-licensor.¹⁰ However, Congress omitted trademarks from this amendment and thus left open the question regarding the impact of rejecting a trademark license.¹¹ In 2012, the Seventh Circuit split from *Lubrizol* in *Sunbeam Products v. Chicago American Manufacturing*, finding that a debtor-licensor's rejection results in a breach of the agreement, not a termination, and therefore does not terminate the licensee's right to use the trademark throughout the duration of the agreement.¹²

THE SUPREME COURT DECISION

The U.S. Supreme Court granted certiorari to consider “[w]hether, under § 365 of the Bankruptcy Code, a debtor-licensor’s ‘rejection’ of a license agreement—which ‘constitutes a breach of such contract,’ 11 U.S.C. § 365(g)—terminates rights of the licensee that would survive the licensor’s breach under applicable non-bankruptcy law.”¹³

Affirming the Seventh Circuit’s reasoning in *Sunbeam*, the Supreme Court held that the rejection of an existing agreement does not revoke a licensee’s right to continue using the trademark.¹⁴ Justice Kagan wrote, “[a] rejection breaches a contract but does not rescind it. And that means all the rights that would ordinarily survive a contract breach . . . remain in place.”¹⁵ In so holding, the Court rejected Tempnology’s assertion that the provisions of section 365 regarding patents, copyrights, and trade secrets create a “negative inference” that rejection terminates the rights of a trademark licensee, stating “Congress’s repudiation of *Lubrizol* for patent contracts does not show any intent to *ratify* that decision’s approach for almost all others. Which is to say no negative inference arises. Congress did nothing in adding Section 365(n) to alter the natural reading of Section 365(g)—that rejection and breach have the same results.”¹⁶ Finally, relying on that interpretation of section 365(g), the Court reasoned that “[o]utside bankruptcy, a licensor’s breach cannot revoke continuing rights given to a counterparty under a contract (assuming no special contract term or state law). And because rejection ‘constitutes a breach,’ the same result must follow from rejection in bankruptcy.”¹⁷

CONCLUSION AND OUTLOOK

The Supreme Court’s decision is favorable to non-debtor licensees in that it allows licensees to either continue using a trademark through the end of the license term or to assert prepetition damage claims resulting from the rejection of the license, allaying licensees’ fears of losing their investment and anticipated returns from the inability to continue to use licensed trademarks following a debtor-licensor’s rejection in bankruptcy. More broadly, it will be interesting to see how non-debtor parties will use the Supreme Court’s rationale that “rejection is not an automatic termination” for other types of executory contracts.



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¹ See *Mission Prod. Holdings, Inc. v. Tempnology, LLC*, No. 17-1657, 2019 WL 2166392 (U.S. May 20, 2019).
² *Id.* at *2.
³ *Id.*
⁴ *Id.* at *3.
⁵ *In re Tempnology, LLC*, 541 B.R. 1, 3 (Bankr. D.N.H. 2015).
⁶ *In re Tempnology LLC*, 559 B.R. 809, 819 (B.A.P. 1st Cir. 2016).
⁷ *In re Tempnology, LLC*, 879 F.3d 389, 392 (1st Cir. 2018).
⁸ See *Mission Prod. Holdings*, 2019 WL at *4.
⁹ See 756 F.2d 1043 (4th Cir. 1985).
¹⁰ See 11 U.S.C. § 365(n) (a non-debtor licensee of rights to "intellectual property" under a rejected contract with the debtor-licensor retains its "rights . . . under such contract and under any agreement supplementary to such contract, to . . . intellectual property . . . as such rights existed immediately before the case commenced . . .").
¹¹ See *id.*
¹² See 686 F.3d 372, 375 (7th Cir. 2012).
¹³ See *Mission Prod. Holdings, Inc. v. Tempnology, LLC*, 139 S. Ct. 397 (2018) (granting the writ of certiorari as to Question 1, which is quoted above).
¹⁴ See *Mission Prod. Holdings*, 2019 WL at *9.
¹⁵ See *id.* at *2.
¹⁶ See *id.* at *7.
¹⁷ See *id.* at *1.