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Have Contract Counterparties Increased Their Negotiating Power in the Wake of *Tempnology*?

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In its 2019 *Mission Prod. Holdings Inc. v. Tempnology LLC* (*Tempnology*) ruling,[1] the U.S. Supreme Court resolved a dispute arising from an ambiguity in § 365(n) of the Bankruptcy Code.[2] While this statute provides a variety of rights and protections for licensees of intellectual property (IP) in the event a debtor-licensor rejects the license, the definition of "intellectual property" in 11 U.S.C. § 101(35A) makes no mention of trademarks. Therefore, the following questions arose: Do trademark licensees enjoy the same protections set forth in § 365(n), or do these licensees somehow enjoy a different level of protection?

Instead of answering this narrow question, the Supreme Court came to a more far-reaching conclusion as to the effect of contract rejection on the nonbreaching, nondebtor party. Specifically, the Court held that the rejection of a trademark licensing agreement amounts to a breach of the agreement, but not a termination or rescission of the rights granted through such license. Therefore, *Tempnology* teaches that a debtor/licensor's rejection of a trademark licensing agreement cannot rescind the licensee's rights to ongoing use of the trademark — an outcome similar to the § 365(n) protection, albeit reached through a different analytical pathway, and potentially applicable in other contexts. *Tempnology* is an important exposition of the law of executory contract rejection — one that resonates in a variety of scenarios beyond the trademark license at issue in that case.

In the nearly two years since the ruling, courts and practitioners have begun to decipher its import and applications in contexts beyond *Tempnology*'s specific facts. As might be expected, contract counterparties are arguing that *Tempnology* limits the impact of the debtor's rejection; for their part, debtors are responding that *Tempnology* should be distinguished by or limited to its facts. Thus, the post-*Tempnology* cases can be harmonized. Under the principles set out by the Supreme Court, rejection relieves a debtor from the burden of continued performance under a disadvantageous contract, but rejection *cannot* divest the counterparty of vested property rights under that same contract. Counterparties will therefore be best served to focus their efforts on the negotiation (pre-bankruptcy) and enforcement (post-bankruptcy) of vested property rights in the underlying agreement.

Background

Section 365 of the Bankruptcy Code provides a framework through which a debtor can elect to either assume (and thereafter assign) or reject an executory contract. If an executory contract is rejected by a debtor, then, pursuant to § 365(g) of the Bankruptcy Code, the debtor is deemed to have breached the contract immediately prior to the bankruptcy filing date.[3] Therefore, rejection results in a pre-petition claim for damages.

Certain Code provisions expressly provide selected counterparties to rejected executory contracts with enhanced post-rejection rights. For example, § 365(n) permits a nondebtor licensee to continue to use the IP licensed to it following a debtor-licensor's rejection of the governing

1 *Mission Prod. Holdings Inc. v. Tempnology LLC*, 139 S. Ct. 1652 (2019).
2 11 U.S.C. § 365(n).
3 11 U.S.C. § 365(g).

license. "Intellectual property" is defined in the Code as including, *inter alia*, patents, copyrights and trade secrets, but not trademarks.[4] Given the conspicuous absence of trademarks from the IP definition, a circuit split developed as to whether § 365(n)'s protections covered trademark licensees.[5] The circuit split was ultimately resolved by the *Tempnology* ruling.

In its 8-1 *Tempnology* decision, the Supreme Court ruled that a nondebtor trademark licensee retains its rights to use licensed trademarks even after a debtor-licensor rejects the trademark license governing the trademark, with such continued use subject to the terms of the trademark license and applicable state law. The facts in *Tempnology* required the Court to consider issues specific to trademark licenses in bankruptcy, but its ruling pervades the entire executory contract framework. In particular, the Court determined that because rejection is treated as a pre-petition breach of the applicable executory contract, such rejection leads to the same result and has the same effect as if it had occurred in the nonbankruptcy context (*i.e.*, that the contract is breached but not automatically rescinded or unwound).[6] Accordingly, the Court's functional holding is that rejection of an executory contract affords the nonrejecting counterparty two options: (1) continue to perform under the contract and retain its rights thereunder; or (2) stop performing under the contract and lose its rights thereunder.

