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Consumer Track

Trustees Administering Unusual Assets

Hon. Cynthia A. Norton
U.S. Bankruptcy Court (W.D. Mo.); Kansas City

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I. Abandonment Issues

A. Basis for Abandonment

Supreme Court held trustees could not abandon property in contravention of state laws designed to protect the public health and safety. ***Midlantic Nat. Bank v. New Jersey Dept. of Environmental Protection*****, 474 U.S. 494 (1986).**

Prior to the bankruptcy filing, the New Jersey Department of Environmental Protection determined that the debtor was violating New Jersey law for storing certain toxic oil at two waste oil processing facilities. While it was negotiating cleanup of the facilities with the Department, the debtor filed a Chapter 11 bankruptcy petition. This caused the Department to issue an administrative order requiring the debtor to clean up the site. The debtor soon converted to chapter 7, and a trustee was appointed. Due to the facilities being over-encumbered by liens and the toxic oil, the trustee was unable to sell the facilities. The trustee therefore filed a notice of intent to abandon the facilities. No one disputed that the properties were burdensome and of inconsequential value of the estate under § 554, but the City and State of New York, where one of the sites was located, objected, contending that abandonment would threaten the public's health and safety and would violated state and federal environmental law. New York rested its objection on public policy and the requirement of 28 U.S.C. § 959(b) which requires a trustee to "manage and operate" estate property "according to the requirements of the valid laws of the State in which such property is situated." The bankruptcy court approved the abandonment and a divided panel of the Third Circuit reversed. Upon abandonment, the trustee removed the 24-hour security and shut off the fire suppression systems, which forced New York to decontaminate the facility. The Supreme Court affirmed the Third Circuit, holding that Congress had not intended to preempt all state law by enacting § 554; rather, "[t]he Bankruptcy Court does not have the power to authorize abandonment without formulating conditions that will adequately protect the public's health and safety." The Court thus held that the bankruptcy court erred in permitting the abandonment of the contaminated site. The Court declined to

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* Prepared by Clay Nordsiek, Law Clerk to the Hon. Cynthia A. Norton, Chief Judge of the Bankruptcy Court of the Western District of Missouri.

reach the question of whether certain laws imposing conditions on abandonment may be so onerous as to interfere with the bankruptcy adjudication itself.

A trustee's "speculative scenario" of assets producing income was not grounds to deny a motion to compel abandonment. *In re Nelson*, 251 B.R. 857 (B.A.P. 8th Cir. 2000).

The debtors filed a motion to compel the trustee to abandon two parcels of land: one with a fair market value of $104,000 with encumbrances of $195,883; and the other with a fair market value of $77,000 and encumbrances of $263,000. The trustee argued that, despite the lack of equity, the parcels were of value to the estate because they could produce rental income. The bankruptcy courtt rejected that argument in part because the trustee had demonstrated no efforts to rent the parcels. In addition, the secured lenders had assignment of rents clauses in their mortgages, so the trustee would not receive any rental income in any event. The trustee argued that, even if the lenders activated their assignment of rents clauses, North Dakota law provided for a one-year redemption period after a foreclosure and, during the redemption period, the owner is entitled to possession and rents from the date of sale until the expiration of the redemption period. The court rejected this argument as "tenuous, at best" because one of the lenders was not subject to the redemption statute, and there had been no evidence that the lender had any intention of foreclosing. Thee BAP affirmed the bankruptcy court's order finding that the parcels were of inconsequential value to the estate and granting the motion to compel abandonment. The BAP held that such a motion could not be denied "on the basis of a speculative scenario which may or may not occur in the future."

Trustee permitted to abandon claims that would require burdensome participation in foreign arbitration. *In re Eurogas, Inc.*, 560 B.R. 574 (Bankr. D. Utah 2016).

The trustee was permitted to abandon certain claims relating to "talc deposits" located in the Slovak Republic as burdensome and of inconsequential value to the estate because it was unclear whether the previous trustee had abandoned the claims, a successor company to the debtor now asserted ownership of the claims, and for the trustee to assert any rights in the claims would require his participation in an expensive, time-consuming foreign arbitration.

B. Noticing of Abandonment

Trustee checking "Yes" on report that property was abandoned did not constitute abandonment. *In re Shelby*, 232 B.R. 746 (Bankr. W.D. Mo. 1999) (Koger, J.).

In a Chapter 7 case, the trustee filed three consecutive trustee reports with the box checked "Yes" in a column entitled "Property Abandoned" next to the listing of the debtor's household goods and furnishings. On a fourth report the trustee left the column blank. In connection with the trustee's objection to exemptions, the bankruptcy court raised, on its own initiative, the question of whether the trustee's reports constituted an abandonment of the property. However, because the trustee had not filed a notice of abandonment under § 554(a) which had been served to all parties in interest, the court concluded that the trustee had not effectively abandoned due to insufficient notice.

