Chapter 11 Luncheon
Sponsored by the Chapter 11 Subcommittee, Susan M. Freeman, Chair
March 15, 2007
12:30 p.m. – 2:30 p.m.

PROGRAM: Who Controls the Reorganized Debtor? – Corporate Governance Issues in Plans of Reorganization

Who chooses the board of directors of a reorganized company, sets management compensation, and makes other critical corporate choices when a plan of reorganization is filed and confirmed? The creditors may be the new shareholders, but the debtor in possession controls the process and may seek to impose provisions that will bind the reorganized debtor for years to come.

Secured Creditors Luncheon
Sponsored by the Secured Creditors Subcommittee, Corinne Ball, Chair; Josefina Fernandez McEvoy, Subcommittee Vice-Chair
March 15, 2007
12:30 p.m. – 2:30 p.m.

PROGRAM: The Next Generation of First and Second Lien Battles: Cash Collateral, DIP Loans, Adequate Protection and Section 363 Sales

A review of recent developments with regard to second liens and their relationship to adequate protection, cash collateral, credit bidding, and default interest.

Business Bankruptcy Committee Program
Sidney P. Levinson and Phoebe Morse, Program Co-Chairs
March 15, 2007
2:30 p.m. – 4:30 p.m.

PROGRAM: The U.S. Trustee Speaks: The U.S. Trustee Program in Chapter 11 – Current Policies

Join Clifford J. White III, the Acting Director of the Executive Office of U.S. Trustees, and a distinguished panel of judges and practitioners to discuss current issues involving the Office of the United States Trustee that arise in Chapter 11 proceedings.

Joint Program of the Business Bankruptcy Committee and the Employee Benefits and Executive Compensation Committee
Babette R. Ceccotti, Program Chair
March 16, 2007
10:30 a.m. – 12:30 p.m.

PROGRAM: Rejecting the Social Contract: Using Bankruptcy to Change Labor and Pension Obligations

Our panelists will discuss how bankruptcy law and the bankruptcy process has been used to restructure labor and pension
Banks, and the policy implications of addressing labor and benefits in the bankruptcy system.

Bankruptcy Committee Forum
Samuel R. Maizel, Forum Chair
March 17, 2007
11:30 a.m. – 1:30 p.m.

FORUM TOPIC: Bankruptcy Cases Before the U.S. Supreme Court: An Analysis of the Court's Methodology and a Look Into the Future Under Chief Justice Roberts

The Forum will cover (1) whether the Supreme Court has any unique approaches to bankruptcy cases and if there is any recognizable and consistent methodology to its resolution of these cases; (2) what kinds of cases the Supreme Court thinks worthy of a grant of certiorari; and (3) how the “Roberts Court” might be expected to deal with any issues or cases in the pipeline for its review.

For a more detailed description of the program and the important issues it will address, please click the link below.

More...

Previews of Spring 2007 Subcommittee Meeting Programs and Related Articles

Business Transactions
Margery Reed, Chair; Phoebe Morse, Vice-Chair

In March, we present a cross-Committee program, joining with the Real Estate Finance Subcommittee of the Section's Commercial Financial Services Committee to present a talk on the intersection of bankruptcy law and letter-of-credit (LC) law. After introducing the key relevant concepts of both bodies of law, we will look at the treatment of LCs in an applicant's bankruptcy and identify some dangers for LC beneficiaries and LC issuers in those bankruptcies — including in the areas of landlord bankruptcy claims, the automatic stay, ipso facto clauses, and preferential transfer law. We will discuss recent cases, the challenges they present to practitioners, and practical advice to meet those challenges. Whether you represent lenders or borrowers, lessors or lessees, landlords or tenants, you will find material and pointers to take back to your own practice.

E-Commerce and Technology-Oriented Bankruptcy Subcommittee
Marc L. Barreca, Chair

This Spring, we will present Pharma and Other IP Patent Portfolios in Bankruptcy Cases: Protecting the Asset and Maximizing Value. When a debtor with a patent portfolio files a bankruptcy case, what are the steps bankruptcy counsel should take to protect the patent portfolio and obtain maximum value? There will be an emphasis on Pharma bankruptcies.

