

International Corporate Rescue



Published by:

Chase Cambria Company (Publishing) Ltd
4 Winifred Close
Barnet, Arkley
Hertfordshire EN5 3LR
United Kingdom

www.chasecambria.com

Annual Subscriptions:

Subscription prices 2017 (6 issues)

Print or electronic access:

EUR 730.00 / USD 890.00 / GBP 520.00

VAT will be charged on online subscriptions.

For 'electronic and print' prices or prices for single issues, please contact our sales department at:
+ 44 (0) 207 014 3061 / +44 (0) 7977 003627 or sales@chasecambria.com

International Corporate Rescue is published bimonthly.

ISSN: 1572-4638

© 2019 Chase Cambria Company (Publishing) Ltd

All rights reserved. No part of this publication may be reproduced, stored in a retrieval system, or transmitted in any form or by any means, mechanical, photocopying, recording or otherwise, without prior permission of the publishers.

Permission to photocopy must be obtained from the copyright owner.
Please apply to: permissions@chasecambria.com

The information and opinions provided on the contents of the journal was prepared by the author/s and not necessarily represent those of the members of the Editorial Board or of Chase Cambria Company (Publishing) Ltd. Any error or omission is exclusively attributable to the author/s. The content provided is for general purposes only and should neither be considered legal, financial and/or economic advice or opinion nor an offer to sell, or a solicitation of an offer to buy the securities or instruments mentioned or described herein. Neither the Editorial Board nor Chase Cambria Company (Publishing) Ltd are responsible for investment decisions made on the basis of any such published information. The Editorial Board and Chase Cambria Company (Publishing) Ltd specifically disclaims any liability as to information contained in the journal.

In re Tempnology, LLC, Rejection of a Trademark Licence is Not Termination of that Licence

Seth H. Lieberman, Partner, and Patrick Sibley, Partner, Pryor Cashman LLP, New York, USA¹

Synopsis

Recently, the US Supreme Court in *Mission Product Holdings, Inc. v Tempnology, LLC*² resolved what the International Trademark Association called ‘the most significant unresolved legal issue in trademark licensing’³ when it found that a contract rejected in bankruptcy pursuant to section 365 of the Bankruptcy Code is a breach, and not an outright revocation, of the contract. In so ruling, the Court held that the licensee of a rejected contract can continue to use the mark post-rejection.⁴

Background

In 2012, Tempnology, a clothing and accessories manufacturer, entered into a contract with Mission Product whereby Tempnology granted Mission Product an exclusive licence to distribute certain Tempnology products and a non-exclusive licence to use the products’ trademarks in the United States and abroad.⁵

In September 2015, less than a year before the agreement was set to expire, Tempnology filed for chapter 11 bankruptcy protection and sought to reject the licensing agreement. After the bankruptcy court granted Tempnology’s motion to reject the contract, Tempnology sought a declaratory judgment that the rejection

terminated the rights that it granted Mission Product to use the trademarks.⁶

Tempnology’s position was based on a negative inference. Section 365 of the Bankruptcy Code, which addresses a debtor’s rejection of an executory contract, singles out specific types of contracts that the non-debtor/non-breaching party can continue to enjoy the benefits of post-rejection.⁷ One of those enumerated contracts is intellectual property licences which, by definition under the Bankruptcy Code, does not include trademarks.⁸ Therefore, Tempnology argued that the Bankruptcy Code’s omission of trademarks from section 365 dictates that a licensee cannot use a trademark post-rejection. The bankruptcy court agreed with Tempnology’s analysis and held that the debtor’s rejection revoked Mission Product’s right to use the licence.⁹

Relying on the Seventh Circuit decision in *Sunbeam Products, Inc. v Chicago American Manufacturing, LLC*,¹⁰ the Bankruptcy Appellate Panel reversed.¹¹ The Panel focused on section 365(g) of the Bankruptcy Code, which provides that a contract rejection ‘constitutes a breach of such contract.’¹² In a non-bankruptcy context, a breach does not eliminate the rights previously conferred onto the non-breaching party. The same is true with a rejected contract in bankruptcy. Accordingly, the Panel allowed Mission Product to continue using the trademark post-rejection.¹³

The First Circuit Court of Appeals reversed the Bankruptcy Appellate Panel and sided with the bankruptcy