C. Withdrawal/Revocation of Abandonment

Abandonment of an asset by a trustee may be revoked when the debtor provided incomplete or false information about the asset. *In re Gales*, 198 F.3d 250 (8th Cir. 1999) (unpublished)

The debtors' attorney assured the trustee that the debtors was not pursuing an unlawful arrest claim against a municipality, and, based on that assurance, the trustee abandoned the claim. When the debtors subsequently pursued the claim, the city moved to reopen the bankruptcy case and set aside the abandonment. The debtors argued the abandonment was irrevocable. The Eighth Circuit acknowledged that abandonment by a trustee is generally irrevocable but held that a bankruptcy court "has the power to modify or set aside an abandonment if the debtor concealed information from the trustee or the trustee was given incomplete or false information about the asset, and there is no prejudice to an innocent owner." The bankruptcy court therefore properly set aside the abandonment to allow the trustee to administer the claim.

Trustee may revoke abandonment when it was based on mistaken belief that a secured creditor was properly perfected and the creditor was not unfairly prejudiced. *In re Lintz West Side Lumber, Inc.*, 655 F.2d 786 (7th Cir. 1981).

The trustee initially abandoned inventory and accounts receivable of the debtor in which he believed a creditor had a perfected security interest. The trustee then discovered the financing statement listed the wrong name of the debtor and, therefore, the security interest was unperfected. The trustee sought to set aside the abandonment and the creditor opposed. The Seventh Circuit affirmed the bankruptcy court's order setting aside the abandonment, explaining:

> [T]he trustee is not attempting to reclaim abandoned property which has undergone an unanticipated increase in value or to unfairly prejudice the purported secured party and owner of the property following abandonment. The trustee is merely attempting to correct the erroneous distribution of property by abandonment to a creditor with a security interest which has subsequently been shown to be unperfected throughout. Under these circumstances, where there has been a mistake in the original abandonment and where the purported secured creditor has not been unfairly prejudiced, we do not believe that the bankruptcy judge is precluded from reconsidering the entry of such an order setting aside a prior abandonment order.

A subsequent unanticipated increase in value is not grounds to revoke a trustee's abandonment. *In re Wornell*, 70 B.R. 153 (Bankr. W.D. Mo. 1986).

The trustee abandoned real estate after concluding that it had no value. The real estate was then sold and $7,000 equity was realized. The bankruptcy court denied the trustee's motion to set aside the abandonment, holding that the trustee "should not be allowed to revoke [an] abandonment when the property later undergoes an unanticipated increase in value." A "mistake" in valuation or "surprise" of sale equity is insufficient; rather, in order to revoke an abandonment, the trustee's mistake must have resulted from being misled or not having complete information.

II. Tort Claims and Class Actions

A. Retention of Counsel (Multiple Counsel)

Because a trustee and debtor have adverse interests in maximizing the value of personal injury actions, a firm that represents the debtor and subsequently the trustee has a conflict of interest and may not be entitled to fees for representing the trustee. *In re Mercury*, 280 B.R. 35 (Bankr. S.D. N.Y. 2002).

The trustee retained as special counsel for a personal injury action the same firm that represented the debtors in the action and in preparation for bankruptcy. The trustee filed a motion to retain special counsel and the firm filed a motion to withdraw as bankruptcy counsel, but neither motion was served on the debtors. Both motions were granted, depriving the debtors of counsel altogether. The firm and the trustee ultimately sought to settle the personal injury action, which the debtors opposed. The firm then applied for fees, which the bankruptcy court denied, holding that: (1) a trustee and debtors have adverse interests in determining how to pursue and maximize the value of personal injury actions; (2) the firm therefore had a conflict of interest (which it did not disclose to the court) by representing the debtors and then the trustee in the personal injury action; (3) the firm had violated its ethical and legal duties by abandoning the debtors without consent in order to represent the trustee; and (4) the firm had violated its ethical and legal obligations by failing to advise the debtors that, in a chapter 7, the trustee would control the personal injury action, whereas in a chapter 11 the debtors would control it. Because of the conflict of interest and the firm's failures in its representation of the debtors, the firm was not entitled to the fees. The bankruptcy court therefore ordered forfeiture of all compensation and reimbursement of expenses.

Trustee is given deference in choosing special counsel because of highly confidential relationship. *In re Smith*, 507 F.3d 64 (2d Cir. 2007).

The trustee sought to remove the debtor's preferred special counsel in a personal injury action. Finding the newly chosen counsel had no conflict of interest, the Second Circuit affirmed the bankruptcy court's order granting the motion because courts "give the trustee [much] deference in choosing special counsel because of the highly confidential relationship between the special counsel-attorney and the trustee-client."

In some circumstances, a bankruptcy court may properly deny a trustee's choice of special counsel in favor of the debtor's counsel. *In re Vouzianas*, 259 F.3d 103 (2d Cir. 2001).