With the continued growth of the software industry and other high-tech businesses, intellectual property issues arise frequently in bankruptcy cases. Bankruptcy law has a major potential impact on the enforceability of license agreements. Bankruptcy can dramatically affect both licensors and licensees of intellectual property. Problems arise in the context of the assumption,
assignment, or rejection of intellectual property licenses under the Bankruptcy Code.

The below linked article outlines the general principles applicable to intellectual property licenses in bankruptcy and provides basic practice tips for licensors and licensees.

More...

Use and Disposition of Property Subcommittee
Sheryl E. Seigel, Vice-Chair

This Spring in Washington, D.C., our subcommittee will present Just When You Think the Deal Done . . . Strategies for Minimizing Post-Closing Adjustment Disputes and Other Tribulations. We will discuss strategic considerations in drafting purchase price adjustment clauses and other provisions in the transaction documents for sales under Section 363 of the Bankruptcy Code.

Going concern sales of insolvent companies are often done under pressure, within a restricted time frame and with the input of stakeholders other than the seller and buyer. The end result sometimes is a purchase agreement that is clear as to the stated purchase price and other deal terms, but has ambiguities relating to post-closing adjustments that can materially affect the final consideration to be paid. Increasingly, it seems that post-closing adjustment provisions are providing fertile grounds for disputes. Even so, these critical provisions within a purchase agreement do not always draw the attention that they merit at the time the agreement is being negotiated.

More...

Claims and Priorities Subcommittee
Margaret M. Anderson, Vice-Chair

Our Spring program is entitled How High Is Your Proof? Must Your Claim Be Everclear? – The Requirements of a Valid Proof of Claim. The panel will explore the 5 Ws (and one H) of proofs of claim: What is a proof of claim? Who may file a proof of claim? When must a proof of claim be filed? Where do I file my proof of claim? Why does a proof of claim need to be filed? How do you properly file a proof of claim and its accompanying exhibits?

Bankruptcy practitioners will share their knowledge on common errors made in filing proofs of claim and successful methods to remedy those errors. We'll also look at amending proofs of claim, transferring claims, and litigating objections to claims.

For a preview of the extensive practical information offered by this program, click the link below.

More...

Corporate Governance Subcommittee
Sandra Mayerson, Spring Program Moderator

Join us at the Spring meeting in Washington, D.C., for When Statutes Collide: BAPCPA, Sarbanes-Oxley and Regulation FD. This panel discusses the obligation of lawyers to advise their clients in public company cases about the impact of the Sarbanes-Oxley Act and of Regulation FD on their fiduciary
duties. The discussion will include a look at the post-BAPCPA duties of creditors' committees under Section 1103 of the Bankruptcy Code.

**Insurance Subcommittee**  
*Robert M. Millner, Chair*

Our Spring subcommittee meeting, *An Update on Insurance Issues in Reorganization Cases*, will include a panel discussion of insurance issues that have arisen in the last year in mass tort and other reorganization cases and of the issues that the panel anticipates may arise over the next year.

**The Committee’s Member-Judges at Work**

We are fortunate to have members of the bankruptcy bench active in the Business Bankruptcy Committee, and this Newsletter provides an opportunity to highlight and discuss some of their recent opinions. In this edition, we examine two such decisions:

**Landlord Damage Claims**

In an opinion authored by the Honorable Philip Brandt, Bankruptcy Judge for the Western District of Washington, the Ninth Circuit Bankruptcy Appellate Panel explains that, while 11 U.S.C. §502(b)(6) may limit a landlord's claim for rejection damages, that Bankruptcy Code section does not automatically require disallowance of damage claims that arise from facts other than the lease rejection.

See the attached article by Christopher M. Alston, Foster Pepper PLLC, Seattle, Washington.

More...

**Executory Contracts – Rejected But Not Gone?**

Where do executory contracts go when they die? Or do they ever really die at all? Cecelia G. Morris, Bankruptcy Judge for the Southern District of New York, issued an opinion last year that provokes questions on the issue of whether executory contracts and unexpired leases that have been rejected – at least, those that have been rejected by operation of law – can safely be considered disposed of.

See the attached article by Christopher Combest, Quarles & Brady LLP, Chicago, Illinois.

More...

