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U.S. Supreme Court Upholds State Law Rights of Trademark Licensees and Other Non-Debtor Contract Parties in Bankruptcy

Attorneys
Douglas Hallward-Driemeier
James M. Wilton
Gregg M. Galardi
Patricia I. Chen
Jonathan R. Ference-Burke

On May 20, 2019, the U.S. Supreme Court issued an 8-1 ruling in the case of *Mission Product Holdings, Inc. v. Tempnology, LLC*. The decision resolves a circuit split, holding that a licensee may retain its right to use licensed trademarks, notwithstanding the debtor-licensor's rejection of the contract in bankruptcy. The Supreme Court's decision has potentially far-reaching implications. Because it interprets foundational Bankruptcy Code provisions, the decision applies not only to licensed trademark rights, but to continuing rights granted to non-debtor counterparties under other types of executory contracts. The decision will greatly enhance the negotiating leverage of trademark licensees and other non-debtor contract parties vis-á-vis secured lenders and unsecured creditors, making it more difficult for debtors to shed burdensome trademark licenses in the process of rebranding and reorganizing retail businesses. Other types of contracts that will benefit from new arguments for post-rejection enforcement include option agreements, asset purchase agreements, franchise agreements, rights of reference to clinical data in pharmaceutical collaboration agreements, and contractual non-competes and other agreements containing negative covenants.

Tempnology, the debtor-licensor, entered into a co-marketing agreement, under which it granted Mission a non-exclusive license to use its trademarks and an exclusive right to distribute certain of its products. After filing for bankruptcy, Tempnology rejected the agreement pursuant to section 365 of the Bankruptcy Code, giving rise to a claim by Mission in the bankruptcy for breach of contract. Mission also asserted that the rejection did not prevent it from continuing to use Tempnology's trademarks or exercising its exclusive distribution rights.

Writing for the majority, Justice Kagan held that, under section 365(g) of the Bankruptcy Code, rejection of an executory contract has the same consequences as a breach under non-bankruptcy law, except that the debtor is relieved of performance obligations and damages are treated as prepetition claims against the bankruptcy estate (which likely may be paid at cents on the dollar). The Court rejected the argument that Congress's omission of trademark licenses from a list of statutory "exceptions" to the general rule that provide specified post-rejection rights under patent and copyright licenses and select other types of contracts, implied, by negative inference, that trademark licensees could not continue use of trademarks post-rejection. The Court also rejected Tempnology's argument that distinctive features of trademarks – particularly the licensor's duty to maintain quality control – required a trademark-specific rule under section 365.

Justice Sotomayor observed in concurrence that the Court's opinion did not resolve the underlying question as to whether a trademark licensee's rights to use the trademark survive a breach under applicable nonbankruptcy law and that "[s]pecial terms in a licensing contract or state law could bear on that question in individual cases." Justice Sotomayor also noted that the Court's opinion will not expand the rights of patent and copyright licensees because these rights are governed by specific rules established by statute.

Critically for Tempnology, the Court limited its opinion to Mission's trademark rights, finding "no reason to doubt" the First Circuit's conclusion that Mission had waived its arguments that its exclusive distribution rights also survived contract rejection. In dissent, Justice Gorsuch noted that the trademark license had expired by its own terms and that it was "far from clear" Mission would be able to seek money damages against Tempnology based solely on a non-exclusive right to "use" the trademark. Because Mission had not "come close to articulating a viable legal theory" for money damages, Justice Gorsuch reasoned that the case should have been dismissed as improvidently granted.

The Ropes & Gray team representing Tempnology included Douglas Hallward-Driemeier, head of the firm's appellate and Supreme Court practice, business restructuring partners James Wilton and Gregg Galardi and counsel Patricia Chen, and appellate and Supreme Court associate Jonathan Ference-Burke. As co-counsel, the Nixon Peabody LLC team included Lee Harrington, George Skelly, Daniel Sklar, and Christopher Desiderio.

For more information regarding this decision, please feel free to contact Douglas Hallward-Driemeier, James Wilton, Gregg Galardi, Mark Bane or your usual Ropes & Gray advisor.