The Trademark Reporter®

International Trademark Association

The Law Journal of the International Trademark Association

July–August, 2020 Vol. 110 No. 4

INTERNATIONAL TRADEMARK ASSOCIATION

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The Trademark Reporter (ISSN 0041-056X) is published electronically six times a year by the International Trademark Association, 675 Third Avenue, New York, NY 10017-5704 USA.

COMMENTARY

LICENSE AGREEMENTS AFTER *MISSION PRODUCT*

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I. INTRODUCTION

In May 2019, the Supreme Court of the United States decided *Mission Product Holdings, Inc. v. Tempnology, LLC*.[1] The decision is at the intersection of trademark and bankruptcy law—specifically, what effect a trademark licensor's bankruptcy has on a licensee's continuing right to use the licensed mark. The Court's decision in favor of the licensee, holding that the license was not automatically terminated by the bankruptcy trustee's rejection of the license, was not a surprise: six amicus briefs were filed, none in favor of Tempnology's position.[2]

The Court's opinion foreclosed any theory that a licensor could use bankruptcy as a tool to automatically rid itself of overly burdensome trademark licenses. However, the Court's opinion, and in particular the concurring opinion filed by Justice Sotomayor, provides some guidance on how a licensor might still be able to reclaim full control of its trademarks in the event of bankruptcy or, conversely, what a licensee might do to ensure it can continue to use the marks even in the event of its licensor's bankruptcy.

II. THE HOLDING AND CONCURRENCE

A fundamental purpose of reorganization bankruptcy is to allow a debtor to regain its financial foothold and repay its creditors.[3] To

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1 587 U.S. ___, 139 S. Ct. 1652, 203 L. Ed. 2d 876 (2019). Eight Justices joined Justice Kagan's majority opinion. The only dissent was filed by Justice Gorsuch, who would have rejected the case as moot.

2 Docket No. 17-1657, Supreme Court of the United States, https://www.supremecourt.gov/search.aspx?filename=/docket/docketfiles/html/public/17-1657.html (last visited Sep. 7, 2019). Filing in favor of Mission were the United States, a group of seven law professors who specialize in U.S. bankruptcy law, the New York Intellectual Property Law Association, and the International Trademark Association. Filing in favor of neither party were the Intellectual Property Owners Association and the American Intellectual Property Law Association.

3 Thompson v. Gen. Motors Acceptance Corp., LLC, 566 F.3d 699, 706 (7th Cir. 2009); N.L.R.B. v. Bildisco & Bildisco, 465 U.S. 513, 528, 104 S. Ct. 1188, 1197, 79 L. Ed. 2d

that end, the Bankruptcy Code provides mechanisms that give the bankrupt estate relief from obligations incurred before the bankruptcy. One mechanism is that the bankruptcy trustee has the option of rejecting an executory contract or alternatively assuming the obligations of the executory contract.[4] A bankruptcy trustee may conclude that the company must be relieved of a burdensome contract in order to successfully reorganize and the trustee will therefore reject the contract.[5] When the contract is rejected, it is treated as a pre-petition breach of the contract by the bankrupt estate,[6] leaving the other party only with a claim for damages, most likely in the pool of unsecured creditors, who in a typical bankruptcy will only receive cents on the dollar.[7]

In *Mission Product*, the debtor, Tempnology, was a trademark licensor. After Tempnology filed for bankruptcy pursuant to Chapter 11, Tempnology's trustee elected to reject a trademark license granted to petitioner Mission. The question before the Court was whether a trademark licensee might still have a license to the trademark even though the licensor rejected the contract.

The lower First Circuit decision, *In re Tempnology LLC*,[8] created a circuit split about the legal effect of the rejection of a trademark license. In the earlier *Sunbeam Products, Inc. v. Chicago American Manufacturing, LLC*,[9] the Seventh Circuit held that the rejection is simply a breach of the license, and a breach under non-bankruptcy law does not eliminate rights already conferred on the licensee as the non-breaching party.[10] According to *Sunbeam*, the non-breaching party had the option to cease performance and simply sue for breach or to continue to perform while retaining the right to claim damages. The licensee, Chicago American Manufacturing, could therefore continue to sell its inventory. In *In re Tempnology*, the First Circuit disagreed with the Seventh, holding that the

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482 (1984) ("rejection can release the debtor's estate from burdensome obligations that can impede a successful reorganization.")

