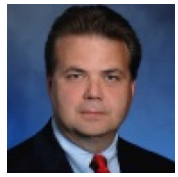
14 Nov
2018

US Supreme Court to decide whether trademark licences can survive bankruptcy

Baker Donelson - USA

Co-published

On 26 October 2018 the US Supreme Court granted *certiorari* in the case of *Mission Product Holdings Inc v Tempnology LLC*. The court will consider to what extent a debtor or licensor's rejection of a trademark licence agreement terminates the rights of a licensee to continue to use the mark. The decision, expected in mid-2019, will resolve a growing split between the circuit courts of appeal.



W Edward Ramage

This division reflects a tension between the intent of US bankruptcy law to give the debtor a fresh start without the burden of unwanted pre-existing contractual obligations and the expectations of IP licensees to gain the benefit of their bargain and their frequently substantial investments based on their licences. Under bankruptcy law, a debtor has the right to assume or reject executory contracts (ie, contracts which have material unperformed obligations remaining for both sides). If rejected, the rejection is deemed to be a pre-petition breach, which gives the other party a right to a pre-petition claim for damages.

This can lead to unfair results, particularly where IP licences are concerned. In the 1985 case of *Lubrizol Enterprises Inc v Richmond Metal,* the debtor rejected a technology licence for a metal coating process. The court treated the rejection as a termination of the licence, thereby stripping the licensee of all rights to carry out the metal coating process.

The US Bankruptcy Act was subsequently amended to provide protection to IP licensees. If an IP licence is rejected by a debtor, then the licensee may elect to treat the contract as terminated or retain its rights (including the right to enforce exclusivity) under the licence for the duration of the licence and any period for which the contract may be extended by the licensee as of right.

The Bankruptcy Act broadly defines 'intellectual property' to include trade secrets, patents and patent applications, plant varieties, copyright and mask works (eg, semiconductor chip products). However, trademarks are not included in the definition. The legislative history indicates that this was deliberate:

"*[T]he bill does not address the rejection of executory trademarks[s],…While such rejection is of concern…such contracts raise issues beyond the scope of [this] legislation. In particular, trademark, trade name and service mark licensing relationships depend to a large extent on control of the quality of the products or services sold by the licensee. Since these matters could not be addressed without more extensive study, it was determined to postpone congressional action in this area and to allow the development of equitable treatment of this situation by bankruptcy courts.*"

In practice, the treatment of trademark licences since this amendment has been decidedly mixed. Some courts have avoided the issue by determining that, at least in the context of asset purchases or mergers and acquisitions, a trademark licence that is a part of the transaction is not executory and thus cannot be rejected. In other contexts, other courts (such as the Court of Appeals for the Seventh Circuit in *Sunbeam Products*) have found that a trademark licence can be rejected – however, while deemed a breach, such a rejection does not automatically terminate the licence. This is based on the reasoning that a breach of a licence by a licensor under common or state law does not necessarily result in termination of the agreement, particularly if the breach is not material. Instead, the rejection merely frees the bankruptcy estate from its obligation to perform under the licence, but the licensee's rights thereunder may continue.

In *Tempnology*, the licensee had exercised its right to terminate a licence agreement, triggering a two-year wind-down period. The licensor subsequently filed for bankruptcy and rejected the licence. The bankruptcy court treated this as a termination of the licence by the debtor and stripped the licensee of its right to continue using the affected trademarks. The Court of Appeals for the First Circuit ultimately approved this approach and expressly rejected the Seventh Circuit's *Sunbeam Products* interpretation. The First Circuit noted that continuing quality control and similar obligations on the part of a trademark licensor meant that a debtor effectively would still have burdens under the licence, even post rejection and that result was contrary to the intent of bankruptcy law.

The US Supreme Court has agreed to hear the *Tempnology* appeal. The specific issue on appeal is as follows:

"*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 non-bankruptcy law*."

For further information contact:

W Edward Ramage
Baker Donelson
View website
Email: eramage@bakerdonelson.com
Tel: +1 615 726 5600

TAGS

North America, **United States of America**