The Supreme Court declined the debtor's invitation to consider the unique burden imposed on a trademark licensor following rejection of its license: The licensee's continued use of the licensed marks leaves the debtor-licensor in the unenviable position of having to choose between expending resources on the quality control of rejected trademark licenses, or discontinuing monitoring and risking the invalidation of those licensed trademarks. As a practical matter, the *Tempnology* ruling requires the debtor/licensor to spend time and money in connection with the rejected license, and therefore negates much of the benefit to the estate from the rejection of such license. Since the *Tempnology* ruling was issued, courts and practitioners have wrestled with how far the Court's ruling extends, and what its holding means for the rights of counterparties to rejected contracts.[7]

In re Orama Hospitality Group Ltd.

In a 2019 ruling following the *Tempnology* decision, the U.S. Bankruptcy Court for the District of New Jersey analyzed *Tempnology* to determine whether a party's rights to specific performance under an executory contract remain enforceable post-rejection, and found that they did not.[8] More specifically, Orama Hospitality Group Ltd. filed for bankruptcy relief while operating a restaurant on premises leased from owner-lessor Mitsuwa Corp.[9] During the course of the case, Mitsuwa initiated an adversary proceeding seeking to compel specific performance of an option to repurchase a liquor license granted to the debtor.[10] However, the chapter 7 trustee[11] objected to Mitsuwa's request for specific performance, asserting that the repurchase-option agreement was executory and had been rejected.[12]

On June 14, 2019, the bankruptcy court held that "[i]t seems incongruous that the Bankruptcy Code would grant the debtor the right to reject (and thus breach) a contract while preserving the right of the counterparty to compel specific performance of the same contract."[13] In so finding, the bankruptcy court distinguished *Tempnology*'s ruling that the nondebtor could continue to use rights granted to it post-rejection from Mitsuwa's attempt to compel the debtor to perform a contractual obligation that was unperformed.[14]

The *Orama Hospitality* case serves as a clarifying addendum to the *Tempnology* ruling. Mitsuwa sought to enforce a provision that had not yet been invoked under a rejected executory contract, rather than protect previously vested property rights, but the bankruptcy court denied Mitsuwa's request.[15] It is interesting to consider whether the result might have been different had the bankruptcy court treated the option as a vested property interest rather than an unperformed contract provision. By characterizing Mitsuwa's request as enforcement under a rejected contract, the bankruptcy court laid the groundwork for the rejection of that request consistent with *Tempnology*.

In re Avianca Holdings SA[16]

Subsequently, in mid-2020, parties in the *Avianca Holdings* bankruptcy case sought to deploy the *Tempnology* ruling in support of their claim to retain current and future accounts receivable sold by the debtor under a rejected pre-petition agreement. In December 2017, Avianca, a Latin America-based airline, entered into a receivables sale, purchase and servicing agreement (RSPA) and certain other related agreements with USAVflow Ltd. (USAV). Under the RSPA, Avianca agreed to provide USAV with Avianca's current rights to credit card receivables under certain credit card-processing agreements and future rights to credit card receivables under certain agreements that might be entered into in the future. In exchange, USAV agreed to provide Avianca with an initial payment of $150 million and certain excess amounts collected under the credit card-processing agreements.

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4 11 U.S.C. § 101(35A).

5 *Compare In re Exide Techs.*, 607 F.3d 957 (3d Cir. 2010), and *Sunbeam Prods. Inc. v. Chi. Am. Mfg. LLC*, 686 F.3d 372 (7th Cir. 2012); *with Mission Prod. Holdings Inc. v. Tempnology LLC (In re Tempnology)*, 879 F.3d 389 (1st Cir. 2018), and *Lubrizol Enters. Inc. v. Richmond Metal Finishers Inc. (In re Richmond Metal Finishers)*, 756 F.2d 1043 (4th Cir. 1985).

6 *Tempnology*, 139 S. Ct. at 1657-58. By relying on § 365(g) rather than § 365(n) in its ruling, the Supreme Court did not need to reach the question of whether § 365(n) encompasses protection of trademark licensees.

7 Some courts have reviewed and relied on aspects of the *Tempnology* decision discussing mootness and jurisdictional questions, but those issues are beyond the scope of this article. *See, e.g., In re Fin. Oversight and Mgmt. Bd. for Puerto Rico*, 987 F.3d 173, at 180-82 (1st Cir. 2021); *In re Sun Edison, et al.*, Case No. 16-10992 (SMB), 2019 WL 2572250, at *9-11 (Bankr. S.D.N.Y. June 21, 2019); *Etc. Tiger Pipeline LLC*, 172 FERC 61155 (2020); *PG&E Corp. v. Fed. Energy. Regulatory Comm. (In re PG&E Corp.)*, 603 B.R. 471, 487-88 (Bankr. N.D. Cal. 2019), *order vacated on other grounds*, *PG&E Co. v. Fed. Energy Regulatory Comm'n*, 829 Fed. App'x 751 (9th Cir. 2020).