4 11 U.S.C. § 365(a) (2018). An executory contract is "a contract that neither party has finished performing." Mission Prod. Holdings, Inc. v. Tempnology, LLC, 587 U.S. ___, ___, 139 S. Ct. 1652, 1657, 203 L. Ed. 2d 876 (2019).

5 Tempnology's stated reason for wanting the license terminated was that the license "had hindered its ability to derive revenue by other marketing and distribution opportunities." Brief for Petitioner at 9, Mission Prod. Holdings, 587 U.S. ___, 139 S. Ct. 1652, 203 L. Ed. 2d 876 (2019) (No. 17-1657).

6 11 U.S.C. § 365(g) (2018).

7 *Mission Prod. Holdings*, 587 U.S. at ___, 139 S. Ct. at 1658, 203 L. Ed. 2d at ___.

8 *In re* Tempnology, LLC, 879 F.3d 389, 404 (1st Cir. 2018), *rev'd and remanded sub nom*. Mission Prod. Holdings, Inc. v. Tempnology, LLC, 587 U.S. ___, 139 S. Ct. 1652, 203 L. Ed. 2d 876 (2019).

9 686 F.3d 372 (7th Cir. 2012).

10 *Id*. at 376-77.

rejection of the license terminated it.[11] Mission therefore had to cease its use of the licensed mark.[12]

In *Mission Product*, the Supreme Court took the *Sunbeam* view. It held that "a debtor's rejection of an executory contract in bankruptcy has the same effect as a breach outside bankruptcy. Such an act cannot rescind rights that the contract previously granted."[13] In other words, Mission still had a license to the mark.

In a concurring opinion, Justice Sotomayor elaborated on the scope of the holding:

> [T]he Court does not decide that every trademark licensee has the unfettered right to continue using licensed marks postrejection. The Court granted certiorari to decide whether rejection "terminates rights of the licensee that would survive the licensor's breach under applicable nonbankruptcy law.". . .The answer is no, for the reasons the Court explains. But the baseline inquiry remains whether the licensee's rights would survive a breach under applicable nonbankruptcy law. *Special terms in a licensing contract or state law could bear on that question in individual cases.*[14]

III. READING INTO THE RULING

The first step in understanding the implication of Justice Sotomayor's comment and the Court's decision is to understand that a bankrupt party cannot be forced to perform.[15] Yet for the licensee to continue to exercise its rights under the license, the licensee must

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11 *In re Tempnology*, 879 F.3d at 404.

12 *Id*. For a full explanation of the two viewpoints, see *In re SIMA Int'l, Inc.*, No. 17-21761 (JJT), 2018 WL 2293705 (Bankr. D. Conn. May 17, 2018).

13 Mission Prod. Holdings, Inc. v. Tempnology, LLC, 587 U.S. ___, 139 S. Ct. 1652, 1666, 203 L. Ed. 2d 876 (2019).

14 *Id*. at ___, 139 S. Ct. at ___, 203 L. Ed. 2d at ___ (internal citation omitted, emphasis added). Justice Sotomayor cites to the amicus brief filed by the American Intellectual Property Law Association, which elaborates on the concept. Brief of the American Intellectual Property Law Association as Amicus Curiae in Support of Neither Party at 20-25, Mission Prod. Holdings, Inc. v. Tempnology, LLC, 587 U.S. ___, 139 S. Ct. 1652, 203 L. Ed. 2d 876 (2019) (Docket No. 17-1657), available at https://www.supremecourt.gov/DocketPDF/17/17-1657/76434/20181217132403519_AIPLA%20Amicus%20Mission%20Product-final.pdf [hereinafter "AIPLA Brief"]. Justice Sotomayor also cited to pages in the opinion where the Court likewise made parenthetical reference to contract terms or state law as affecting the scope of the license post-bankruptcy.

