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INTRODUCTION

Under section 365 of title 11 of the United States Code (the "Bankruptcy Code") a trustee or a debtor-in-possession may reject an executory contract. Rejection has the same effect as a breach outside of bankruptcy; rejection does not rescind the rights that the contract previously granted or terminate the contract. Under section 365(n) of the Bankruptcy Code, a licensee of intellectual property may retain the right to use such intellectual property notwithstanding the rejection of such license provided it is an executory contract. A contract is executory when there is performance due, to some extent, from both parties.[1] A licensing contract is executory because the licensor grants the license and provides associated goods or services during the licensed term, and the licensee, in return, pays continuing royalties or fees.[2] Said otherwise, in a licensing contract, performance is due from both sides until the very end of the contract term, and therefore the contract is considered executory. When an executory contract licenses out trademark rights, there was a question as to whether or not those rights are terminated when the contract is rejected.

Circuit Courts consulted previous case law, Congressional intent, and statutory interpretation to decide whether a license to use a trademark in an executory contract remains

[1] *See NLRB v. Bildisco & Bildisco*, 465 U. S. 513, 522, n. 6 (1984).
[2] *See Mission Products Holdings, Inc. v. Tempnology, LLC,* 587 U.S. ___, 10 (2019).

after rejection. After a circuit split as to this question, the Supreme Court, in *Mission Products Holdings, Inc. v. Tempnology, LLC* ("*Mission*"), finally attempted to create a legal standard to apply to rejected trademark executory contracts, however the holding in this case left some lingering ambiguities. What remains ultimately clear from the holding in *Mission* is that rejection does not rescind the trademark rights previously granted by an executory contract. This memorandum explores (1) the legal standard and confusion that led to the circuit split prior to *Mission*, (2) the current law as articulated in *Mission*, and (3) some of the remaining ambiguities post *Mission*.

I. The Legal Standard when Applied to Trademark Rights in the Rejection of an Executory Contract Remained Ambiguous Prior to *Mission*

A. The Fourth Circuit Held that Rejection of an Executory Contract Withdraws Any Intellectual Property Rights Granted Therein

In 1985, the Court of Appeals for the Fourth Circuit first addressed the ability of a non-debtor to continue using intellectual property following rejection of a contract under chapter 11 of the Bankruptcy Code.[3] This case involved an executory contract licensing a patent.[4] The licensor filed and was eventually approved for both chapter 11 bankruptcy and rejection of the contract between the parties.[5] In this case, the relevant question was whether the licensee could continue to use the patent, or if that right terminates at the time of rejection. The Fourth Circuit analyzed legislative history to decide this question and reasoned that while rejection of a contract under section 365(g) of the Bankruptcy Code equates to a breach of contract, outside of bankruptcy, legislative history makes clear that the "purpose of the provision is to provide only a damages remedy for the non-bankrupt party."[6] The court then applied this reasoning and found that the licensee of a patent cannot rely on provisions in an executory agreement providing for

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[3] *See Lubrizol Enterprises, Inc. v. Richmond Metal Finishers* ("*Lubrizol*), 752 F.2d 1043, 1043 (4th Cir. 1985).
[4] *Id*. at 1044.
[5] *Id*.
[6] *Lubrizol Enterprises, Inc.*, 752 F.2d at 1048.

continued use of the patent upon "breach" of the contract by the licensor during rejection.[7] Said differently, a debtor's rejection of an executory contract worked to revoke its grant of a patent license.[8]

When the Fourth Circuit interpretation of 365(g) is applied, only money damages are available to the licensee, not continued use of the intellectual property.[9] The allowance of specific performance (continued use of the patent rights) would "seriously undercut the core purpose of rejection."[10] The court concluded that through rejecting the contract, the right to use the patent was terminated.[11]

B. Congress Amended Section 365(n) to Ensure the Continuation of Intellectual Property Licenses in Chapter 11 Bankruptcy Cases, but did not include Trademark in the Definition of Intellectual Property

Following the decision in *Lubrizol*, Congress quickly amended Bankruptcy Code Section 365(n) to effectively reverse the Fourth Circuit's holding and ensure the continuation of intellectual property licenses after rejection of executory contracts in bankruptcy cases.[12] This amendment clarified the actual congressional intent behind rejecting an executory contract licensing intellectual property rights.[13] The licensee of intellectual property rights has the choice to treat the rejection of an executory contract as a termination of the contract, or to retain its rights to the intellectual property under section 365(n).[14] Through this amendment, Congress clarified that the intent of rejection is not to provide mere monetary damages but to give a licensee a choice between damages or the ability to continue to exercise the rights provided in the executory contract.

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7 *Id*.
8 *Id*. at 1045–48.
9 *Id*.
10 *Id*.
11 *Id*. at 1045–48.
12 102 Stat. 2538 (1988).
13 *Id*.
14 *Id*.

