Simpson Thacher

Memorandum

U.S. Supreme Court Holds That Bankrupt Licensor Cannot Terminate Trademark License

June 3, 2019

On May 20, 2019, in *Mission Products v. Tempnology*,[1] the Supreme Court resolved a circuit split by ruling that a bankrupt licensor's rejection of a trademark license does not terminate the license, thereby preventing the licensee from using the trademark.

Practice Tips

At first blush, the decision is good for licensees—they can still use the trademark after rejection. Rejection does permit the trademark licensor to stop performing its obligations under the license, but in many non-exclusive licenses the licensor has little to do—it generally does not agree to maintain, renew or enforce the mark against third parties. On the other hand, the licensor of an exclusive trademark license generally does have such obligations to ensure that the exclusivity has value, and the licensor's non-performance of those obligations may materially harm the licensee, even if the licensee can still use the mark.

Some trademark licensees are now better off than licensees of patents or copyrights, for which the licensor's rejection is governed by Section 365(n).[2] Until this case, these licensees had explicit post-rejection rights so long as they paid their royalties and waived their right of setoff, while trademark licensees were generally out of luck. Now, rejected trademark licensees can keep using the trademark with no Section 365(n) conditions, and non-bankruptcy law governs their rights.

But non-bankruptcy law creates uncertainty, and licenses may be treated differently based on the specific facts at issue and the governing non-bankruptcy law in a particular jurisdiction. As Justice Sotomayor notes in her concurrence, the obligations of a trademark licensee post-rejection (e.g., payment of royalties,

[1] *Mission Product Holdings, Inc. v. Tempnology, LLC*, No. 17-1657, slip op. at 1 (May 20, 2019).

[2] 11 U.S.C. § 365(n). All Section 365 references are under Title 11.

required approvals) will vary based on applicable state law and the contract's specific terms. Future cases will be needed to shed light on this issue, and the fact-specific nature of each case may limit its precedential value.

Meanwhile, future trademark licensees should draft with this uncertainty in mind. For example, payments could be clearly allocated between trademark and non-trademark IP and between license royalties and payments for services (e.g., marketing support). This way, the licensee can better quantify its damages claim after a rejection. The license could even provide for liquidated damages and/or explicit setoff rights if the licensor breaches the agreement. Finally, the license could provide for power of attorney or the licensee's contingent right to take certain actions (e.g., renew the licensed trademark) if the licensor fails to do so. Separately, certain deal structures can mitigate the risk that the licensor files for bankruptcy in the first place—these can be discussed with the authors of this memorandum.

Case History and Analysis

Clothing manufacturer Tempnology filed for bankruptcy and rejected the non-exclusive license it had granted to Mission Product Holdings to use the "Coolcore" trademark. The Bankruptcy Court approved the rejection. The parties agreed that (i) Tempnology could cease performing and (ii) Mission had a Section 365(g) claim for pre-petition damages. But Tempnology also sought a declaration that its rejection terminated the license, and the Bankruptcy Court agreed, noting that Section 365(n)—which allows IP licensees to retain their licenses after a licensor's rejection—does not protect trademark licensees. The Bankruptcy Appellate Panel, following Seventh Circuit precedent, affirmed on the Section 365(n) issue, but reversed the Bankruptcy Court by holding that, even though rejection had occurred, it did not terminate the license and Mission could still use the "Coolcore" trademark.[3]

The First Circuit reversed the BAP, holding that rejection of a trademark license terminated the licensee's rights to use the trademark because Section 365(n) protection did not apply. In doing so, the First Circuit noted that a trademark licensor must engage in quality control to keep its trademarks valid, and a bankrupt licensor accordingly would be forced to perform executory obligations, in contravention of its rejection, if the licensee were permitted to continue using the mark.[4]

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[3] *In re Tempnology LLC*, 559 B.R. 809, 823 (B.R.A.P. 1st Cir. 2016); *In re Tempnology, LLC*, 541 B.R. 1, 8 (Bankr. D.N.H. 2015); *see* § 365(n) (covering "intellectual property licenses"); 11 U.S.C. § 101(35A) (defining "intellectual property" to include patents and copyrights, but not trademarks).