The debtor suffered a personal injury at work, retained counsel, and filed suit. Several years later, he filed a chapter 7 case. The trustee sought to remove debtor's counsel in the personal injury action and to retain his own. The bankruptcy court denied the motion under the circumstances of the case, finding: (1) the trustee made no showing the debtor's counsel was incompetent or was mishandling the case; (2) debtor's counsel had invested several years and much money in the case; and (3) debtor's counsel had already established a good working relationship with the debtor, who was the sole witness in the case. The Second Circuit affirmed, noting the bankruptcy judge "did not lightly reject" the trustee's generally wide discretion in choosing special counsel.

B. Date Cause of Action Arises

The plaintiff's silica exposure claim was property of the previous bankruptcy estate under each of the "sufficiently rooted" test, "accrual" approach, and the "blended" approach. *Murray v. 3M Company*, 297 F.Supp.3d 869 (E.D. Ark. 2018).

After being diagnosed in 2011 with silicosis, the plaintiff filed a product liability suit against 3M alleging that a 3M mask had failed to protect him from silica exposure leading to lung damage. The plaintiff filed bankruptcy in 2009 and received a discharge. 3M moved to dismiss the silica exposure case for lack of subject matter jurisdiction, arguing the plaintiff did not have standing because the cause of action was property of the bankruptcy estate giving only the trustee standing. The court addressed three potential tests for deciding the issue of whether the silica exposure claim was property of the estate.

The court first recognized the Eighth Circuit's previous use of the "sufficiently rooted" test, requiring that the cause of action be sufficiently rooted in the debtor's pre-bankruptcy past to be property of the estate. (Citing *Longaker v. Boston Scientific Corp.*, 715 F.3d 658 (8th Cir. 2013)). Second, the court recognized the Eighth Circuit's previous use of the "accrual approach," requiring that, under state law, the elements of the cause of action had accrued at the time of filing. (Citing *In re Deer*, 266 B.R. 772 (B.A.P. 8th Cir. 1999)). Third, the court recognized a "blended" approach, requiring "a fact-intensive analysis" of

whether a "substantial portion" of the claim existed prepetition such that the action is "sufficiently rooted" in the prepetition past and it would be "inequitable" to deprive the estate of the claim. (Citing *In re Harber*, 553 B.R. 522 (Bankr. W.D. Pa. 2016)).

The court concluded that the silica exposure claim was property of the estate under all three tests. Rejecting the plaintiff's argument that he was not aware of the silica claim until his diagnosis in 2011, the court found that with reasonable diligence the plaintiff "should have discovered the causal connection" between the defective mask and his lung injuries, based on the fact that he had been involved in an earlier asbestos lawsuit. Therefore, the claims were "sufficiently rooted" in the plaintiff's prepetition past because the claim arose from prepetition silica exposure to silica and the plaintiff should have had prepetition notice. And the accrual approach was satisfied because all elements of the product liability claim had accrued at the time of filing. Finally, because both of those tests were met, the blended approach was also met.

Post-petition settlement proceeds from the debtor's mesh pelvic sling product liability claim was not property of the estate because it was not "sufficiently rooted" in the debtor's prepetition past, since the debtor only became aware of a potential injury postpetition. *Mendelsohn v. Ross*, 251 F.Supp.3d 518 (E.D.N.Y. 2017).

The debtor had a mesh pelvic sling implanted in 1999. She filed bankruptcy in 2004 and did not disclose any cause of action related to the pelvic sling. She received her discharge in 2005. In 2011, the FDA issued an advisory opinion regarding possible defects of the pelvic sling. In 2012, the debtor became aware of the issues, asserted a product liability claim, and settled for over $105,000. The debtor had not suffered any actual injury from the pelvic sling, however. The trustee moved to reopen the case to administer the settlement proceeds, claiming the cause of action had been property of the estate. The bankruptcy court denied the motion, ruling the cause of action was not property of the estate because the action had not accrued prepetition inasmuch as not all elements of the cause of action had existed at the time as there had been no injury.

The district court rejected the bankruptcy court's analysis but ultimately affirmed. The district court framed the issues as whether the post-petition property (the settlement proceeds) were "sufficiently rooted in the pre-bankruptcy past" where the underlying facts did not yet, and may never, establish all the elements of a cause of action (because the

actual injury may never occur). The district court concluded it was not sufficiently rooted in the pre-bankruptcy past because:

> it was the combination of an event that occurred in her prebankruptcy past (the implantation of the medical device) and certain post-bankruptcy events (the FDA issued an advisory opinion regarding possible defects with the medical device; appellee became aware of the possible defects) that created the interest that resulted in the settlement proceeds.

The district court emphasized that "the most critical element that created [the debtor's] interest" in the proceeds was receiving actual notice of the possible defects, which occurred post-petition. Therefore, the proceeds were not property of the estate.