8 *Mitsuwa Corp. v. Orama Hospitality Grp. Ltd. (In re Orama Hospitality Grp. Ltd.)*, 601 B.R. 340, 348-49 (Bankr. D.N.J. 2019).

9 *Id.* at 343.

10 *Id.*

11 Orama Hospitality Grp. Ltd. initially filed for chapter 11 relief, but subsequently converted to chapter 7. *In re Orama Hospitality Grp. Ltd.*, Case No. 17-21720 (JKS), at ECF 1, 104 (Bankr. D.N.J. 2017).

12 *In re Orama Hospitality Grp. Ltd.*, 601 B.R. at 347.

13 *Id.* at 349-50.

14 *Id.* at 350. In addition, the bankruptcy court found that the option to repurchase violated New Jersey law. *Id.*

15 *Id.* at 348-49.

16 The facts outlined in *In re Avianca Holdings SA, et al.*, 618 B.R. 684 (Bankr. S.D.N.Y. 2020), as described herein have been simplified for the purpose of brevity.

On May 10, 2020, Avianca Holdings SA and its affiliated debtors filed for chapter 11 relief in the U.S. Bankruptcy Court for the Southern District of New York. On June 23, 2020, seeking to recover the receivables free and clear of USAV's claims, the Avianca debtors filed a motion to reject the 2017 agreements with USAV. USAV and other impacted parties opposed the requested relief and argued that by rejecting the RSPA and other agreements, the Avianca debtors sought to unwind the 2017 transaction and to recover receivables sold by the debtors in 2017 — all in contravention of the principles set forth in *Tempnology*. The USAV parties asserted that even if the agreements could be rejected, USAV would still be entitled to receive all proceeds from future credit card receivables agreements because future credit card receivables were among the rights that Avianca sold to USAV in the 2017 transaction. The Avianca debtors contended that the rejection of the RSPA and related agreements constitutes a breach after which the debtors need not continue to perform, and therefore, that following a rejection, the Avianca debtors would no longer be obligated to transfer future receivables to USAV.

In a ruling entered on Sept. 4, 2020, the bankruptcy court split the baby. Based on the holding and reasoning of the *Tempnology* decision, the bankruptcy court determined that the rejection of the RSPA *would* permit Avianca to discontinue future performance under the agreement.[17] If Avianca entered into new credit card-processing agreements with parties other than USAV, it would not need to transfer to USAV any of the receivables generated under these new agreements.[18] However, rejection would not permit Avianca to unwind or avoid the prior transaction with USAV, and therefore would not eliminate Avianca's obligation to transfer to USAV all receivables generated under the existing credit card-processing agreements.[19] Because those receivables were sold to USAV in 2017, contract rejection could not vitiate USAV's vested rights in those receivables.[20] This decision further crystalizes the principle that counterparties to a rejected contract — here, the USAV parties — would be entitled to retain vested property rights (*i.e.*, receivables due under existing agreements), but would not be able to compel performance of rights under the rejected contract (*i.e.*, the right to process and collect receivables under future processing agreements).

In re Sanchez Energy Corp.

On May 6, 2021, the U.S. Bankruptcy Court for the Southern District of Texas entered a memorandum opinion further expanding upon the emerging view that vested property interests survive rejection under § 365.[21] In reaching this decision, Hon. **Marvin Isgur** was required to analyze a group of midstream gathering agreements and a related development agreement, all of which were conveyed to the debtors in a prebankruptcy purchase of certain oil and gas interests. In his prior decision in the *Alta Mesa* case, Judge Isgur had concluded that "[r]eal property covenants are not executory and are not subject to rejection,"[22] a statement that his *Sanchez Energy* decision recognizes "could lead one to believe that a debtor cannot reject an executory contract which creates a real property covenant."[23]

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Judge Isgur followed a different analytical path in *Sanchez Energy*, primarily informed by the Supreme Court's teaching in *Tempnology*.[24] With express reliance upon and citation to *Tempnology*, Judge Isgur held that the debtors could reject the executory contracts at issue, even if those agreements contain vested property rights in the form of covenants that run with the land, but that covenants determined to run with the land would not be terminated by such rejection.[25] Judge Isgur explained that "real property covenants provide an example of the type of contract right that survives rejection," but that "the presence of a real property covenant does not hinder a debtor's right to reject its future performance duties under an executory contract."[26] The *Sanchez Energy* decision is thus very much in line with the rest of the developing post-*Tempnology* jurisprudence — drawing a distinction between the vested property rights under the rejected agreements (which survive rejection) and the go-forward performance obligations under these agreements (which end with rejection).