Notes

- 1 The views expressed herein are solely those of Messrs Lieberman and Sibley, and not necessarily the views of Pryor Cashman LLP or any of its attorneys. The authors would like to thank Andrew S. Richmond for his work in connection with this article.
- 2 No. 17-1657, 2019 WL 2166392 (May 20, 2019).
- 3 *Amicus Curiae* Brief of the International Trademark Association In Support Of Petitioner at 3, *Mission Product Holdings, Inc. v Terminology, LLC*, 2019 WL 2166392 (May 20, 2019) (No. 17-1657), 2018 WL 6618030, at *4.
- 4 *Mission Prod. Holdings*, 2019 WL 2166392, at *1.
- 5 *Id.* at *2.
- 6 *Id.* at *3.
- 7 11 U.S.C. §§ 365 (h), (i), (l), (n).
- 8 *Id.* §§ 101(35A); 365(n).
- 9 *In re Tempnology, LLC*, 541 B.R. 1, 7 (Bankr. N.H. 2015).
- 10 686 F.3d 372, 376–77 (7th Cir. 2012).
- 11 *In re Tempnology, LLC*, 559 B.R. 809, 820–23 (BAP 1st Cir. 2016).
- 12 *Id.* at 820 (quoting 11 U.S.C. § 365(g)).
- 13 *Id.*; see *id.* at 820, 822 (noting that a ‘rejection does not terminate the contract’ nor does it ‘vaporize Mission’s trademark rights under the Agreement’).

court, embracing Tempnology's negative inference analysis.¹⁴ The First Circuit further reasoned that the distinct nature of trademark law necessitates such a holding. A licensor has to monitor and control the goods associated with its trademark. Therefore, absent a revocation of the agreement, a debtor would be forced to continue to monitor the goods post-rejection, thereby frustrating the underlying purpose of contract rejection, namely, to 'release the debtor's estate from burdensome obligations.'¹⁵

The US Supreme Court granted *certiorari* to resolve the split between the First and Seventh Circuits.¹⁶

Supreme Court decision

The issue before the Supreme Court was how to treat a contract rejection. On the one hand, rejection could be treated the same as a breach of contract outside of bankruptcy, whereby the non-breaching party has a claim for damages while it can simultaneously continue to enjoy the benefits of the contract. On the other hand, contract rejection could be treated as a termination of the entire contract, revoking all rights and obligations conferred by the contract. The Supreme Court favoured the former interpretation.¹⁷

Before specifically addressing licence agreements, the Supreme Court generally analysed contract rejections in bankruptcy. Section 365(a) of the Bankruptcy Code allows a debtor to assume or reject any executory contract or unexpired lease.¹⁸ Rejection 'constitutes a breach of such contract.'¹⁹ As the term 'breach' is not defined in the Bankruptcy Code, the word's definition is that used in the general commercial context.²⁰ Outside of bankruptcy, when one party breaches an executory contract or lease, the non-breaching party can either (i) terminate the contract and return the product it contracted to use or (ii) choose to honour

the agreement, continue to make payments and sue the breaching party for damages caused by the breach. Conversely, the breaching party cannot unilaterally terminate the contract and demand the non-breaching party return the goods. Said differently, the breaching party cannot revoke the agreement in its entirety.²¹ Therefore, in bankruptcy, when a debtor rejects, and thereby breaches, the contract, 'the debtor and counterparty do not go back to their pre-contract positions. Instead, the counterparty retains the rights it has received under the agreement.'²²

Licence agreements are no exception. When a debtor-licensor rejects a licence agreement, 'the breach does not revoke the license or stop the licensee from doing what it allows.'²³ Although the debtor is freed from performing its obligations under the agreement, 'the debtor cannot rescind the license already conveyed. So the licensee can continue to do whatever the license authorizes.'²⁴

The bankruptcy estate does not bestow any property rights onto a debtor not otherwise conferred outside of bankruptcy.²⁵ As a result, a debtor cannot, upon rejection, 'recaptur[e] interests it had given up' to its counterparty upon entering into a contract.²⁶ Once a debtor licenses out the right to use its mark, it cannot reclaim those rights simply by rejecting and breaching the contract.