The debtor's product liability claim was not "sufficiently rooted" in the prepetition past and was not estate property because the "critical element" of actual injury occurred post-petition. *In re Harber*, 553 B.R. 522 (Bankr. W.D. Pa. 2016).

The debtor had both hips replaced. In 2011 she received notice that the implants may be defective and became part of a class action suit seeking damages. The debtor filed bankruptcy in 2014, disclosing the cause of action in her schedules with a $0 value. She received her discharge that year, with the exception that the trustee did not abandon the cause of action. The debtor was then advised by her personal injury attorney to voluntarily dismiss her class action claim because, they believed, she had not suffered any injury, would therefore be ineligible for any settlement proceeds, and may have her action dismissed with prejudice. The debtor then discovered her implants were in fact defective and corrective treatment was necessary, but she nevertheless chose to voluntarily dismiss her suit. Counsel in the class action proposed to refile the claim and settle for potentially $142,000, and the trustee moved to reopen the case to administer any proceeds.

The bankruptcy court first determined the claim accrued post-petition when the debtor received actual notice that the implants were in fact defective. Although the court determined the claim was "rooted" in the debtor's pre-bankruptcy past because both the implants occurred prepetition, it was not "sufficiently rooted" in the debtor's pre-bankruptcy past because the "critical element" of actual injury had not occurred prepetition. In making this determination the court noted that: (1) the debtor had not manifested any

symptoms pre-petition; (2) had not purposefully delayed medical attention; and (3) there was no evidence the injury developed slowly over time.

The bankruptcy court also rejected the trustee's argument that the debtor was judicially estopped from arguing the action was not property of the estate where, out of an abundance of caution, the debtor had disclosed the action in her schedules.

The debtor's product liability claim was sufficiently rooted in the prepetition past and was estate property because the debtor had suffered actual injury prepetition. *In re Carroll*, 2018 WL 2754487 (Bankr. E.D. Cal. June 6, 2018).

The debtor had a transvaginal mesh implanted in 2003. She subsequently underwent five additional procedures to alleviate pain and anguish and other symptoms caused by the implant. The debtor filed bankruptcy and received a discharge in 2009 without disclosing a potential product liability claim. In 2011, the FDA issued a warning of defects related to the implant, and upon learning of this, the debtor became part of a class action and settled for $240,000. The trustee moved to reopen the estate to administer the proceeds as property of the estate.

The bankruptcy court held the proceeds were property of the estate. Distinguishing the case from *Mendelsohn*, summarized above, the bankruptcy court held the claim was sufficiently rooted in the debtor's pre-bankruptcy past because she had actually suffered an injury prepetition—the pain and the surgeries—and therefore all elements of her cause of action had existed at the time of filing. That the debtor was not aware of her claim prepetition did not alter the analysis.

C. Debtors' Rights to any Portion

Bankruptcy judge withheld determination of whether claim proceeds were exempt under personal injury exemption statute until the claim was liquidated and damages were allocated between personal injury damages and non-personal injury damages. *In re Key*, 255 B.R. 217 (Bankr. D. Neb. 2000).

In a Title VII employment discrimination case, the debtor alleged racial discrimination and retaliation against a former employer and sought as damages back pay and benefits, reinstatement or front pay, compensatory damages for medical expenses, pain and suffering, emotional distress damages, and punitive damages. In bankruptcy, the debtor sought to exempt the proceeds of this action under the Nebraska personal injury exemption statute, but the trustee objected. Concluding that within the context of the personal injury exemption statute that the debtor's "causes of action included damages for personal injury and damages other than for personal injury," the bankruptcy judge withheld his determination of whether any proceeds were exempt until the claims were liquidated. The bankruptcy judge nevertheless recommended that: (1) the claims should be pursued for the mutual benefit of the debtor and the estate; (2) the trustee should consider retaining the debtor's counsel for the suit as special counsel; (3) any settlement should explicitly state the types of damages the proceeds were to remedy; and (4) if tried, special interrogatories should be used to allocate the proceeds amongst the types of recovery sought.

Debtor's class action claim was not estate property when potential statutory damages would be fully exempt and trustee's proposed settlement raised concerns of being a "buy off" of the class action. *In re Presswood*, 559 B.R. 204 (Bankr. S.D. Ill. 2016).

The debtor filed bankruptcy in 2012 without disclosing any causes of action. Subsequently, the debtor became the named plaintiff in a class action lawsuit for violations of the Telephone Consumer Protection Act based on two violations allegedly occurring in 2011. The debtor filed an amended Schedule B valuing the claim at $500 and filed an amended Schedule C claiming it as exempt. The trustee sought to settle the lawsuit for $10,000 to which the debtor objected. The debtor asserted that the settlement was an impermissible "buy off" of the class action and that his claim should be abandoned because its actual value, $500, was fully exempt.