This clarification should have provided certainty regarding the question of the continuation of intellectual property rights after contract rejection, subject to one caveat. Section 101(35A) of the Bankruptcy Code does not include "trademark" in the definition of intellectual property.[15] This section defines intellectual property as "includes trade secrets, patents, patent applications, plant varieties, copyrights and mask works for semiconductor chip products."[16] Consequently, circuit courts split on how to bridge the gap between section 365(n), the intent of Congress, and the absence of trademark in section 101(35A).[17]

C. A Circuit Split Resulted from the Courts Struggling to Ascertain a Clear Legal Standard as Applied to Trademark Rights in the Rejection of an Executory Contract

In *Sunbeam Products, Inc. v. Chicago American Manufacturing, LLC* ("*Sunbeam Products*"), the Seventh Circuit attempted to answer whether section 365(n) applies to executory contracts for trademark rights.[18] In *Sunbeam Products,* the circuit court sought to decide whether *Lubrizol* correctly determined whether intellectual property rights terminate after rejection of an executory contract.[19] The court analogized the rejection in this case with breaching the contract before bankruptcy.[20] The parties would have several options to remedy the breach, and the court reasons that "[o]utside of bankruptcy, a licensor's breach does not terminate a licensee's right to use intellectual property" and that during a breach and consequently, during rejection, "nothing about this process implies that any rights … have been vaporized."[21] If rejection of a contract is equivalent to a breach, then rejection "merely frees the estate from the obligation to perform and has absolutely no effect upon the contract's continued existence."[22] As far as the absence of trademark in section 101(35A), the court explained that the "limited definition in § 101(35A)

[15] 11 U.S.C. §101(35A) (2012).
[16] *Id*.
[17] *See Mission Products Holdings, Inc.*, 587 U.S. ___, 17.
[18] 686 F.3d 372, 376 (7th Cir. 2012).
[19] *See Id*. at 376.
[20] *Id*.
[21] *Id*. at 377
[22] *Id*. at 376.

means that § 365(n) does not affect trademarks one way or another" and that Congress left trademark out of the definition merely for "more time for study, not to approve" and the effect of amending section 365(n) remains the same for trademark cases.[23] Obviously unpersuaded by *Lubrizol*, the Seventh Circuit held that rejection equates to breach of a contract, and trademark rights are exercisable after rejection.[24]

Following *Sunbeam Products*, the First Circuit decided a similar intellectual property issue, regarding trademarks in an executory contract after rejection.[25] In this case the debtor/licensor, Tempnology, LLC, manufactured clothing and accessories designed to stay cool during exercise.[26] Tempnology marketed the products under a brand name "Coolcore," using trademarks to distinguish this particular athletic gear from other ordinary workout gear on the market.[27] In 2012, Tempnology entered into a contract with the petitioner, Mission Product Holdings, Inc. ("Mission"), pursuant to which Tempnology granted Mission an exclusive license to distribute certain Coolcore products and a non-exclusive license to use Coolcore trademarks.[28] Before the agreement expired, Tempnology filed a voluntary petition for relief under chapter 11 of the Bankruptcy Code with the United States Bankruptcy Court for the District of New Hampshire. Soon afterward, the bankruptcy court had to decide whether a rejection of the executory contract between Tempnology and Mission deprives Mission of its rights to use the trademark licensed to them under the contract. The bankruptcy court allowed Tempnology to reject the executory licensing agreement with Mission.[29]

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[23] *Id*. at 375.
[24] *Id*. at 377.
[25] *See In re Tempnology, LLC*, 879 F.3d 289 (1st Cir. 2018).
[26] *See Mission Products Holdings, Inc,* 587 U.S. ___, 17 (2019).
[27] *Id*. at 1.
[28] *Id*. at 2.
[29] *Id*. at 3.

Consequently, Mission lost the previously granted rights to use the Coolcore trademark. This case followed the appeals process through the Bankruptcy Appellate Panel, which adopted the Seventh Circuit rationale, and held that Mission's rights to the Coolcore trademark did not seize to exist upon Tempnology's rejection of the contract.[30] However, following the Bankruptcy Appellate Panel decision, the First Circuit rejected this line of reasoning and adopted the Fourth Circuit rationale holding that upon rejection of the contract, Mission's rights to the Coolcore trademark were revoked upon the rejection of the contract.[31] Because of this disagreement between the circuits as to how to apply section 365(n) to trademark cases, the Supreme Court granted certiorari and heard this case to resolve the circuit split and attempt to provide a clear framework for these cases moving forward.

