SCOTUS FINALLY CLARIFIES RIGHTS OF LICENSEES OF BANKRUPT BRANDS

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Chapter 11 Debtor, Tempnology, LLC ("Tempnology") is feeling the heat today, May 20, 2019, as the United States Supreme Court held that Mission Product Holdings, Inc., ("Mission"), a licensee of Tempnology's "Coolcore" products, can continue to use Tempnology's trademarks to sell and distribute its products in the United States. The Supreme Court's decision resolved a significant circuit split, at least for trademark licensing agreements, as to whether Section 365 of the Bankruptcy Code can shield a debtor-licensor from its licensees continued use of licensed trademarks.

Tempnology entered into a licensing agreement with Mission in 2012 that granted Mission a license to use Tempnology's "Coolcore" trademark and logo to distribute and sell athletic gear under the "Coolocore" brand ("License Agreement"). When Tempnology filed for bankruptcy in 2015, it attempted to reject the Licensing Agreement under Section 365(a) of the Bankruptcy Code and asserted that Mission therefore was not permitted to continue selling products under the Coolcore name. The Bankruptcy Court agreed with Tempnology's argument and terminated Mission's rights to use Tempnology's trademark, leaving Mission with only a prepetition claim for damages stemming from the breach of contract. Initially, the Bankruptcy Appellate Panel reversed and found that rejection of the License Agreement resulted in a breach of contract by Tempnology, not termination of Mission's right to license. The First Circuit Court of Appeals agreed with the lower Bankruptcy Court and overturned the Appellate Panel's decision.

The Supreme Court rejected the Bankruptcy Court's decision and the First Circuit's affirmance noting courts have struggled with this issue for years. On the one hand, some Circuits, including the Seventh Circuit have held that a rejection has the same consequence as a contract breach outside bankruptcy: it gives the counterparty a claim for damages, while leaving intact the rights the counterparty has received under the contract. Alternatively, according to other Circuits, including the First and Fourth Circuits, a rejection has the effect of a rescission, terminating the counterparty's rights leaving it only with a claim for damages.

The Court ultimately held that a Section 365(a) rejection of a trademark license agreement does not terminate the contracted rights of the licensee, in this case, the continued use of the licensed marks. The Court considered how real-world executory contracts work outside of bankruptcy. Ultimately, the Court reasoned its decision on the longstanding bankruptcy doctrine "the estate cannot possess anything more than the debtor itself did outside bankruptcy." *Board of Trade of Chicago v. Johnson*, 264 U.S. 1, 15 (1924).

As a result of this ruling, potential debtors and their bankruptcy counsel should be cognizant that a bankruptcy petition does not alter the debtor's duty to monitor and exercise quality control over its licensees, which now clearly have the right to continue using the licensed marks. Debtors attempting to reorganize will have to use its limited resources to maintain quality control of its trademarks, even in bankruptcy, or risk erosion of the brand or, quite possibly, invalidity of the trademark(s) at issue. Such a result could ultimately wipe out the debtor's only significant remaining asset.

The full opinion can be read here.

For more information on the topic, please contact the authors, Geoff Lottenberg, on our Dispute Resolution Team, or Michael Niles on our Business Reorganization Team.

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