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The U.S. Supreme Court will decide the future of trademark licenses in bankruptcy

By Peter C. Blain

The holders of trademark licenses invest vast sums to bring products to market, and the loss of the right to use the marks would spell financial ruin for many licensees. The United States Bankruptcy Code grants licensees of patents and copyrights the right to continue to the use the technology post-rejection of the license agreement. However, Congress specifically omitted trademarks from such protections, to "…allow the development of equitable treatment of [trademarks] by bankruptcy courts." S. Rep. No. 100-505, at 5 (1988), as reprinted in 1998 U.S.C.C.A.N. 3200, 3204.

In last year's Expert Guide, I discussed the clash between two Circuit Courts of Appeals regarding the rights of trademark licensees to continue to use the marks following rejection of the trademark license agreement. I suggested that given the importance of the issue, the U.S. Supreme Court would likely decide the Circuit conflict. On 26 October 2018, the U.S. Supreme Court agreed to do so and granted certiorari in the case of *Mission Product Holdings, Inc. v. Tempnology LLC* (Case No. 17-1657). This year, the Court will decide the following issue:

Whether, 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 nonbankruptcy law.

The Lubrizol Decision and Section 365(n)

In 1985, in *Lubrizol Enterprises, Inc. v. Richmond Metal Finishers, Inc.*, 756 F.2d 1043 (4th Cir. 1985) the Fourth Circuit Court of Appeals jolted the U.S. insolvency world holding that rejection of a patent license agreement terminated all continuing rights to use the patent. Congress quickly responded enacting 11 U.S.C. § 365(n), which permits licensees of patents and copyrights to continue to use the technology post-rejection. However, because of a trademark licensor's obligation to monitor the quality of goods associated with marks, Congress excluded trademarks from the protections of 11 U.S.C § 365(n) and left the treatment of trademarks to be developed by bankruptcy courts.

Sunbeam Products Clashes with Tempnology

The Seventh Circuit was the first Circuit Court of Appeals to grapple with the issue in *Sunbeam Products, Inc. v. Chicago American Manufacturing, LLC*, 686 F.3d 372 (7th Cir. 2012). Because a trademark licensor's breach outside of a bankruptcy proceeding does not divest a licensee's right to use the mark, the court held that rejection of an executory trademark license agreement constitutes a breach but does not terminate the agreement or divest the licensee of the right to use the mark post-rejection.

Last year, in *Mission Product, Holdings, Inc. v. Tempnology, LLC (In re Tempnology, LLC)*, 879 F.3d 389 (1st Cir. 2018), the First Circuit Court of Appeals rejected Sunbeam, ruling that licensees under trademark license agreements which are rejected pursuant to Code section 365(a) have no right to use the marks post-rejection. The court based its decision principally upon the lack of assurance that the bankrupt licensor would continue to fulfill its obligation to monitor the quality of goods produced under the mark, which would risk misleading the public about the goods being sold.

Positions of the Parties

In its Supreme Court brief, Respondent Tempnology argues that given the unique nature of executory trademark license agreements and the licensor's obligations to monitor the quality of goods produced under the mark, upon rejection of the agreement under 11 U.S.C. § 365(a) the only remedy available to a counterparty is to file a claim for monetary damages in the bankruptcy case. Unlike patents or copyrights, argues the Respondent, trademarks do not create a property interest in the trademark but only a contractual right to use it. To permit a right to use the mark post-rejection would elevate the licensee's rights above the claims of other general unsecured creditors, thus frustrating the Bankruptcy Code's policy of equality of asset distribution.

Petitioner Mission Product Holdings argues that trademark license agreements do indeed create prepetition property rights, and submits that Tempnology offers no rationale to the contrary. Moreover, Sunbeam correctly decided—as with a licensor's breach outside of bankruptcy — the rejection of an executory trademark license agreement is deemed to be a breach which does not terminate the contract or extinguish the right to use the mark.

Five Amicus Curiae Briefs

Given the economic impact of the Tempnology decision, it is not surprising that five separate parties filed amicus curiae ("friend of the court") briefs. All five, to varying degrees and for various reasons, criticise the First Circuit's decision.

Intellectual Property Owners Association ("IPO")

IPO urges the Supreme Court to reject the First Circuit's "bright line" rule that rejection of a trademark license agreement bars all post-rejection use. Tempnology misconstrues trademark law by assuming that a licensor's obligation of quality control would impose an undue burden. More importantly, IPO argues that the vast majority of trademark license agreements will never be impacted by a bankruptcy proceeding. However, affirming the decision will require all parties to incur extensive costs in negotiating the consequences of what will likely be a very remote possibility for most contracting parties. Rather, until Congress acts, the bankruptcy courts should start with Sunbeam presumption that post-rejection use of the mark is authorised. In those cases where this doesn't make sense, the bankruptcy courts should be allowed the discretion to take an equitable approach based upon the facts of each case.

New York Intellectual Property Law Association and The American Intellectual Property Law Association

Both amici argue that a rejection of a trademark license agreement should be treated the same as a breach outside of bankruptcy – an act which does not terminate the contract or the right of the licensee to use the mark. Both go on to discuss that under trademark law, the licensor's obligation to monitor the quality of trademarked goods remains present even if the license agreement is rejected. Quality monitoring is necessary to preserve the value of the mark if the licensor wants to retain the trademark for its own use or grant a license to another party post-rejection.

Law Professors and the United States

Seven law professors argue that the First Circuit resuscitates Lubrizol, which was wrongly decided and which has been consistently rejected by both courts and legal scholars. The professors cite 27 scholarly articles which argue that Sunbeam correctly decided that rejection does not terminate an executory trademark license agreement or the licensee's right to use the mark. The power to reject, argue the professors, is the power to breach not the power to avoid settled property rights. Amicus United States also argues that Sunbeam was correctly decided and, just as with a breach outside of bankruptcy, rejection does not empower the trademark owner to revoke the rights of the licensee to use the mark.

Conclusion

Tempnology was wrongly decided and should be reversed by the Supreme Court. If the Court refuses to do so, Congress should legislate a proper result. However, whether the Court will decide correctly or Congress will step in is wholly uncertain. The entire U.S. bankruptcy community waits anxiously for the outcome of this clash of the Circuits.