The bankruptcy court agreed with the debtor. Finding no evidence that the debtor's claim would give rise to more than $500 damages under the statute, the court valued the claim at $500 and found it fully exempt. Therefore, the court held the action was not property of the estate and the trustee had no authority to settle. The court also noted its "serious concerns" the settlement was a "buy off" because: (1) the settlement was only for debtor's action and no other putative class members; and (2) the settlement would effectively have dismissed the class action because the debtor was the only named plaintiff and the statute of limitations had run.

D. Real Party-in-Interest

Trustee was not judicially estopped from pursuing a personal injury action the debtor failed to disclose. *Copelan v. Techtronics Industries Co., Ltd.*, 95 F.Supp.3d 1230 (S.D. Cal. 2015).

The bankruptcy court granted the trustee's motion to substitute himself as the real party in interest in the debtor's personal injury action. The court also denied the defendant's motion to dismiss on grounds of judicial estoppel because the debtor had originally failed to disclose the action in his schedules. The bankruptcy court held that "the Trustee cannot be judicially estopped from pursuing this suit on behalf of creditors" solely because the debtor had failed to disclose. *See also Parker v. Wendy's Intern., Inc.*, 365 F.3d 1268 (11th Cir. 2004) (holding trustee was not judicially estopped where debtor had failed to disclose cause of action); *Canterbury v. Federal-Mogul Ignition Co.*, 483 F.Supp.2d 820 (S.D. Iowa 2007) (same) (citing *Parker*).

Attorney for "surplus" debtor sanctioned for filing claims on debtor's behalf because the trustee was the real party in interest to those claims. *In re Griffin*, 330 B.R. 737 (W.D. Ark. 2005).

A "surplus" Chapter 7 debtor—assets exceeded debts by $14 million—filed a cross-claim and counterclaim in an ongoing suit against the debtor, asserting that the debtor (and not the estate) was the real party in interest because, due to the surplus, any proceeds from the claims would go to the debtor. The bankruptcy court sanctioned the debtor's attorney $1,100 for the filings on grounds that: (1) in a chapter 7 case, the trustee becomes the real

party in interest in any claims of the debtor; and (2) the fact that there was a surplus had no effect on the analysis. The district court affirmed.

Trustee cannot be a proper class action named plaintiff because of conflicts of interest. *Dechert v. Cadle Co.*, 333 F.3d 801 (7th Cir. 2003).

The Seventh Circuit held that a trustee, in substitute for the debtor, could not be a proper named plaintiff in a class action lawsuit because of the inherent conflict of interest between the fiduciary duties of being a trustee—to maximize the value of the claim for unsecured creditors—and the fiduciary duties of being a class representative—to represent all members of the class equally.

III. Administering Intellectual Property

Trustee's rejection of a trademark licensing agreement did not terminate licensee's right to continue using the trademark pursuant to § 365(g). *Sunbeam Products, Inc. v. Chicago American Mfg., LLC*, 686 F.3d 372 (7th Cir. 2012).

The debtor entered a contract that allowed a manufacturer to use its trademarks in manufacturing and selling box fans. The trustee sold all the debtor's assets, including the trademark, but the purchaser did not want the manufacturer using the trademark to compete against it. The trustee therefore rejected the contract under § 365(a), but the manufacturer continued using the trademark. The bankruptcy court allowed the continued use on equitable grounds because the manufacturer had invested substantial resources into making box fans branded with the debtor's trademark.

The Seventh Circuit rejected the bankruptcy court's equitable-grounds holding, but ultimately affirmed the ruling that the manufacturer could continue using the trademark. Deciding that the "limited definition" of intellectual property in § 101(35A) and the provisions in § 365(n) "[did] not affect trademarks one way or the other," the court turned to § 365(g). Holding that, under § 365(g), because rejection of a contract is treated as a breach as if outside of bankruptcy, a non-breaching party's "rights remain in place" after rejection, and therefore, the manufacturer's right to use the trademark remained in place after the trustee's rejection.

After trustee rejected intellectual property licensing agreement, licensee's election under § 365(n) to retain its rights did not preserve its rights to exclusive distribution or trademark use. *In re Tempnology, LLC*, 879 F.3d 389 (1st Cir. 2018) (petition for cert. filed June 12, 2018).

The debtor granted another company a non-exclusive, limited license in its trademark for its products. In chapter 11 bankruptcy, the now debtor-in-possession rejected the licensing agreement and argued the rejection ceased the company's right to use the trademark because § 365(n) did not cover trademarks. The bankruptcy court concluded that § 365(n) did not cover trademarks; that Congress's choice to not include trademarks in § 365(n) left such rights unprotected from rejection; and therefore, the company's right to use the trademark was not protected. The company appealed, and the BAP reversed following the holding in *Sunbeam*, summarized above.

