

Rejecting Trademarks and Exclusive Distribution Rights in Bankruptcy

Article By:

Blake Wong

The US Court of Appeals for the First Circuit concluded that a debtor in bankruptcy is entitled to reject grants of trademark licenses and exclusive distribution rights. Although Chapter 11 of the Bankruptcy Code protects a licensee's rights to intellectual property when the licensor seeks reorganization, trademark licenses and exclusive distribution rights are not "intellectual property" that qualifies for this protection. *Mission Product Holdings, Inc. v. Tempnology, LLC*, Case No. 16-9016 (1st Cir., Jan. 12, 2018) (Kayatta, J) (Torruella, J, concurring in part, dissenting in part).

Tempnology made clothing and accessories (such as towels, socks and headbands) designed to remain cool even during exercise. Tempnology marketed these products under the brands "Coolcore" and "Dr. Cool," and protected its products and brand names using patents, trademarks and other intellectual property rights. Tempnology's business suffered heavy losses, so it sought reorganization under Chapter 11 and to reject some of its contracts that were still in effect.

One of those contracts was a "Co-Marketing and Distribution Agreement" between Tempnology and Mission. The agreement contained three provisions relevant to the Court's analysis, in which Tempnology granted to Mission:

- An exclusive right to distribute certain Tempnology products
- A non-exclusive license to Tempnology intellectual property other than trademarks
- A non-exclusive license to certain Tempnology trademarks

The trademark license was accompanied by standard restrictions designed to ensure quality control for Mission's use of the Tempnology trademarks.

Under Chapter 11 of the Bankruptcy Code, a debtor may "reject" executory contracts, which results in the other party losing the ability to compel the debtor's performance. Section 365(n) contains an exception: when the debtor is a licensor of intellectual property rights, the licensee may retain its rights to the intellectual property. The parties disagreed on whether § 365(n) allowed Mission to retain its exclusive distribution rights and its trademark license.

The Court determined that § 365(n) does not protect exclusive distribution rights. An exclusive distribution right is simply a restriction on a right to sell certain products and is distinct from an

intellectual property license. Mission could have this exclusive distribution right even if it did not have an intellectual property license. Section 365(n) does not protect an exclusive right to sell merely because the right appears in an agreement that also contains an intellectual property license.

The Court also determined that § 365(n) does not allow a licensee to retain rights under a trademark license. The definition of “intellectual property” in § 365(n) lists six types of intellectual property, none of which are trademarks. The purpose of a debtor’s ability to reject executory contracts is to allow the debtor to free itself of certain obligations and achieve a successful reorganization. A trademark license might impede such a result, because trademark license agreements generally require the licensor to maintain quality control over products bearing the licensed trademark. Such obligations existed in the Tempnology-Mission agreement, including standard obligations prohibiting Mission from using the trademarks in a disparaging way, requiring Mission to use the trademarks in compliance with Tempnology’s trademark usage guidelines, and giving Tempnology the right to review and approve Mission’s use of the marks. Allowing Mission to retain its trademark license would be contrary to the purpose of freeing Tempnology of obligations in its executory contracts.

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