**Featured Article**

*Spotlight on...Professional Retention*  
*Sharon Z. Weiss and Gil Hopenstand, Weinstein, Weiss & Ordubegian LLP, Los Angeles, California*
In order to be employed by a trustee or debtor in possession in a bankruptcy case, a professional must establish, among other things, that he, she, or it is a disinterested person under 11 U.S.C. §101(14). When is a law firm "disinterested" or "not disinterested"? What if you have subtenants who lease space from your law firm who also represent parties adverse to your clients? What if your firm engages "contract attorneys" on a limited basis, and one of those attorneys also represents a party adverse to your client? How far do you need to search to determine whether you are making the proper disclosures in your employment application?

This article examines those questions and considers how to manage challenges to one's disinterestedness.

More...
BUSINESS BANKRUPTCY COMMITTEE TO PRESENT PROGRAM
ON THE SUPREME COURT AT THE 2007 ANNUAL SPRING MEETING

By Samuel R. Maizel, Pachulski Stang Ziehl Young Jones & Weintraub, Los Angeles, California

I. Overview of Program.

The Business Bankruptcy Committee will present a program entitled

BANKRUPTCY CASES BEFORE THE U.S. SUPREME COURT: An Analysis of the Court’s
Methodology and a Look Into the Future Under Chief Justice Roberts, at the Annual Spring
Meeting. The program is scheduled to be held on March 17, 2007, at 11:30 a.m. – 1:30
p.m., in Ballroom West A of the Renaissance Hotel, in Washington, DC. The program will
cover (1) whether the Supreme Court has any unique approaches to bankruptcy cases and if there
is any recognizable and consistent methodology to its resolution of these cases; (2) what kinds of
cases the Supreme Court thinks worthy of certiorari being granted; and (3) how the “Roberts
Court” might be expected to deal with any issues or cases in the “pipeline” for its review.

The panelists are all experienced Supreme Court practitioners, with numerous
appearances before the Supreme Court. Lisa Blatt has served as an Assistant to the Solicitor
General in the United States Department of Justice since July 1996. During that time she has
argued 22 cases before the United States Supreme Court. Three of those cases have involved the
Bankruptcy Code: Archer v. Warner; Lamie v. United States Trustee, and Marrama v. Citizens
Bank of Massachusetts. Eric Brunstad is a partner at Bingham McCutchen where he focuses on
bankruptcy litigation and appellate matters. He has argued several cases in the U.S. Supreme
Court, and has prepared numerous Supreme Court briefs. His Supreme Court cases include,
among many others, Marshall v. Marshall; Central Virginia Community College v. Katz;
Credit Corp., and Tennessee Student Assistance Corp. v. Hood. Craig Goldblatt’s practice at Wilmer Cutler Pickering Hale and Dorr focuses on complex civil and appellate litigation, with an emphasis on bankruptcy-related litigation and other restructuring matters. His Supreme Court experience includes representing Elliott and Carol Archer in Archer v. Warner, as well as participating in the Supreme Court in many other bankruptcy cases, including Marshall v. Marshall, Rousey v. Jacoway, and Lamie v. U.S. Trustee. This term, he participated in both of the bankruptcy cases now pending before the Supreme Court -- Marrama v. Citizens Bank and Travelers v. PG&E. The panel moderator will be Sam Maizel, from Pachulski Stang Ziehl Young Jones & Weintraub. He chairs the Business Bankruptcy Committee on Litigation and has recently finished a book for the American Bankruptcy Institute on Bankruptcy Appellate Practice.

The United States Supreme Court is, of course, the final arbiter of disputes involving the Bankruptcy Code. Over the 25 years since the inception of the Bankruptcy Code, the Supreme Court has decided over 66 cases directly affecting bankruptcy law and the Bankruptcy Code. However, in the past 18 months, at least two significant changes in the Supreme Court’s composition suggest a discussion of the Supreme Court’s approach to bankruptcy cases merits review. First, on September 29, 2005, John Glover Roberts, Jr., became the seventeenth Chief Justice of the United States. Second, on January 31, 2006, Associate Justice Sandra Day O’Connor – the only Justice with practical bankruptcy-practice experience – retired. The net result: perhaps a Supreme Court with no practical bankruptcy experience but, because of that, the potential for surprising results. The program will discuss what this could mean for bankruptcy practitioners.
This change in composition can only suggest where the Supreme Court might go in future bankruptcy cases, but no one can be certain. For example, the Supreme Court surprised many during 2006 with its decision in *Howard Delivery Serv., Inc. v. Zurich American Ins. Co.*, where Justice Ruth Bader Ginsburg wrote, in an opinion for a majority that could guide bankruptcy practitioners’ interpretation of the "plain meaning" doctrine in bankruptcy cases for years to come, that, when it comes to bankruptcy law, interpretation of Bankruptcy Code provisions must take into consideration the principle that “the Bankruptcy Code aims, in the main, to secure equal distribution among creditors . . . [and] the complementary principle that preferential treatment of a class of creditors is in order only when clearly authorized by Congress.”

