Ferraiuoli LLC
Looking Forward

Bankruptcy and Creditor's Rights Department

September 20, 2019
Notice to Clients and Friends

Recent Supreme Court Opinion of Executory Contracts and Impact on Intellectual Property Cases

On May 20, 2019, the U.S. Supreme Court issued an important decision on the treatment of trademark licenses after rejection in the case of Mission Product Holdings, Inc. v. Tempnology LLC, --- U.S.---, 139 S.Ct. 1652 (2019). This decision has a meaningful impact on bankruptcy and Intellectual Property ("IP") cases and will foreseeably have implications on the effectiveness of rejection of executory contracts.

Tempnology, LLC is a company that manufactured athletic sportswear and licensed the right to use its Coolcore trademark and related rights to a licensee Mission Product Holdings, Inc. As such, Mission was entitled to distribute some of Tempnology's products, had a license to Tempnology's intellectual property; and use Tempnology's trademark and logo to sell the products.[1]

In 2015, Tempnology filed for Chapter 11 relief with the US Bankruptcy Court for the District of New Hampshire. In bankruptcy, Tempnology rejected the licensing agreement, which the court approved. This allowed Tempnology to stop operating under the contract with Mission. However, Tempnology believed the bankruptcy court's approval also resulted in termination of the rights it had granted Mission to use the "Coolcore" trademarks. Many courts have held that, following the rejection of an agreement such as a license in a bankruptcy case, non-debtor parties are limited to file a general unsecured claim, which typically receive much less than the face value of their claims. Some courts like the US Court of Appeals for the Seventh Circuit in Sunbeam Products, Inc. v. Chicago American Manufacturing, LLC, 686 F.3d 372 (7th Cir. 2012), however, have held that the rejection does not terminate a licensee's rights and that the non-debtor licensee retains certain post-rejection enforcement rights. In In re Tempnology LLC, 541 B.R. 1 (Bankr. D.N.H. 2015), the Bankruptcy Court granted declaratory judgment in favor of Tempnology premised on 11 U.S.C. § 365(n) and found that Tempnology's rejection of the contract also revoked Mission's right to use the Coolcore trademarks.

On appeal, the US Bankruptcy Appellate Panel for the First Circuit ("BAP") reversed adopting the analysis in the Sunbeam case and concluded that Mission may continue to use the Coolcore trademarks. On subsequent appeal, the US Court of Appeals for the First Circuit reversed the BAP and reinstated the Bankruptcy Court's decision terminating Mission's license by agreeing with the bankruptcy court's reasoning that a negative inference arose from § 365(n). Ultimately, the US Supreme Court granted *certiorari* to intervene and resolve the split between the Seventh and First Circuits.
In short, the US Supreme Court adopted the Seventh Circuit's reasoning and reversed the First Circuit's decision. As summarized by Eric Goodman and Ferve Khan in *Tempnology: Trademark License Rejection in Chapter 11*, the majority's opinion examined three arguments:

1. whether rejection constituted a breach or rescission of the contract;
2. whether a negative inference arose from § 365(n)'s treatment of non-trademark intellectual property licenses; and

[1] *Tempnology: Trademark License Rejection in Chapter 11,* American Bankruptcy Institute (ABI), August 2019. https://s3.amazonaws.com/abi-org-corp/journals/news_08-19.pdf

3. whether special features of trademark licenses compelled treatment of rejection as rescission.[2]

The crux of the decision is that rejection of an "executory contract" in a bankruptcy is only a breach of the contract, not a rescission thereof. "The question is whether the debtor-licensor's rejection of that contract deprives the licensee of its rights to use the trademark. We hold it does not. A rejection breaches a contract but does not rescind it. And that means all the rights that would ordinarily survive a contract breach, including those conveyed here, remain in place." Mission, 139 S.Ct. at 1657–58. The resulting implications are more profound. Upon the breach of the contract under § 365, not recession, it will be necessary to conduct an analysis of non-bankruptcy law to determine the scope of the non-debtor party's post-rejection rights. A case-by-case inquiry must be made to determine whether the licensee's rights would survive a breach under applicable non-bankruptcy law.

Except for very limited situations, it no longer matters whether a contract is "executory" in a bankruptcy, since the outcome is the same whether or not the contract is executory.[3]

Hence, if a bankrupt licensor rejects a license of any intellectual property (even a trademark), the license is not necessarily terminated, even without the help of § 365(n), which purports to permit a licensee to retain the rights to a license of certain intellectual property if the licensor rejects it in bankruptcy. The US Supreme Court effectively held that § 365(n) was not needed and that its enactment was based on a misconception that rejection equates to rescission. Thus, licensees no longer need to include verbose language regarding § 365(n), and they should not need a "belts and suspenders" security interest in the licensed rights.[4]

Most importantly, if a bankrupt licensee rejects a license, the licensee may be able to retain the licensed rights even without making any further payments to the licensor unless the contract expressly permits the licensor to terminate (which is rare).[5] In most cases, a bankrupt licensee may reject a license, not pay anything further to the licensor, and retain the rights. In some recent Hollywood bankruptcies, the bankrupt licensees did not take this position, but most likely will. This is the single biggest risk facing licensors and their financiers.

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[2] *Tempnology: Trademark License Rejection in Chapter 11,* American Bankruptcy Institute (ABI), August 2019. https://s3.amazonaws.com/abi-org-corp/journals/news_08-19.pdf

[3] *New Supreme Court Bankruptcy Decision Will Have Big Impact On Hollywood, Forbes, May 20, 2019.* https://www.forbes.com/sites/schuylermoore/2019/05/20/new-supreme-court-bankruptcy-decision-has-big-impact-on-hollywood/#5981c38820c7

[4] *Id.*

[5] *Id.*