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Preserving and Protecting Value Following the Recent Supreme Court Decision Shifting the Landscape on Intellectual Property Licenses

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In May 2019, the U.S. Supreme Court decided the *Mission Product Holdings, Inc. v. Tempnology, LLC* case. The *Mission Products Holdings* decision provides a reminder to intellectual property license parties that periodic review of, and potential amendments to, license terms is critically important. The case dealt with the rejection of a trademark license by a bankrupt licensor. However, the court made clear that the ruling applies broadly to every type of agreement rejected by a debtor under Section 365 of the Bankruptcy Code. Intellectual property licensors and licensees may very well have no realistic concerns about filing bankruptcy themselves. But proper diligence relating to the preservation and protection of the value associated with a license includes being prepared for the potential financial insolvency or bankruptcy of the license counterparty.

The *Mission Products* 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. Tempnology attempted to use its Chapter 11 bankruptcy filing as a means to reject a trademark license with Mission, and thus terminate Mission's rights under the license. The bankruptcy court held that rejection of the license agreement revoked Mission's right to use the COOLCORE marks. The Bankruptcy Appellate Panel reversed, holding that rejection acted merely as a breach of the license, rather than a termination. On appeal to the First Circuit, the court reinstated the bankruptcy court decision that rejection effectively terminated the license agreement.

The Supreme Court took the opportunity to directly address the meaning and effect of rejection under bankruptcy law. The court relied on the language of Bankruptcy Code Section 365(g), which unambiguously states that rejection of a license or other "executory contract" constitutes a breach of such agreement, which is deemed to have occurred immediately before the filing of the bankruptcy case. Critical to the court's decision was a finding that a party – including a debtor in bankruptcy – should not be permitted to use its breach to deny the other party its rights under a contract. The court thus made clear that an intellectual property license party cannot use bankruptcy – or the threat of bankruptcy – as a sword to effectuate a complete loss of the other party's rights under the license.

Importantly, Justice Sotomayor wrote a concurring opinion stating that the *Mission Products* decision should not be read to grant every trademark licensee the unfettered right to continue using a mark post-rejection. Rather, a case-by-case inquiry must be made to determine whether, in fact, the licensee's rights would survive a breach under applicable non-bankruptcy law. Such non-bankruptcy law will include federal law such as the Lanham Act, as well as state breach of contract law. Bankruptcy law will prevent the non-debtor party from requiring the debtor to continue to perform all of its obligations under the license. Other than that, however, the protections set forth in all other applicable non-bankruptcy laws will continue to apply.

The *Mission Products* case changes the landscape relating to every type of intellectual property license such that rejection in bankruptcy can no longer be seen as a cataclysmic event that leaves the non-debtor party with no further rights under the agreement. To put it another way, the Supreme Court has shifted negotiating leverage away from financially unstable parties who may be tempted to use the threat of bankruptcy to force the other party to the negotiating table. While this is certainly a positive development for non-debtor parties, they should not rest on their laurels. The *Mission Products* holding provides an opportunity for proactive parties to amend license terms in order to put them in the best legal position possible if, in fact, they ever find themselves having to deal with the bankruptcy filing of their license counterparty. Issues include, but certainly are not limited to, the following:

Post-Breach Rights and Obligations. Because the *Mission Products* case makes clear that rejection will act as a breach, it is critically important for parties to review, understand, and potentially amend license terms dictating what rights and obligations the non-breaching party will have following a breach. Consider a trademark licensor that files bankruptcy, rejects the license, and ceases to police or otherwise maintain the mark. In that situation, the agreement may eventually be considered a "naked license," thus denying the licensee the value for which it bargained. Depending on the specific circumstances, trademark licensees should consider a number of different license amendments to deal with the issue. For example, the license could be amended to provide a funding mechanism for the licensee to rely upon if the licensee is forced to take up the policing duties. In addition, the license could be amended to include terms that automatically assign the trademark in the event the licensor breaches and abandons its obligations. Licensors and licensees of other types of intellectual property should likewise review their licenses and contemplate what they would – or would not – be able to do to protect themselves following a breach by the other party.

Authority Required for Certain Actions Under the License. Certain licenses may require one party to seek consent from the other party prior to being authorized to take action. For example, a licensee may be required to obtain written consent from the licensor in order to market a particular product for sale. Or the license may state that in the event of a breach by either party, no further product may be sold. If the licensor files bankruptcy and rejects the license, it is unclear whether the licensee would continue to be bound by such terms. License agreements should be amended to address the particular situation of rejection and make clear that the licensee can continue to sell product and otherwise reap economic benefits from the license.

Intellectual Property Escrow Agreements. The *Mission Products* case did not address or affect settled bankruptcy law providing that the bankruptcy filing itself cannot act as a triggering event under a license. Such terms – deemed "ipso facto clauses" – remain unenforceable. For example, even if the license terms clearly provide that the license will terminate automatically upon the bankruptcy filing of one party, such terms will not be enforced and the license will remain in effect. However, if the debtor determines to reject the license agreement, the license terms relating to the effect of such rejection (i.e., a breach of the license) will be enforceable. This includes terms relating to the deposit of intellectual property into an escrow agreement. Non-debtor parties (typically licensees) should consider requiring that intellectual property be placed into such an escrow with terms requiring such valuable property to be conveyed upon rejection. Absent such an agreement, the rejecting party may refuse to provide services such as infringement policing or software updates, and the non-debtor party will be left with rights to uncontrolled marks or obsolete technology that decreases in value by the day.