CARLTON FIELDS

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

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What happens to the business of a trademark licensee when the licensor goes bankrupt has always been an uncertain gray area.

In general, a party to an existing contract who goes into bankruptcy has the right to 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, 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 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. In order 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, 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 it can no longer afford, thereby placing estate assets in jeopardy.

The Supreme Court, in *Mission Product Holdings, Inc. v. Tempnology, LLC,* 587 U.S. ____, 139 S. Ct. 397 (2019), recently addressed and resolved the uncertainty.

Tempnology granted Mission Products a nonexclusive license to use certain of its trademarks for clothing. Tempnology went into bankruptcy, rejected the trademark license, and the bankruptcy court held that the rejection terminated the license agreement in its entirety. 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.

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), 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(s) subject to the terms and conditions of the license (such as continuing royalty payments).

In addressing the issue of potential loss of the trademark's value, 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) of the Bankruptcy Code 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 the 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.

Perhaps the best way to mitigate future issues is by the inclusion of appropriate provisions in the license agreement addressing the rights and obligations of the parties in the event of one party's bankruptcy.

For further information, please contact the author of this article or a Carlton Fields' intellectual property attorney.

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