II. **Bankruptcy cases often serve as a crucible for competing theories of statutory interpretation.**

   In a 1993 article, Bob Rasmussen noted the ascendancy of “textualism” in the Supreme Court’s treatment of bankruptcy cases. “The Supreme Court’s bankruptcy cases evince a definite trend toward textualist interpretation. Of the twenty-four bankruptcy cases decided in the past seven terms involving statutory interpretation, the Court adopted a textualist approach in nineteen of them.” Bob Rasmussen, *A Study of the Costs and Benefits of Textualism: The Supreme Court’s Bankruptcy Cases*, 71 Wash. U. L. Q. 535 (1993). As a general proposition, the Court is at least as “textualist” today as it was 15 years ago — perhaps more so by virtue of the appointments of Chief Justice Roberts and Justice Samuel A. Alito, Jr.

   In truth, many of the Court’s most significant decisions bearing on theories of statutory construction have arisen in the bankruptcy context. Specifically, questions arise when a “literal”

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1 Sections II, III, and IV are drawn from notes prepared by Craig Goldblatt and will be, along with other materials, part of the written materials for the program.
construction of statutory language runs contrary to what a court views as sound bankruptcy policy — or in extreme cases, produces “absurd” results.

III. Concerns for sound bankruptcy policy.

At times, the Court is required to weigh the “most natural” meaning of the statutory language against a reading that it believes best serves the overarching purposes of the Bankruptcy Code. See Howard Delivery Serv., Inc. v. Zurich American Ins. Co. (giving narrow reading to statutory priorities in order to serve the interest of achieving equal distribution to unsecured creditors).

In Marrama v. Citizens Bank of Massachusetts, the Debtor contends — relying on the plain statutory text — that an individual debtor has a right to convert a case to chapter 13 at any time. Citizens Bank of Massachusetts and the chapter 7 trustee, supported by the United States, argue (among other things) that such a reading runs contrary to the bankruptcy purpose of avoiding abuse of the bankruptcy process. This case may, therefore, yield another opinion that addresses the balance between concerns for the objectives of bankruptcy policy and the most natural reading of statutory language.

Significantly, no member of the current Supreme Court claims particular expertise or knowledge of bankruptcy law. While in the past, particular Justices, such as Justices Douglas, Blackmun, and O’Connor, seemed to have a comprehensive sense of the overarching purposes of bankruptcy law and the way in which its various statutory pieces fit together as a whole, there does not appear to be any member of the current Court who is associated with a particular interest in bankruptcy law matters.
IV. Argument that giving language “plain meaning” itself serves bankruptcy policy purposes.

One of the purposes of replacing the former Bankruptcy Act of 1898 with the current Bankruptcy Code was to bring greater reliability and the principles of the rule of law into bankruptcy administration. Commercial creditors will be more likely to do business with troubled companies and individuals in financial difficulty if they believe they will be treated fairly and evenhandedly in the event of bankruptcy.

It is nevertheless the case that many sophisticated commercial parties believe that they are at a disadvantage in bankruptcy litigation matters as against a debtor in possession or a trustee. Their concern is that the objective of facilitating the debtor’s reorganization and/or maximizing the recovery for creditors will lead bankruptcy courts — in the name of serving “bankruptcy policy” — systematically to favor “the estate” over various deep pocket defendants. Extensive litigation over mandatory withdrawal of the reference, “core” vs. “non-core” proceedings, and the scope of “related-to” jurisdiction reflects concern with the ability of parties to obtain a fair hearing in bankruptcy court.