The First Circuit reversed the BAP and affirmed the bankruptcy court. Addressing *Sunbeam*, the First Circuit agreed with the Seventh Circuit that no "equitable" grounds existed for use of a trademark to continue after rejection. But the First Circuit rejected the Seventh Circuit's § 365(g) analysis. Explaining that trademarks are "public-facing messages to consumers" that "signal uniform quality" and "protect a business from competitors who attempt to profit from its developed goodwill," the First Circuit held that, by preserving a trademark licensee's use rights under § 365(g), courts would be forcing debtors to continue bearing the same burdens—monitoring and controlling the trademark use and product quality—that the debtors had sought relieve by rejecting the license. The First Circuit found this proposition inconsistent with both the purpose of rejection under § 365(a) and the debtor's ability to obtain a fresh start in bankruptcy. Therefore, it held that the debtor's rejection of the trademark licensing agreement ceased the company's right to use the trademark.

IV. Administering Liquor License/Alcohol, Firearms, & Drugs

A. Liquor License/Alcohol

State alcohol control commission's requirement that buyer of liquor license take the license subject to being on state "delinquency list" violated the automatic stay as an act to "exercise control" over estate property. *In re J.F.D. Enterprises, Inc.*, 183 B.R. 342 (Bankr. D. Mass. 1995).

The debtor, a liquor retailer, was over $400,000 delinquent on bills to liquor wholesalers, causing the state's alcohol control commission to place the debtor's liquor license on a "delinquency list" which prevented purchasing on credit. The trustee moved for approval of the sale of the liquor license free and clear of all liens under § 363, including its placement on the delinquency list, and the bankruptcy court approved. The state commission then approved the sale, but subject to the buyer being substituted for the debtor on the delinquency list. The buyer filed a motion in the bankruptcy court to require the state commission remove the license from the delinquency list altogether. The bankruptcy court granted the motion, holding that the state's substitution requirement constituted an improper act to "exercise control over property of the estate" under § 362(a)(3) and thus violated the automatic stay. The substitution requirement constituted an exercise of control because being on the delinquency list would prevent any potential buyer from being able to purchase alcohol on credit, which decreased the value of the license to the estate. Therefore, the approval of the sale could not be conditioned on the substitution, and the state commission was order to remove the license from the delinquency list.

Employee of debtor's bar could enforce an involuntary lien for unpaid wages against debtor's liquor license by imposing a constructive trust on the proceeds from the trustee's sale of the liquor license. *In re Barnes*, 276 F.3d 927 (7th Cir. 2002).

An employee of a bar owned by the debtor had filed a notice of employee's lien on "any and all assets" of the debtor for unpaid wages and obtained a default judgment foreclosing the lien. After the debtor filed bankruptcy, the Chapter 7 trustee sold the bar's liquor license. The employee filed an adversary proceeding to enforce the lien against the proceeds of the liquor license. Although Indiana law was explicit that liquor licenses are not "property," the license was treated as property of the estate because § 541 so broadly

defines property of the estate. Further, the employee could obtain an involuntary lien in the license under Indiana law.

Liquor license considered a "mere privilege" under state law was "property of estate" that could be sold, no lien could attach to the license or its proceeds because it was not "property" under state law. *In re Circle 10 Restaurant, LLC*, 519 B.R. 95 (D. N.J. 2014).

The trustee sold the debtor's liquor license. A creditor had filed a secured claim asserting a security interest in the liquor license. The trustee moved to reclassify the creditor's claim as unsecured, arguing the creditor's security interest had never attached because the liquor license was not "property" to which a lien could attach. The creditor objected, arguing first that the trustee should be judicially estopped from asserting inconsistent positions that the liquor license was "property of the estate" that he could sell but was not "property" to which the security interest could attach and also that the liquor license constituted a general intangible under the UCC.

The court agreed with the trustee. The court held: (1) because the liquor license had value, it was property of the estate that the trustee could sell; (2) the trustee was not judicially estopped because what constituted "property of the estate" for bankruptcy purposes and "property" to which a lien could attach were distinct questions; (3) the liquor license was a "mere privilege" under state law and thus could not be a general intangible to which the creditor's security interest could attach; and (4) because the security interest could not attach the liquor license, it did not attach to the sale proceeds.

B. Drugs

"Cause" existed to dismiss debtors' chapter 7 case because trustee could not administer marijuana-related assets, and debtors could not convert to chapter 13 because of feasibility issues. *In re Arenas*, 535 B.R. 845 (B.A.P. 10th Cir. 2015).

Debtors living in Colorado filed chapter 7 bankruptcy. The debtors were licensed to grow and dispense marijuana under state law. Their nonexempt assets included 25 marijuana plants, and the majority of their income ($4,265 of $7,235) consisted of marijuana sales and rent from a marijuana dispensary. The bankruptcy court dismissed the case for cause

because, in order to administer the marijuana income and marijuana plants as part of the estate, the trustee would be required to violate the federal Controlled Substances Act. The bankruptcy court also denied the debtors' motion to convert to chapter 13, finding that the plan was not proposed in "good faith and not by any means forbidden by law" because administration would also require the chapter 13 trustee to violate the Controlled Substances Act. The BAP affirmed. However, in affirming the finding of lack of good faith in the chapter 13 context, the BAP rested instead on feasibility, finding that without the marijuana income—which the trustee could not administer—the debtors' budget deficit was too great to propose a confirmable plan. The BAP did not reach the question of whether the debtors' plan was proposed by "any means forbidden by law."