Just as it argued in the lower courts, Tempnology first focused its Supreme Court brief on the negative inference drawn from section 365 of the Bankruptcy Code. Tempnology reasoned that by not limiting the types of contracts that survive post-rejection, 'the statute's "general rule" would "swallow the exceptions."²⁷

Yet, as Justice Kagan noted, Tempnology's interpretation ignores the simple reading of 365(g) of the Bankruptcy Code, which states that a rejection 'constitutes a breach of such contract.'²⁸ Instead, each subsection singling out specific types of executory contracts was enacted to address a specific problem.²⁹

Notes

14 *In re Tempnology, LLC*, 879 F.3d 389 (1st Cir. 2018).

15 *Id.* at 402.

16 *Mission Prod. Holdings, Inc. v Tempnology, LLC*, 139 S. Ct. 397 (2018).

17 *Mission Prod. Holdings*, 2019 WL 2166392, at *5.

18 11 U.S.C. § 365(a).

19 *Id.* § 365(g).

20 *Mission Prod. Holdings*, 2019 WL 2166392, at *5.

21 *Id.*

22 *Id.* at *6.

23 *Id.*

24 *Id.*

25 *Id.*; see 11 U.S.C. § 541(a)(1) (the estate consists of, among other things, 'all legal or equitable interests of the debtor in property as of the commencement of the case').

26 *Id.*; see D. Baird, *Elements of Bankruptcy* 97 (6th ed. 2014) ('A debtor's property does not shrink by happenstance of bankruptcy, but it does not expand, either.')

27 *Mission Prod. Holdings*, 2019 WL 2166392 at *7 (quoting Brief for Respondent at 19, *Mission Product Holdings, Inc. v Terminology, LLC*, 2019 WL 2166392 (May 20, 2019) (No. 17-1657), 2019 WL 193112, at *19).

28 11 U.S.C. § 365(g).

29 *Mission Prod. Holdings*, 2019 WL 2166392 at *7 ('What the legislative record [reflects] is that whenever Congress has been confronted with the consequences of the [view that rejection terminates all contractual rights], it has expressed its disapproval.' (quoting M. Andrew, 'Executory Contracts in Bankruptcy: Understanding "Rejection"' (1988) 59 *University of Colorado Law Review* 845, 931)).

For example, section 365(n) of the Bankruptcy Code, which addresses the continued use of a patent licence post-rejection, was enacted to repudiate the Fourth Circuit's decision in *Lubrizol Enterprises v Richmond Metal Finishers*,³⁰ where the court held that the debtor's rejection rescinded its grant of the patent licence to the licensee.³¹ Therefore, Tempnology's supposed 'exceptions' are not limitations, but rather are illustrations of the general rule.

Tempnology's second argument was that the alternative will leave a debtor with a no-win situation, forced to decide between expending scarce resources on quality control and maintain the value of the mark or, absent monitoring the mark, risk losing a valuable asset. Either choice 'would impede a [debtor's] ability to reorganize' thereby 'undermin[e] a fundamental purpose of the Code.'³²

In response, the Supreme Court exposed Tempnology's flawed logic. Tempnology sought to define a general rule based on an obstacle present in its specific situation. In arguing for the treatment of all rejected contracts, Tempnology referred to the specific challenges facing debtors with a rejected but unrevoked trademark licence agreement. That analysis would, as Justice Kagan stated, 'allow the tail to wag the Doberman.'³³ Moreover, despite the goal of enabling a debtor's reorganisation, the Bankruptcy Code is not a free-for-all to permit anything that would advance that goal.³⁴ Section 365 of the Bankruptcy Code does not exempt a debtor from burdens found in general applicable law.³⁵ Therefore, the Supreme Court concluded that a debtor's rejection of an executory contract has the same effect as a breached contract outside of bankruptcy, reversing the First Circuit's judgment and remanding the case for further proceedings.³⁶

Notes

30 756 F.2d 1043, 1045–48 (4th Cir. 1985).

31 *Mission Prod. Holdings*, 2019 WL 2166392, at *7.

32 *Id.* at *8 (quoting Brief for Respondent at 59–60, 2019 WL 193112, at *60).