At least on an atmospheric basis, and perhaps more significantly than that, the Supreme Court decisions adopting a strict view of statutory construction, as well as the decisions of various courts of appeals limiting the scope of Section 105 of the Bankruptcy Code, signal to lower courts and to litigants that litigated outcomes will be driven by application of the rule of law, rather than a particular judge’s view of which outcome best serves the objectives of “bankruptcy policy.”
It is certainly arguable that in the long run, promoting confidence in the fairness of the bankruptcy system is itself a more important “bankruptcy policy” objective than the outcome of any particular statutory dispute.
Intellectual Property Licenses and Bankruptcy

By Marc Barreca and John Knapp

With the continued growth of the software industry and other high-tech businesses, intellectual property issues arise frequently in bankruptcy cases. Bankruptcy law has a major potential impact on the enforceability of license agreements. Bankruptcy can dramatically affect both licensors and licensees of intellectual property. Problems arise in the context of the assumption, assignment, or rejection of intellectual property licenses under Section 365 of Title 11 of the United States Code (the “Bankruptcy Code”). This article outlines the general principles applicable to intellectual property licenses in bankruptcy and provides basic practice tips for licensors and licensees.

I. How does bankruptcy affect intellectual property licenses?

A. General Principles

1. Bankruptcy does not revive license agreements terminated prior to bankruptcy.

Bankruptcy has limited relevance to the pre-bankruptcy termination of a license. A trustee or debtor in possession has no ability to revive a contract effectively terminated under state law prior to bankruptcy. Debtors in possession and trustees must generally conduct business in compliance with non-bankruptcy laws, including intellectual property laws. The termination of a license pre-petition precludes a licensee debtor (such as a debtor in possession or its trustee) from using any of the intellectual property post-petition. Similarly, a pre-petition termination by a licensor debtor also terminates all rights of the non-debtor licensee, and the non-debtor licensee is not entitled to any of the protections of Section 365(n) of the Bankruptcy Code, discussed infra.

There are at least two caveats. One is that state or other applicable non-bankruptcy law must be consulted to determine whether termination was actually effective. The other is that the termination of a right that has value to the bankruptcy estate may constitute a preferential transfer or fraudulent conveyance, which may be subject to avoidance by the bankruptcy court in an action by the debtor in possession or trustee.

Also, the grant of a license may be revoked by a debtor in possession or trustee using the “strong-arm” powers of Section 544, the preferential transfer provisions of Section 547 and the fraudulent transfer provisions of Section 548. Among other rights, the debtor in possession has whatever rights a hypothetical judicial lien creditor or an unsecured creditor would have to avoid transfers of property and recover them for the benefit of the estate.

2. Bankruptcy sets deadlines for a trustee or debtor in possession to decide how to proceed with respect to its intellectual property
licenses, to the extent they constitute executory contracts or unexpired leases.

In Chapter 7 liquidation cases, under Section 365(d)(1) of the Bankruptcy Code, a trustee must assume or reject an executory contract or unexpired lease within 60 days of the order for relief or the subject contract or lease is deemed rejected. The court may extend this time for cause.

In Chapter 11 cases, under Section 365(d)(2) of the Bankruptcy Code, a trustee or debtor in possession may assume or reject an executory contract or unexpired lease of personal property at any time before confirmation of a plan. However, the non-debtor party to the contract or lease may move the court to set an earlier time for assumption or rejection or to grant relief from the automatic stay to terminate the agreement; otherwise, the non-debtor party is required to continue to accept performance from the debtor.7

3. The automatic stay prevents termination of a license during bankruptcy without bankruptcy court approval.

The automatic stay of Section 362(a) of the Bankruptcy Code precludes unilateral termination of a contract by a non-debtor party before its expiration. Courts have held this to be so even where the contract provides for “at-will” termination.8 Even if the debtor commits a post-petition breach, the non-debtor party must obtain relief from stay to terminate the contract.9

4. The non-debtor party’s limited enforcement options and payment rights require bankruptcy court approval.

The debtor in possession or trustee, unlike the non-debtor party, may enforce a license in accordance with its terms, in the “limbo period” after the bankruptcy case filing but prior to assumption.10 A non-debtor party to a license may not enforce the license prior to its assumption and instead must move the bankruptcy court to set a time for assumption or rejection.11 The non-debtor party may also seek post-petition payments as an administrative expense priority claim to the extent of the value of the benefit provided to the debtor in possession or trustee during the bankruptcy.12 This value may be difficult to prove.13 Even if the debtor in possession or trustee uses goods provided under an executory contract, if the goods were delivered pre-petition, no “post-petition benefit” is conferred.14