ADMINISTERING INTELLECTUAL PROPERTY†

a. Purchase and Sale of Intellectual Property
    i. Generally governed by Sections 363 and 365 of the Bankruptcy Code and Rules 2002, 4001, 6004 and 6006 of the Federal Rules of Bankruptcy Procedure.

b. Assignability of Non-Exclusive Patent Licenses
    i. Often include anti-assignability clauses, which limits ability of licensee to transfer licensor's rights without consent.
    ii. Nonexclusive patent licenses are executory contracts that generally may be assumed or rejected, because each party to the contracts owes material continuing performance to the other. *See Everex Sys. v. Cadtrak Corp.* (*In re CFLC, Inc.*), 89 F.3d 673, 677 (Bankr. S.D.N.Y. 1997).
    iii. Trustee may not assign a nonexclusive patent license to a third party, absent consent of the licensor, because federal patent law precludes the holder of a nonexclusive license from assigning it. *CFLC*, 89 F.3d at 679.

c. Debtor's ability to retain non-exclusive patent licenses
    i. *In re Catapult Entm't, Inc*., 165 F.3d 747, 749-50 (9th Cir.), *cert. dismissed*, 528 U.S. 924 (1999), Catapult, the debtor-in-possession, sought court approval to assume two nonexclusive patent licenses. The licensor objected.
    ii. Catapult argued that Section 365(f)(1) of the Bankruptcy Code "provides that executory contracts, once assumed, may be assigned notwithstanding any contrary provisions contained in the contract or applicable law." Catapult posited that Section 365(c)(1) should not be read to prohibit

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assumption because that would result in Section 365(f)(1) having no meaning.

iii. Ninth Circuit held that "applicable law" referenced in Section 365(c)(1) to determine whether a contract can be assumed is the law relating to whether a licensor is excused from accepting performance from another licensee, while the "applicable law" referenced in Section 365(f)(1) relates to whether a contract can be "assigned," notwithstanding the identity of the proposed assignee.

iv. Catapult further argued that Section 365(c)(1) is internally inconsistent when read to prohibit assumption of an executory contract by a debtor.

v. The Court found that Section 365(c)(1) requires a determination as to whether "applicable law" permits assumption and assignment (i) where the debtor wants to assume and even if the licensor has consented to assumption by the debtor or (ii) if the debtor wants to assign the executory contract.

vi. The Ninth Circuit further rejected Catapult's argument that, since the types of contracts described in Section 365(c)(2) are nonassignable under state law, Section 365(c)(2) was necessary because subsection (c)(1) would permit nonassignable contracts to be assumed notwithstanding applicable law.

vii. The Ninth Circuit applied what has become known as the "hypothetical test" and found that, if, under applicable law, a debtor is not allowed to assign an executory contract to a third party without the non-debtor party's consent, then the debtor-in-possession cannot assume the contract even though the debtor-in-possession may have no intention of assigning it to a third party. Id. at 750.

viii. The Ninth Circuit found that federal patent law constituted applicable law under which nonexclusive patent licenses are "personal and assignable only with the consent of the licensor" (quoting *CFLC*, 89 F.3d at 680) and held that a debtor-in-possession's inability to assign a nonexclusive patent license precludes that debtor-in-possession from assuming the license as well.

d. Exclusive Patent Licenses
    i. Differ from non-exclusive patent licenses in that the assignee may distinguish between non-exclusive license and exclusive license for a particular field of business or market and exclude others from using the patented technology. In effect, the assignee does not need to assume the right; the assignee already owns it. *See In re Access*, 237 B.R. at 44 (dicta). However, one court has held that an exclusive patent license is assignable despite the objection of the licensor under Section 365(c)(1). *In re Supernatural*, 268 B.R. at 779.

e. Non-exclusive copyright and trademark licenses
    i. Courts generally hold that nonexclusive copyright licenses are nonassignable without consent of the licensor under the Copyright Act. *See Emmylou Harris v. Emus Records Corporation*, 734 F.2d 1329 (9th Cir. 1994) (court refused to approve an assignment of a nonexclusive recording copyright license because of the personal nature of the contract); *In re Patient Educ. Media, Inc.*, 210 B.R. at 240 (holding generally that nonexclusive copyright licenses are nonassignable because the Copyright Act protects rights that are designed to "motivate the creative activity of authors and inventors" that include the right to control who uses materials under copyrights); *In re Valley Media, Inc*., 279 B.R. 105, 135 (Bankr. D. Del. 2002) (nonexclusive copyright licenses are nonassignable without consent of the licensor under Copyright Act).
    ii. Assignment of any nonexclusive trademarks may be affected by statutory restrictions imposed under 15 U.S.C. § 1060 which require that a mark may not be assigned alone, but only together with the goodwill associated with it. *See Marshak v. Green*, 746 F.2d 927 (2d Cir. 1984); *Clark & Freeman Corp. v. Heartland Co. Ltd*., 811 F. Supp. 137 (S.D.N.Y. 1993); *Matter of Roman Cleanser Co*., 802 F.2d (6th Cir. 1986); *In re Specialty Foods of*