[4] This issue created the circuit split: *Compare In re Tempnology, LLC*, 879 F.3d 389, 395 (1st Cir. 2018) (rejection terminates licensee's rights), *with Sunbeam Products, Inc. v. Chicago Am. Mfg., LLC*, 686 F.3d 372 (7th Cir. 2012) (rejection does not terminate such rights). Adding to the split, see *In re Crumbs Bake Shop*, 522 B.R. 766, 772 (Bankr. D.N.J. 2014) (courts should apply § 365(n) to trademark licenses on a case-by-case basis); *In re Lakewood Eng'g*, 459 B.R. 306 (Bankr. N.D. Ill. 2011) (same); *In re Matusalem*, 158 B.R. 514 (Bankr. S.D. Fla. 1993) (refusing to allow bad-faith rejection by trademark licensor).

The Supreme Court reversed, holding that a trademark licensor's rejection does not terminate the license. It held that the debtor can stop performing its ongoing obligations but cannot rescind a previously-granted license—otherwise, the debtor would be in a better position than it was prior to bankruptcy. Conversely, equating rejection with termination would circumvent the Code's strict limits on avoidance actions. The Court noted that Section 365(n) omits trademark licensees from its post-rejection protections, which means that the general rule of Section 365(g) applies to them; namely, a rejection is simply a pre-petition breach.

Justice Sotomayor raised two notable points in her concurrence. First, a post-rejection trademark licensee does not have an "unfettered right" to use the trademarks; rather, the licensee's rights will be governed by applicable non-bankruptcy law, which may differ based on the governing state law or contract terms at issue. Second, although Section 365(n) explicitly protects licensees for IP other than trademarks, it imposes conditions on those benefits—the licensee must make all royalty payments and waive its right of setoff. No such restrictions apply to a rejected trademark licensee; applicable non-bankruptcy law will determine its rights and obligations under the license.

To discuss any of these issues further, including contract drafting and deal structures in anticipation of a potential licensor bankruptcy, please contact any of the attorneys below.

NEW YORK CITY

Elisha D. Graff
Bankruptcy
+1-212-455-2312
egraff@stblaw.com

Lori E. Lesser
Intellectual Property/Licensing
+1-212-455-3393
llesser@stblaw.com

Sandeep Qusba
Bankruptcy
+1-212-455-3760
squsba@stblaw.com

William T. Russell, Jr.
Bankruptcy Litigation
+1-212-455-3979
wrussell@stblaw.com

Michael H. Torkin
Bankruptcy
+1-212-455-3752
michael.torkin@stblaw.com

PALO ALTO

Harrison J. (Buzz) Frahn
Intellectual Property Litigation
+1-650-251-5065
hfrahn@stblaw.com

Jeffrey E. Ostrow
Intellectual Property Litigation
+1-650-251-5030
jostrow@stblaw.com

Marcela Robledo
Intellectual Property/Licensing
+1-650-251-5027
mrobledo@stblaw.com

Simpson Thacher Worldwide

UNITED STATES

New York
425 Lexington Avenue
New York, NY 10017
+1-212-455-2000

Houston
600 Travis Street, Suite 5400
Houston, TX 77002
+1-713-821-5650

Los Angeles
1999 Avenue of the Stars
Los Angeles, CA 90067
+1-310-407-7500

Palo Alto
2475 Hanover Street
Palo Alto, CA 94304
+1-650-251-5000

Washington, D.C.
900 G Street, NW
Washington, D.C. 20001
+1-202-636-5500

EUROPE

London
CityPoint
One Ropemaker Street
London EC2Y 9HU
England
+44-(0)20-7275-6500

ASIA

Beijing
3901 China World Tower A
1 Jian Guo Men Wai Avenue
Beijing 100004
China
+86-10-5965-2999

Hong Kong
ICBC Tower
3 Garden Road, Central
Hong Kong
+852-2514-7600

Tokyo
Ark Hills Sengokuyama Mori Tower
9-10, Roppongi 1-Chome
Minato-Ku, Tokyo 106-0032
Japan
+81-3-5562-6200

SOUTH AMERICA

São Paulo
Av. Presidente Juscelino
Kubitschek, 1455
São Paulo, SP 04543-011
Brazil
+55-11-3546-1000