Conclusion

The initial post-*Tempnology* jurisprudence signals that courts are imposing some reasonable limits on the Supreme Court's holding: protecting the benefits of contract rejection while declining to require continued performance under burdensome rejected contracts. Thus far, *Tempnology* has not opened the door to counterparties reviving rejected contracts through theories of specific performance or other equitable remedies. At the same time, courts are utilizing *Tempnology* to recognize and protect the vested property rights of counterparties to rejected contracts.

Notably, a practical distinction might develop between post-rejection treatment of IP-related agreements and other

17 *Id.* at 707.
18 *Id.* at 706-08. On Sept. 18, 2020, the USAV parties appealed the bankruptcy court's decision. *In re Avianca Holdings SA*, Case No. 20-11133 (MG), at ECF 959, 960 (Bankr. S.D.N.Y. 2020). After subsequent and additional litigation ensued between the parties, in October 2020, the bankruptcy court sent the issues between the Avianca debtors and the USAV parties to mediation. *Id.* at ECF 1125. Ultimately, the parties reached a consensual settlement, which was approved by the bankruptcy court on March 17, 2021. *Id.* at ECF 11468, 1480.
19 *Id.*
20 *In re Avianca Holdings SA*, 618 B.R. at 705-07.
21 *In re Sanchez Energy Corp.*, 2021 WL 1822708 at *1 (Bankr. S.D. Tex. May 6, 2021).
22 *In re Alta Mesa Res. Inc.*, 613 B.R. 90, 98 (Bankr. S.D. Tex. 2019).
23 *In re Sanchez Energy Corp.*, 2021 WL 1822708 at *8.
24 *Id.*
25 *Id.* at *6.
26 *Id.* at *8-9.

executory contracts, owing to the fact that IP licensees enjoy vested property rights. The *Tempnology* ruling made it clear that these vested property rights survive rejection, notwithstanding the fact that the debtor-licensor might need to expend resources on quality control of the rejected licenses. In this way, the nonrejecting counterparty might have the leverage to compel some degree of performance by the debtor-licensor under its rejected license — merely by virtue of the counterparty's continued use of the vested trademark rights. Many counterparties in non-IP contexts will not have vested rights in the underlying assets and therefore will not have the same degree of leverage to require continued performance.

As the post-*Tempnology* jurisprudence continues to evolve, contract counterparties may consider how to structure their relationships to obtain vested property rights, in addition to rights of ongoing performance under relevant agreements. *Tempnology* demonstrates that these sorts of enhanced property rights are likely to survive contract rejection[27] and might become an important negotiating tool for purposes of obtaining some degree of additional performance. In addition, in anticipation of potential debtors seeking to sell assets free and clear of counterparties' rights post-rejection, and as the effects of doing so are not yet clear, parties to newly drafted agreements might weigh the pros and cons of including language detailing what the necessary adequate protection would need to be in order to sell free and clear of the nondebtor parties' interest. While such a provision would not be binding on the court in a subsequent bankruptcy proceeding (and might even be viewed as an implicit consent to a free-and-clear sale), such a provision would be helpful to the counterparty in asserting its entitlement to adequate protection. Mindful of these issues and arguments, financially stressed companies might be reluctant to grant their counterparties vested property rights and might impose conditions that limit or terminate the granting of such rights.

Tempnology has created real negotiating leverage for contract counterparties holding vested property rights. Parties can be expected to dispute, on a case-by-case basis, what constitutes a vested property right and what constitutes an unperformed contractual provision. As these battles play out, practitioners and companies alike should be on the lookout for further additions to the post-*Tempnology* body of law and further judicial crystallization of *Tempnology*'s impact. abi

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27 While these vested property rights may survive contract rejection, there might be alternative grounds by which a debtor may strip away those rights. In particular, these rights may be vulnerable to a free-and-clear sale under 11 U.S.C. § 363, or a "strong-arm" challenge under 11 U.S.C. § 544(b). However, a consideration of these alternate bases for challenge is beyond the scope of this article.