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Trademarks, Bankruptcy, and Leverage: What Manufacturers and Other Trademark License Parties Should Know About A Potential Landmark Case Before the Supreme Court

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On February 20, 2019, the United States Supreme Court heard oral arguments in the case *Mission Products, Inc. v. Tempnology, LLC*. The case has important implications for manufacturers and other parties to trademark licenses when a trademark licensor files, or threatens to file, bankruptcy. Lower courts including the First Circuit found that, in the event of a trademark licensor bankruptcy filing, the licensor may reject the trademark license, prevent the licensee from further use of the license, and leave the licensee with the sole remedy of filing a claim in the bankruptcy case. Other courts have disagreed with the effect of a trademark license rejection in bankruptcy, finding that a trademark licensee may retain certain rights following a licensor rejection. When the Supreme Court rules, the *Tempnology* case is slated to be a landmark decision both on the general issue of what rejection truly means in bankruptcy and on the specific issue of whether a trademark licensee's rights can essentially be destroyed in a licensor bankruptcy case.

The decision is likely to have broad implications for trademark license parties no matter which way the Supreme Court rules. If the court holds that the rejection of a trademark license effectively terminates the rights of a licensee, both licensors and licenses will know that such a "nuclear option" is available in bankruptcy and negotiating leverage will swing heavily toward a licensor. On the other hand, a decision finding that licensees retain rights post-rejection will make a bankruptcy filing a much less attractive option for a licensor as a solution for dealing with a licensee. Both trademark licensors and licensees should, therefore, be aware that the bankruptcy sword or shield (depending on your perspective) may be about to change.

The *Tempnology* case involved Tempnology, LLC, a company that manufactured athletic sportswear and licensed the right to use its COOLCORE trademark and related rights to a licensee called Mission Product Holdings, Inc. More details about the company, the bankruptcy court decision, and the First Circuit decision can be found here. In summary, Tempnology attempted to use its Chapter 11 bankruptcy filing as a means to terminate the rights of the trademark license to Mission. Normally, following the rejection of an agreement such as a license in a bankruptcy case, non-debtor parties are limited to filing a general unsecured claim. Depending on the case, general unsecured claimants may receive much less than the face value of their claims. However, some courts have held that rejection does not "vaporize" a licensee's rights and the non-debtor licensee thus may retain certain post-rejection enforcement rights. To that point, outside of the bankruptcy context, a licensor's breach of a trademark license agreement does not mean that the licensee no longer has any rights in the license. In fact, state law provides a number of licensee remedies short of termination.

On appeal to the First Circuit, the court disagreed with the characterization that refusing to permit post-rejection rights would "vaporize" a trademark licensee's rights. The licensee continued to have rights, the court noted, but they were limited to filing a claim for rejection damages. The court further noted that the purpose of rejection under the Bankruptcy Code is to free a debtor of costly obligations and that this purpose would be thwarted if a trademark licensor debtor were required to deal with post-rejection assertions of rights by the licensee.

Mission appealed to the Supreme Court and certiorari was granted on October 26, 2018. While Mission requested review of several issues, the Supreme Court limited the matter to one issue: whether a debtor/licensor's rejection of a license agreement terminates rights of the licensee that would survive the licensor's breach under applicable non-bankruptcy law. In addition to the briefs filed by the parties, there were several notable amici curiae briefs, the majority of which adopted Mission's position that a trademark licensee should retain certain rights post-rejection. Such amici curiae briefs in support of Mission included the United States, the New York Intellectual Property Law Association, a number of revered law professors, and the International Trademark Association. Moreover, the United States, as represented by the Assistant to the Solicitor General, participated in oral argument in support of Mission.

During the oral arguments, the Justices probed the issue of a trademark licensor's obligations, including contractual obligations under the terms of a license as well as obligations to maintain the trademark under the Lanham Act. This is an important point because rejection is designed to relieve a debtor of its contractual obligations in order to unburden the bankruptcy estate. The Lanham Act, however, may impose continuing obligations on the licensor with respect to the rejected license. Mission argued that Bankruptcy Code section 365 and the concept of rejection speaks to contractual obligations and that the obligation to maintain a trademark is outside the agreement. Justice Breyer challenged the argument with an analogy of a landlord for an igloo whose obligation included air conditioning the premises: "You know, you break your promise to air condition, no more igloo." There were also some notable statements from the United States, which called the Tempnology's position "extortionate" because the threat of a rejection would put the licensee to the "choice between paying a higher royalty payment or shutting down their business and firing all their workers."

Tempnology responded by arguing that a trademark license involves a special relationship that deals with the trademark owner's reputation. The Justices challenged Tempnology on that point by asking how a licensor's breach would be treated outside of bankruptcy. When pressed on the point, Tempnology could not point to any case law or other authority that would compel the licensee to stop using the license as a result of the licensor's breach. Justice Kagan succinctly summarized the parties' positions that Mission was arguing rejection means breach and Tempnology was arguing that rejection means rescission. The fact that the applicable Bankruptcy Code section – section 365(g) – uses the word "breach" suggests that the Justices may be leaning in favor of Mission in the case. Note, however, the issue of mootness may preclude a substantive decision in this case. Both Justices Gorsuch and Sotomayor asked pointed questions on why the case is not moot on a number of grounds, including the fact that no court actually entered an order specifically preventing Mission from using the COOLCORE trademark post-rejection. The United States responded that the effect of the bankruptcy court order was to prevent such usage. It is not entirely clear, but it seemed that the Justices were able to get past the issue of mootness.

The issues in the *Tempnology* case have broad implications on whether a Chapter 11 bankruptcy can be used as a sword by a trademark licensor to relieve itself of what it perceives as burdensome licensee obligations. Under the law as adopted by the First Circuit, the scales are tipped decidedly in the favor of a debtor/licensor. If the Supreme Court rules in favor of Mission, it will provide clarity on what exactly rejection means in these circumstances and it will constitute a significant readjustment of negotiating leverage.