What The Justices Are Focusing On In Bankruptcy TM Case

By **Woods Drinkwater and John Baxter** (March 1, 2019)

Woods Drinkwater

John Baxter

The U.S. Supreme Court heard oral argument in the matter of Mission Product Holdings Inc. v. Tempnology LLC (In re Tempnology LLC) on Feb. 20, 2019.[1] The petitioners hope to resolve a circuit split regarding ongoing trademark usage pursuant to a license agreement following the rejection of such agreement under Title 11 U.S.C. Sections 365(a) and (n).

Case Overview

The primary issue in Tempnology first arose in the seminal 1985 case Lubrizol Enters. Inc. v. Richmond Metal Finishers Inc., in which the Fourth Circuit held that an "executory contract" under Section 365(a) of the Title 11 of the United States Code included intellectual property licenses.[2] Further, the Lubrizol court held that rejection of an executory contract effectively terminates an intellectual property license.

Three years later and in reaction to Lubrizol, Congress enacted additional legislation to define "intellectual property" within the Bankruptcy Code. Congress also added Bankruptcy Code Section 365(n) regarding what happens to intellectual property following the rejection of an executory contract.

After the revisions by Congress, Bankruptcy Code Section 101(35A) defines intellectual property as:

(A) Trade secret;

(B) Invention, process, design, or plant protected under Title 35;

(C) Patent application;

(D) Plant variety;

(E) Work of authorship protected under Title 17; or

(F) Mask work protected under Chapter 9 of Title 17;

To the extent protected by applicable nonbankruptcy law.

The cumulative effect of Lubrizol and the newly enacted legislation gave a nondebtor licensee the freedom to continue using patents, trade secrets and copyrights, among others enumerated in Section 101(35A), pursuant to a license notwithstanding rejection of the license contract in bankruptcy. The legislation did not, however, address trademark. Congress intentionally omitted trademark from its definition of intellectual property.

After Congress' revisions to clarify the treatment of intellectual property under the Bankruptcy Code, Lubrizol remained well-regarded precedent for nearly three decades. Then, in 2012, the Seventh Circuit issued its opinion in Sunbeam Products Inc. v. Chicago American Manufacturing LLC.[3] The court in Sunbeam held that rejection of an executory trademark license contract only extinguished the debtor-trademark-licensor's obligations, but not the license itself. The Sunbeam court found that Congress did not intend to "vaporize" a contracting party's rights through rejection. Under Sunbeam, a licensee retains its right to use the trademark after rejection even though the debtor is absolved of its relevant obligations under that license agreement.

The Tempnology case is poised to resolve the circuit split that has arisen in light of the Sunbeam holding. Specifically, the question presented to the court in Tempnology is:

> Whether under Section 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.

Oral Argument

The oral argument, and the court's questions, seemed to focus on three main areas of inquiry: (1) the effect of rejection on a trademark license contract; (2) the Bankruptcy Code's treatment of trademark, in general; and (3) the unique characteristics of trademark.

Regarding the first area of inquiry, the court sought to analogize the rights conveyed by a trademark license to a leasehold interest or other more tangible right. In doing so, the justices proposed scenarios of what would happen, both in and outside of bankruptcy, in the rejection of a lease or other obligation in which the breaching party had an affirmative obligation.

The court argued that a breaching party does not get to elect whether to take back the property conveyed; it is instead the option of the nonbreaching party to either rescind the contract or sue for damages. The court found that concept to be axiomatic of contract law — regardless of the property or rights being conveyed. Therefore, rejection of a contract in bankruptcy which amounts to a breach would not give the breaching party the right to decide what to do with the conveyed property — in this case a license.

Justice Elena Kagan found this to be especially true in her questioning of the respondent. She remarked that it appeared the respondent was advocating for rescission of the contract by rejection, which is not what the Bankruptcy Code allows.

Next, the court discussed the fact that Congress elected not to include trademark in the definition of "intellectual property" in Bankruptcy Code Section 101(35A). Section 365(n) of the Bankruptcy Code allows a licensee of an intellectual property right to elect to retain its rights or treat the contract as terminated by the rejection. Justice Sonia Sotomayor questioned whether it would be the Supreme Court's place to apply protections for an intellectual property which is not enumerated in the statutory definition. Justice Ruth Bader Ginsburg, on the other hand, remarked that Congress' silence may have been intentional based on the Lubrizol case. The differences between trademark and other intellectual property make trademark more difficult.

Finally, the court discussed the unique nature of trademark itself. The petitioner and the United States both argued that trademark is unique in that there is a statutory requirement for oversight of a registered mark. A registered owner must take an affirmative stance to ensure that its mark is utilized in a manner consistent with brand identity and quality. Failure to do so may result in dilution or cancellation. That statutory oversight is not affected by bankruptcy and must continue post-petition. Rejection of a trademark contract would not affect the trademark owner's required oversight. The court referred to this statutory duty as quality control.

The petitioner and United States noted that relinquishment of such quality control may, eventually, cause a trademark's cancellation. That process is not immediate, but gradual. The respondent, in contrast, stated that trademark's unique nature made active quality control a requirement to a valid license. Following rejection, the respondent argued, a licensee is not permitted to continue to exercise the license because the licensor is no longer obligated to monitor the mark. Essentially, when quality control ceases, the mark becomes abandoned and loses value.

The transcript did not reveal a clear-cut decision in either party's favor, though the court did appear to favor the petitioner's argument and reasoning. The court did not agree with the respondent's preference for rescission of a licensing contract and further disagreed with the respondent’s contention that a breaching party may have the option to elect a remedy after breach.

It is too early to tell the outcome of this case, and mootness may control the ultimate decision. On rebuttal, the petitioner very cogently summed up the overarching issue:

> [T]his is not about whether the debtor can abandon the trademark and get rid of its monitoring obligations. It’s about whether the estate can take back the rights in the license and resell them to somebody else and distribute the proceeds among creditors, and it can’t[.] Rejection doesn’t let the estate claw back interests in the debtor’s assets that the debtor conveyed before bankruptcy.[4]

Intellectual property and bankruptcy practitioners will have to wait to find out.

W. Woods Drinkwater and John T. Baxter are associates at Nelson Mullins Riley & Scarborough LLP.

[1] Transcript of Oral Argument at 4, Mission Product Holdings, Inc. v. Tempnology, LLC, n/k/a Old Cold LLC, No. 17-1657, available at https://www.supremecourt.gov/oral_arguments/argument_transcripts/2018/17-1657_21o3.pdf.

[2] Lubrizol Enters. Inc. v. Richmond Metal Finishers Inc., 756 F.2d 1043 (4th Cir. 1985).

[3] Sunbeam Products Inc. v. Chicago American Manufacturing LLC, 686 F.3d 372 (7th Cir. 2012).

[4] Transcript of Oral Argument at 64-65, Mission Product Holdings, Inc. v. Tempnology, LLC, n/k/a Old Cold LLC, No. 17-1657.