II. Trademarks Now Considered Intellectual Property under Section 365(n) and Contract Rejection in Chapter 11 Cases Does not Terminate Trademark Licenses

On review, the Supreme Court upheld the rationale used in the Seventh Circuit, and the Bankruptcy Appellate Panel, that a debtor's rejection of an executory contract giving rights to a trademark under section 365 of the Bankruptcy Code has the same effect as a breach of that contract outside bankruptcy.[32] Thus, the Supreme Court clarified that rejection does not grant any special rights to debtors that are not awarded in a regular breach of contract situation outside of bankruptcy. The Court reasoned that Congress amended section 365(n) to "reinforce and clarify the general rule that contractual rights survive rejection" and even if trademarks are absent from section 101(35A) the congressional intent of intellectual property rights surviving rejection still applies.[33]

[30] *In re Tempnology, LLC*, 559 B.R. 809, 830–823 (Bkrtcy. App. Panel CA1 2016).
[31] *In re Tempnology, LLC,* 879 F.3d 289 (4th Cir. 2018).
[32] *Mission Products Holdings, Inc.*, 587 U.S. at 16.
[33] *Id*. at 13–14.

Currently, in the case of a rejection of an executory contract that licenses trademark rights, trademarks are intellectual property for the purposes of section 101(35A) and consequently, section 365(n) applies equally to trademark cases and does not terminate the previously granted trademark rights. The licensee has a choice between terminating the contract and pursuing regular breach of contract remedies, or to retain its rights under the contract.[34]

III. Legal Standard Set Forth in *Mission Products Holdings, Inc.* does not Entirely Clear Up the Ambiguities in Trademark Contract Rejection Cases

The Supreme Court in *Mission* acknowledged that Congress omitted "trademark" in section 101(35A). This omission still leaves an ambiguity as to Congressional intent. The Supreme Court provided a clear understanding that rejection is a breach of contract, and now allows lawyers to foresee licensees choosing to continue to exercise their trademark rights after rejection. In her concurrence in *Mission*, however, Justice Sotomayor stated that the Court did not "decide that every trademark licensee has the unfettered right to continue using licensed marks postrejection."[35] It is, therefore, "unclear if trademark licensees are required to continue making royalty payments with no right to deduct damages from their payments even if they otherwise could have done so under nonbankruptcy law–or if such a deduction is indeed available to a trademark licensee electing to retain its rights to use a mark."[36] This uncertainty, echoing Justice Sotomayor's concurrence, leaves Congress the opportunity to tailor a provision specifically for trademark licenses and to address the extent trademark licensees are distinct in comparison to licensees of other forms of intellectual property.[37]

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[34] 102 Stat. 2538.
[35] *See Mission Products Holdings, Inc.*, 587 U.S. at 1 (Sotomayor, J., concurring).
[36] *See* Elizabeth Burkhard, Phillip Nelson & Lynne Xerras, *Mission (Products) Accomplished: Trademark License Not Rescinded Upon Rejection in Bankruptcy – Supreme Court Decision Ends Circuit Split, Interprets Bankruptcy Code Section 256(g) Broadly and Favorably* (May 28, 2019), https://www.jdsupra.com/legalnews/mission-products-accomplished-trademark-69512/#_edn26.
[37] *See Mission Products Holdings, Inc.*, 587 U.S. at 2 (Sotomayor, J., concurring).

Further, because of the decision in *Mission*, debtors/licensors now need to consider that while the Bankruptcy Code favors reorganization, "it does not permit anything and everything that might advance that goal."[38] As a result of the integration of non-bankruptcy law needed to determine the scope of the non-debtor party's rights in trademark licensing contracts, there is now a degree of uncertainty in the planning and strategy of many potential chapter 11 bankruptcy cases involving intellectual property.[39] The debtor/licensor may have to choose between expending scarce resources on quality control and reputation of their trademark on the one hand, or risking the loss of a valuable asset, in this case their trademark, on the other.[40] Although Tempnology argued that either choice would impede a debtor's ability to reorganize[41] the Supreme Court made clear that a breach is a breach, and there are no special provisions when looking to bankruptcy law, or elsewhere.

CONCLUSION

The Supreme Court in *Mission* provided a clear legal standard for trademark contract rejection cases moving forward. When a contract terminates in a chapter 11 bankruptcy case, and the contract licenses out trademark rights, then section 365(n) prevails. The licensee retains all of the rights provided under section 365(n). Bankruptcy law need not be held separately from regular contract law, and that while "trademark" might be missing from section 101(35A), it should be treated, for now, as if it is not.

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[38] *Id*. at 15.
[39] *See* Jason B. Binford, *The Supreme Court Decision Mission Products Holdings, Inc. v. Tempnology, LLC Has Broad Implications for Licenses and Other Agreements in Bankruptcy: Analysis* (May 22, 2018), https://www.foley.com/en/insights/publications/2019/05/supreme-court-decision-mission-products-analysis.
[40] *Id*.
[41] *Id*.