CARLTON FIELDS

Supreme Court: Trademark Owner in Bankruptcy Can't Cancel Its Trademark Licenses

September 11, 2019

What happens to the business of a trademark licensee when the licensor goes bankrupt has always been an uncertain gray area. In general, under section 365 of the Bankruptcy Code, a party to an existing executory contract who goes into bankruptcy has the right to "assume," or maintain, that contract and continue performing its obligations under it, or it can "reject" the contract, and essentially walk away from any further performance obligations. The Bankruptcy Code specifically defines a "rejection" of a contract to be a breach of the contract, not an invalidation. In other words, the contract continues on, only now just on the side of the non-bankrupt party. The rights and obligations of the other party under the contract continue, the other party becomes an unsecured creditor, and the debtor or bankruptcy estate may be liable to the other party for any damages caused by the breach, assuming that there are any funds to pay them. The Bankruptcy Code specifically addresses the treatment of patent and copyright licenses in the event of the licensor's bankruptcy, but there are no specific provisions addressing trademarks. This has created uncertainty in the federal courts because of the nature of trademark licenses. For a trademark license to be valid, and not an invalid "naked license," the licensor must exercise quality control over the goods or services with which the licensee uses the licensed mark. If the licensor goes into bankruptcy and rejects the license, and if it fails to continue its obligations of quality control, it can lose the rights to its mark. If, on the other hand, it continues the license solely to exercise quality control, it may be using up scarce time and resources that it can no longer afford, thereby placing estate assets in jeopardy. The Supreme Court, in *Mission Product Holdings, Inc. v. Tempnology, LLC NKA Old Cold, LLC*, 587 U.S. ____ (2019), recently addressed and resolved the uncertainty. Tempnology granted Mission Products a non-exclusive license to use certain of its trademarks for clothing. Tempnology went into bankruptcy and rejected the trademark license. The Bankruptcy Court for the District of New Hampshire held that the rejection terminated the license agreement in its entirety. Consistent with prior precedent from the Seventh Circuit, the Bankruptcy Appellate Panel reversed, on the grounds that the rejection only constituted a breach, not termination. The First Circuit reversed *that* decision, agreeing with the original Bankruptcy Court decision that rejection equated to termination

in full. The Supreme Court took the case to resolve the split between the First and Seventh Circuits. Justice Kagan, writing for the majority, held that a trademark license is to be treated no differently than any other executory contract under section 365(g) of the Bankruptcy Code, so that rejection of the trademark license by the licensor in bankruptcy, absent any special provisions in the license agreement itself, only constitutes a breach. The license is neither terminated nor invalidated. The non-bankrupt party has the right to continue using the licensed trademark, or trademarks, subject to the terms and conditions of the license (such as continuing royalty payments). In addressing the issue of potential loss of the value of the trademark, and its effect on the estate assets (and the licensee as well), Justice Kagan noted: "In thus delineating the burdens that a debtor may and may not escape, Congress also weighed (among other things) the legitimate interests and expectations of the debtor's counterparties. The resulting balance may indeed impede some reorganizations, of trademark licensors and others." In essence, *Mission Product Holdings* determined that trademark licenses are executory contracts under section 365(g), and that trademarks are to be treated as any other valuable company asset that is leased or licensed-be it a car or a copier. If a company goes bankrupt, it must make the hard choices of which assets to keep and which to sell. If the company doesn't want to lose the *trademark* itself, it can always choose to continue the license agreement. If it doesn't want to lose the *value* of the trademark, it can always *sell* the mark to the licensee or another entity. What can a licensee do to protect itself in the event that its licensor may go into bankruptcy? The Bankruptcy Code is meant to protect the debtor and there are few, if any, safe havens for the non-debtor licensee. If the licensee has the bargaining power, its best option is to obtain a security interest in the licensed trademarks and record the security interest in both the United States Patent and Trademark Office (USPTO) and the relevant state agencies as a UCC filing. That way the licensee is at least a secured creditor and jumps to the head of the line when the debtor's estate is allocated. Alternatively, the licensee may be able to persuade the licensor to place its trademarks in a holding company that would keep the trademarks out of the debtor-licensee's bankruptcy estate. What the licensee cannot do, however, is to rely on "ipso facto" provisions that attempt to use financial events, including filing of bankruptcy petitions, to trigger assignments of the licensed trademarks or other changes in the terms of the license agreement that favor the licensee. Under the Bankruptcy Code, these provisions are unenforceable, as are transfers made within 90 days of the licensor filing for bankruptcy. In the absence of certainty, the licensee's best protection is to know its licensor, do its due diligence, and assure itself to the extent that it can of the licensor's financial stability. *Originally published in "The Voice" Volume 18, Issue 36 by DRI, The Voice of the Defense Bar on September 11, 2019. View original publication (PDF).*

Related Practices

Intellectual Property

©2024 Carlton Fields, P.A. Carlton Fields practices law in California through Carlton Fields, LLP. Carlton Fields publications should not be construed as legal advice on any specific facts or circumstances. The contents are intended for general information and educational purposes only, and should not be relied on as if it were advice about a particular fact situation. The distribution of this publication is not intended to create, and receipt of it does not constitute, an attorney-client relationship with Carlton Fields. This publication may not be quoted or referred to in any other publication or proceeding without the prior written consent of the firm, to be given or withheld at our discretion. To request reprint permission for any of our publications, please use our Contact Us form via the link below. The views set forth herein are the personal views of the author and do not necessarily reflect those of the firm. This site may contain hypertext links to information created and maintained by other entities. Carlton Fields does not control or guarantee the accuracy or completeness of this outside information, nor is the inclusion of a link to be intended as an endorsement of those outside sites.