15 N.L.R.B. v. Bildisco & Bildisco, 465 U.S. 513, 532, 104 S. Ct. 1188, 1199, 79 L. Ed. 2d 482 (1984) ("We conclude that from the filing of a petition in bankruptcy until formal acceptance, the [] agreement is not an enforceable contract"). For example, if the license is exclusive, the licensor may be able to avoid the exclusivity provisions post-bankruptcy. Refraining from using the mark in order to give the licensee exclusivity may be considered specific performance that cannot be required of a licensee. *See* 11 U.S.C. § 365(n)(1)(B) (2012) (characterizing exclusivity in the context of patent and copyright licenses as specific performance).

still abide by the license's terms.[16] Thus, the holding of *Mission Product* is not a categorical rule that the licensee may continue to exploit the license in all circumstances. A trademark license might have provisions, express or implied, with which the licensee will not be able to comply post-bankruptcy because of the licensor's behavior, therefore effectively forcing the licensee into an election of damages because any attempt to exercise the trademark license would necessarily place the licensee in breach, perhaps even in a state of infringement.

In the brief Justice Sotomayor cited to, the American Intellectual Property Law Association gave examples of this principle at work. One is a license with a condition that the licensor must affirmatively approve a prototype before the licensee will be allowed to manufacture the goods. If the licensor does not respond to requests for approval, the licensee cannot manufacture the product and is left only with a claim against the licensor for breach.[17] The second example is one where there is no express quality control provision, but the licensor provides the critical ingredient for the licensed product. If the licensor no longer manufactures the critical ingredient, the licensee should not be allowed to use a substitute supplier for the missing ingredient. The licensee's remedy will be damage only for the licensor's breach in failing to provide the ingredient, not the latitude to obtain the ingredient from a different vendor.[18]

In each example, the licensee cannot exercise its rights without some affirmative action by the licensor. Since the licensor cannot be compelled to perform, the licensee's only remedy would be damages for the licensor's breach of contract. Should the licensee proceed without complying with the terms of the rejected license, particularly those related to quality control, the resulting goods would be unlicensed and the continued use of the licensor's trademark on them infringing.[19] The licensee would therefore be exposed to a claim from the bankruptcy estate for infringement remedies should it proceed without the assistance of the licensor.

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16 S & R Corp. v. Jiffy Lube Int'l, Inc., 968 F.2d 371, 376 (3d Cir. 1992) ("Under basic contract principles, when one party to a contract feels that the other contracting party has breached its agreement, the non-breaching party may either stop performance and assume the contract is avoided, or continue its performance and sue for damages. Under no circumstances may the non-breaching party stop performance *and* continue to take advantage of the contract's benefits.") (emphasis in original).

17 AIPLA Brief at 23.

18 AIPLA Brief at 24.

19 *See*, *e.g.*, El Greco Leather Prods. Co. v. Shoe World, Inc., 806 F.2d 392, 395 (2d Cir. 1986) (failure to obtain certificate of inspection from licensor, as required in the license agreement, rendered products non-genuine; hence, use of the mark on such goods was infringing); *see also* Warner-Lambert Co. v. Northside Dev. Corp., 86 F.3d 3, 8 (2d Cir. 1996) (enjoining the sale of stale product even though the contract did not expressly prohibit its sale).