33 *Id.*

34 *Id.*; *Florida Dep't of Revenue v Piccadilly Cafeterias, Inc.*, 554 U.S. 33, 51 (2008) (noting the Bankruptcy Code is not a 'remedial statute' and the Supreme Court 'has rejected the notion that "Congress has a single purpose in enacting Chapter 11."' Instead, the Bankruptcy Code 'strikes a balance between a debtor's interest in reorganizing and restricting its debts and the creditors' interest in maximizing the value of the bankruptcy estate.' (quoting *Toibb v Radloff*, 501 U.S. 157, 163 (1991)).

35 *Mission Prod. Holdings*, 2019 WL 2166392, at *8.

36 *Id.* at *9.

International Corporate Rescue

International Corporate Rescue addresses the most relevant issues in the topical area of insolvency and corporate rescue law and practice. The journal encompasses within its scope banking and financial services, company and insolvency law from an international perspective. It is broad enough to cover industry perspectives, yet specialized enough to provide in-depth analysis to practitioners facing these issues on a day-to-day basis. The coverage and analysis published in the journal is truly international and reaches the key jurisdictions where there is corporate rescue activity within core regions of North and South America, UK, Europe Austral Asia and Asia.

Alongside its regular features – Editorial, US Corner, Economists’ Outlook and Case Review Section – each issue of *International Corporate Rescue* brings superbly authoritative articles on the most pertinent international business issues written by the leading experts in the field.

International Corporate Rescue has been relied on by practitioners and lawyers throughout the world and is designed to help:

- Better understanding of the practical implications of insolvency and business failure – and the risk of operating in certain markets.
- Keeping the reader up to date with relevant developments in international business and trade, legislation, regulation and litigation.
- Identify and assess potential problems and avoid costly mistakes.

Editor-in-Chief: Mark Fennessy, Proskauer Rose LLP, London

Emanuella Agostinelli, Curtis, Mallet-Prevost, Colt & Mosle LLP, Milan; Scott Atkins, Norton Rose Fulbright, Sydney; James Bennett, KPMG, London; Prof. Ashley Braganza, Brunel University London, Uxbridge; Dan Butters, Deloitte, London; Geoff Carton-Kelly, FRP Advisory, London; Gillian Carty, Shepherd and Wedderburn, Edinburgh; Charlotte Cooke, South Square, London; Sandie Corbett, Walkers, British Virgin Islands; Katharina Crinson, Freshfields Bruckhaus Deringer, London; Hon. Robert D. Drain, United States Bankruptcy Court, Southern District of New York; Matthew Kersey, Russell McVeagh, Auckland; Prof. Ioannis Kokkoris, Queen Mary, University of London; Professor John Lowry, University College London, London; Neil Lupton, Walkers, Cayman Islands; Ian McDonald, Mayer Brown International LLP, London; Nigel Meeson QC, Conyers Dill Pearson, Hong Kong; Professor Riz Mokal, South Square, London; Mathew Newman, Ogier, Guernsey; Karen O’Flynn, Clayton Utz, Sydney; Professor Rodrigo Olivares-Caminal, Queen Mary, University of London; Christian Pilkington, White & Case LLP, London; Susan Prevezer QC, Quinn Emanuel Urquhart Oliver & Hedges LLP, London; Sandy Purcell, Houlihan Lokey Howard & Zukin, Chicago; Professor Professor Arad Reisberg, Brunel University, London; Daniel Schwarzmann, PricewaterhouseCoopers, London; The Hon Mr Justice Richard Snowden, Royal Courts of Justice, London; Anker Sørensen, De Gaulle Fleurance & Associés, Paris; Kathleen Stephansen, New York; Angela Swarbrick, Ernst & Young, London; Dr Artur Swierczok, CMS Hasche Sigle, Frankfurt; Meiye Tan, Oon & Bazul, Singapore; Stephen Taylor, Isonomy Limited, London; Richard Tett, Freshfields Bruckhaus Deringer, London; William Trower QC, South Square, London; Mahesh Uttamchandani, The World Bank, Washington, DC; Robert van Galen, NautaDutilh, Amsterdam; Miguel Virgós, Uría & Menéndez, Madrid; Prof. em. Bob Wessels, University of Leiden, Leiden, the Netherlands; Maja Zerjal, Proskauer Rose, New York; Dr Haizheng Zhang, Beijing Foreign Studies University, Beijing.

For more information about *International Corporate Rescue*, please visit www.chasecambria.com