Pittsburgh, Inc., 91 B.A. (W.D. Pa. 1988); *Bambu Sales, Inc. v. Sultana Crackers, Inc*., 683 F. Supp. 899 (E.D.N.Y. 1988).

f. Exclusive copyright licenses
   i. Courts are split on assignability of exclusive copyright licenses. The Ninth Circuit has held that exclusive copyright licenses are nonassignable without consent of licensor because the Copyright Act prohibits such assignment. *Gardner v. Nike, Inc*., 279 F.3d 774, 780 (9th Cir. 2002) (exclusive copyright license non-assignable); *Ward v. National Geographic Society*, 208 F. Supp. 2d 429, 442 (S.D.N.Y. 2002) (agreeing with *Gardner*); *In re Hernandez*, 285 B.R. at 806-809 (holding that an exclusive patent license was not assignable without the consent of licensor and fellow licenses because under federal patent law such assignment is likewise prohibited).
   ii. Courts that have held they are assignable. *In re Golden Books Family Entertainment, Inc.*, 269 B.R. 300 (Bankr. Del. 2001) (holding the copyright license was assignable because it was exclusive); *ITOFCA Inc. v. Mega Trans Logistics, Inc.*, 2003 U.S. App. LEXIS 4024, at *38 (7th Cir. 2003) (citing In re Golden Books that exclusive licenses can be assigned without the licensor's consent); *Murray v. Franke-Misal Techs. Group LLC*, 268 B.R. 759 (Bankr. M.D. La. 2001).

g. General Article 9 rule [9-501 and 9-502] for perfecting a security interest in a debtor's personal property:
   i. File a financing statement describing the collateral with the secretary of state in the debtor's state of residence.
   ii. Patents, Trademarks, Registered copyrights
   iii. One exception for rules of perfection is in the area of certain types of intellectual property.
      a) There is federal law that preempts or supplements the UCC's perfection rules.

iv. Under the Patent Act, an “assignment, grant or conveyance” must be recorded with the Patent and Trademark Office within 3 months of the date of the assignment, grant, or conveyance.

a) However, there is disagreement as to whether this language preempts filing under the general Article 9 rule.

v. Trademark assignments must also be recorded in the United States Patent and Trademark Office within 3 months after the date of the assignment.” 15 U.S.C. 1060(a)(4).

a) While there are cases that distinguish between security interests and assignments (and thereby rule that security interests need only be perfected via Article 9 rules), the prudent course it to file both a statement with the USPTO and one in the debtor’s state of residence.

vi. A long-standing case from the Ninth Circuit, *In re Peregrine Entertainment Ltd*, 116 B.R. 194, holds that the requirements under the Copyright Act, that “any transfer of copyright ownership or other documents pertaining to a copyright,” may be recorded in the United States Copyright Office. In *Peregrine*, the court held that a security interest in a registered copyright is a transfer under the Copyright Act, which preempts the UCC, and provides the sole avenue for perfecting a security interest in a registered copyright. Given this case, a prudent investor might file both with the copyright office and the secretary of state to be sure its interest is secured.

vii. Other intellectual property that can be used as collateral is software and domain names or websites. Under Article 9, software is split into two categories. The first category of software is that which is embedded in a good to an extent that it will be considered under the UCC as a part of the good (and treated as such). Under UCC 9-102(a)(44), a good includes embedded software if: “(i) the program is associated with the goods in such a manner that it is customarily considered part of the goods, or (ii) by becoming the owner of the goods, a person acquires a right to use the program in connection with the goods.” For example, an operating system on a phone or computer would be considered embedded software and

therefore a good. All other types of software are considered general intangibles and a security interest therein is perfected by filing a financing statement that lists 'general intangibles.'

h. *Cyber Solutions Int'l v. Pro Mktg. Sales, Inc.*, 634 Fed.Appx. 557, 565 (6th Cir. 2016)
    i. Post-petition lender who took security interest in assignment of technology updates funded by its loan (subject to the interests of the pre-petition lender) took junior lien to pre-petition lender whose security interest included all personal property 'owned or acquired' by debtor.
    ii. Focus on language of the post-petition contract that required the debtor to assign or agree to assign its rights in the technology to the lender, as opposed to the language in the pre-petition contract that gave the lender the rights to any technology the debtor 'owned or acquired.'
    iii. Ownership pre-empts assignment.