IV. LOOKING FORWARD

Given that the law is now clear, both the licensor and the licensee will want to include mechanisms in the license that will protect their interests should the licensor go into bankruptcy. The licensor will want to include terms that require its performance, so that it can deny performance after filing a petition for bankruptcy and effectively preclude the licensee from manufacturing or distributing products. The licensee will want to include backup provisions for critical functions if the licensor refuses to perform. Bargaining power is likely to determine who will be better situated in the case of a bankruptcy, and the vigor of the negotiation may depend on the likelihood of the licensor's bankruptcy.[20]

A licensor wanting to maximize its flexibility in the event of its own bankruptcy might consider these provisions:

- Include a gating mechanism in the license before a licensee can place products on the market. Trademark licenses commonly require approval of product or marketing materials, so the gate can be as simple as requiring a positive response, rather than silence, for the approval of the licensed product or materials.
- If a manufactured product must include ingredients or supplies provided by the licensor, ensure that the license states that no substitutions are allowed.
- If the trademark license is tied to a patent or copyright license, the trademark license can be contingent on use of the mark with the patented or copyrighted property and terminate if the copyright or patent license terminates.[21]
- Ensure that the license is for a fixed term and require express renewal of the license by the licensor rather than having automatic renewal.

From the licensee's perspective, if unsuccessful at resisting the licensor's efforts to include affirmative acts for quality control, the negotiating licensee may also consider implementing provisions that offer it some protection, perhaps invoked only in the case of the licensor's breach:

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[20] In *Sunbeam*, the licensee was aware of the licensor's precarious financial position and included contract terms specifically for that eventuality. Sunbeam Prod., Inc. v. Chicago Am. Mfg., LLC, 686 F.3d 372, 374 (7th Cir. 2012). This may have played a role in the *Sunbeam* court's conclusion, reaching an outcome that confirmed the benefit of the fully informed bargain.

[21] Note that the Bankruptcy Code has a special provision for copyright and patent licenses that protects the licensee's ability to continue to exercise the patent or copyright license, similar to what the Court concluded here for trademark licenses. 11 U.S.C. § 365(n) (2018). The termination of the trademark license would therefore happen only if there was a "poison pill" that made the copyright or patent license sufficiently unfavorable such that the licensee would instead settle for damages.

- Set standards for a substitute component or ingredient in the license.
- Continue to manufacture goods or provide services without further quality review provided that there is no change in facilities or materials.
- Allow sell-through of all warehoused goods.[22]

What if a licensor has not been prescient enough to include a gating mechanism in the trademark license agreement? Even where the trademark license includes no express quality control standards at all, quality control is an inherent part of every trademark license.[23] Even in the absence of expressly stated standards, the licensor can ask the bankruptcy court to enforce all implicit quality control requirements, bringing to bear the interest of the public in consistent quality to persuade the court that some control by the licensor must be incorporated into the licensee's activities.[24]

The bankruptcy trustee may have to make hard choices when deciding whether to reject a trademark license. Its non-performance may expose the estate to a substantial damages claim. But a well-crafted license agreement will give the trustee a mechanism for regaining the ability to license the trademark on better terms. Likewise, the forward-thinking licensee can also protect its investment by including provisions that ensure its continued operations, and its financial health, in the event of the licensor's bankruptcy.

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[22] Selling existing inventory is one of the activities that the plaintiff wanted enjoined in the *Sunbeam* case. *See Sunbeam*, 686 F.3d at 374.

[23] Dawn Donut Co. v. Hart's Food Stores, Inc., 267 F.2d 358, 367 (2d Cir. 1959); *see also* Eva's Bridal Ltd. v. Halanick Enters., Inc., 639 F.3d 788, 791 (7th Cir. 2011); Barcamerica Int'l USA Tr. v. Tyfield Importers, Inc., 289 F.3d 589, 595 (9th Cir. 2002) ("[a] trademark owner may grant a license and remain protected provided quality control of the goods and services sold under the trademark by the licensee is maintained."); Societe Comptoir de L'Industrie Cotonniere Etablissements Boussac v. Alexander's Dep't Stores, Inc., 299 F.2d 33, 35 (2d Cir. 1962) ("a bare license is a fraud upon the public and unlawful").

[24] *See*, *e.g.*, Bank of N. Carolina v. RCR Mktg., LLC, No. 1:10CV663, 2010 WL 5020502, at *7 (M.D.N.C. Dec. 3, 2010) (although no written license was in evidence, entering injunction granting licensor in bankruptcy the authority to monitor operations of the licensee's restaurant for purposes of quality control).