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Argument analysis: Meandering argument suggests justices likely to narrow bankrupts' power to rescind licenses in bankruptcy

The second and last argument of the week came in the Supreme Court's most important bankruptcy case of the year, *Mission Product Holdings Inc. v. Tempnology, LLC*. The case presents a problem that has confused lower courts for more than 30 years: What happens when a debtor exercises its statutory right to reject a contract in bankruptcy? It is plain from the language of the statute that the debtor's rejection should be treated as a "breach" of the contract, and that the counterparty can sue the bankrupt for damages. The question, though, is whether the rejection's "breach" operates to rescind the entire contract. In this case, for example, the contract in question is a trademark license, and the debtor not only wants to terminate its own obligations under the contract; it also wants to retract the licensee's right to use the debtor's trademark.

You might wonder, if this problem has plagued lower courts for 30 years, why Congress has not responded. In fact, it has. Specifically, shortly after the 1985 decision of the U.S. Court of Appeals for the 4th Circuit in *Lubrizol Enterprises v. Richmond Metal Fin* (holding that a debtor can terminate rights under a patent license), Congress promptly amended the Bankruptcy Code to provide that the licensee of a patent can retain its rights even if the licensor rejects the license in bankruptcy. The problem is that Congress' amendment applies to patent and copyright licenses, but not to trademark licenses. Hence this case.

Not surprisingly, one common topic in the argument was the significance of that congressional amendment (Section 365(n) of the Bankruptcy Code). During the presentation of Danielle Spinelli on behalf of the licensee, Mission Product, Justice Sonia Sotomayor seemed to think that Congress' decision to establish a specific regime in Section 365(n) to protect patent and copyright licensees would make it odd for the Supreme Court to imply a protective regime for trademark licensees. For her, it seemed "counterintuitive … or counterlogical" for "trademark [us]ers [to] get more rights than [365(n)] provides to other licens[ee]s in the intellectual property field." (I should acknowledge that I've changed the transcript's reference in Sotomayor's question from "licensors" to "licensees," both because that seems to me the only reasonable way to interpret her comment and because that seems to be how Spinelli understood it.)

Justice Ruth Bader Ginsburg, in contrast, plainly thought it made more sense to say that Congress "didn't take any position on *Lubrizol* one way or another in the trademark context[.] It did quite specifically in the patent context, but it didn't either approve or disapprove" *Lubrizol* as applied to trademark licenses.

The second major thread of the argument involved the conventional understanding of a "breach" of contract. Spinelli's point was that ordinarily the party that breaches a contract doesn't get the right to retract whatever the counterparty has received; usually the non-breaching party has the option to sue for damages or rescission. Justice Elena Kagan, among others, seemed to find that point central. For example, questioning Douglas Hallward-Driemeier (appearing on behalf of Tempnology, the bankrupt company that wants to rescind the license), she commented that "what you're saying is that [the statute] tells you … that you can unwind the entire deal. And that's not the effect of a breach outside of bankruptcy, certainly in the usual context. … [W]hat language are you pointing to in [the statute] that says anything other than we look to see what happens when you breach?"

Later, even more pointedly, Kagan commented: "Ms. Spinelli says the effect of rejection is breach, and you say the effect of rejection is rescission. And … you know, honestly, Ms. Spinelli has this language [in Section 365(g)] that says [rejection] constitutes a breach." Kagan's point seemed to land well with several of the other justices. Justice Stephen Breyer remarked to Hallward-Driemeier that in "contract law over the course of the centuries … [t]he ordinary rule is [that the non-breaching party] can keep the property that he's got if he wants. Isn't that the ordinary rule?" Going even further, Justice Samuel Alito expressed distaste for the implication of Hallward-Driemeier's argument that "because the licensor doesn't want to [perform under its contract], the licensor in breach of the contract gets a more favorable result? It doesn't seem to make any sense."

If that group of justices offered one rationale for a ruling that would favor licensees, Ginsburg brought up another problem for the debtor's attempt to rescind. As documented in Mission Product's brief and an amicus brief of bankruptcy professors, there is a strong consensus that *Lubrizol* was wrong, and that a decision from the U.S. Court of Appeals for the 7th Circuit articulating the "breach" perspective on rejection, in *Sunbeam Products Inc. v. Chicago American Manufacturing, LLC*, offers a better approach to the issue. Apparently responding to that consensus, Ginsburg challenged Hallward-Driemeier to explain why "the scholars in this field, the bankruptcy field, disagree with your interpretation and they say *Lubrizol* was wrong and *Sunbeam* was right."

The case is far from over. For one thing, there is a substantial possibility that the case may be moot, about which Sotomayor and Justice Neil Gorsuch repeatedly pressed the advocates. So it would not be entirely surprising if the justices do not reach the question presented. But if they do, they seem likely to rule for the licensees.

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Editor's Note: Analysis based on transcript of oral argument.

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Past cases cited in this post:

Lubrizol Enterprises v. Richmond Metal Fin, 756 F.2d 1043 (4th Cir. 1985)
Sunbeam Products Inc. v. Chicago American Manufacturing, LLC, 686 F.3d 372 (7th Cir. 2012)

[**Disclosure**: Goldstein & Russell, P.C., whose attorneys contribute to this blog in various capacities, is among the counsel on an amicus brief in support of the petitioner in this case. The author of this post is not affiliated with the firm.]

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