5. Insolvency or filing for bankruptcy alone is probably not a basis to terminate the license once bankruptcy begins.

Generally, a debtor in possession or trustee may assume or assign a contract or lease despite default provisions triggered by the debtor’s bankruptcy filing, its insolvency or poor financial condition, or the appointment of a trustee or custodian.15 Contract provisions that, although not specifically referring to a
debtor's financial condition, in effect create defaults inherent in a bankruptcy setting, may also be unenforceable. However, to the extent a license of intellectual property excuses the non-debtor party from accepting performance from or rendering performance to a party other than the debtor, these “ipso facto” provisions may also be enforceable if authorized by the bankruptcy court.

B. Practice Tips

1. Terminate the license prior to bankruptcy. If termination for insolvency is desired, clearly define insolvency-related defaults in the license agreement.
2. If there is any dispute, file a motion or other proceeding in the bankruptcy court to determine that the termination was effective pre-petition.
3. If termination of the license is desired after bankruptcy, file a motion to shorten the time for assumption or rejection of executory contracts under Section 365(d)(2), a motion for a determination that the license may not be assumed or assigned under Section 365(c)(1) or a motion for relief from the automatic stay under Section 362(d).
4. If payments by the trustee or debtor in possession are not being made after bankruptcy, file a request for allowance and payment of an administrative expense under Section 503(b)(1)(A) or to compel assumption of the license under Section 365(d)(2).
5. If actions by the trustee or debtor in possession are required to protect the non-debtor’s interests during the bankruptcy, file a motion for adequate protection.
6. Be vigilant during the case and object to sale motions, Chapter 11 plans or other actions by the trustee or debtor in possession to the extent they violate the non-debtor’s intellectual property rights.

II. Is a license an executory contract?

A. General Principles

Only contracts which are executory may be assumed, assigned, or rejected under Section 365 of the Bankruptcy Code. The Bankruptcy Code does not define “executory.” Bankruptcy courts most often cite the definition developed by Professor Vern Countryman for whether a contract is executory. Under the Countryman definition, a contract is executory where both the debtor and the non-debtor party have unperformed obligations such that failure of either to complete performance would constitute a material breach excusing the performance of the other.

As a general rule, non-exclusive licenses of intellectual property are considered executory contracts, whereas exclusive licenses are not. Whether sufficient
performance remains due on both sides for the contract to be executory is frequently a difficult question. Negative covenants have been determined to be sufficient to make a contract executory. Even the common license agreement provision prohibiting the parties from suing for infringement has been construed as sufficient for a license agreement to remain executory.

B. Practice Tip

It is extremely difficult for non-debtor licensees to prevent rejection based on lack of executory duties. However, see infra as to Section 365(n) protections for licensees.

III. Can a license be assigned to a third party by a bankruptcy trustee or debtor in possession?

A. General Principles

An executory contract must be assumed in order to be assigned under §365. Absent consent by non-debtor patent or copyright licensors, both assumption and assignment are prohibited in many circuits. Even in circuits where assumption may be permissible, assignment will be prohibited unless the licensor consents.

1. Anti-assignment provisions are unenforceable in run-of-the-mill executory contracts.

Assignment of a lease or contract relieves the bankruptcy estate of liability for any future breach. A trustee or debtor in possession may usually assign an executory contract or unexpired lease regardless of anti-assignment provisions. If anti-assignment provisions are to be overridden, the trustee or debtor in possession must first assume the contract or lease, including provision for cure of defaults, and, as discussed above, provide adequate assurance of performance by the assignee regardless of whether there had been a previous default. Courts have construed contract provisions as the equivalent of unenforceable anti-assignment clauses where the effect of the provision is to restrict assignment.

2. Licenses are inherently non-assignable without licensor consent.

A debtor in possession or trustee may not assign an executory contract if applicable law would excuse the non-debtor party from accepting performance or rendering performance to the trustee or assignee and the non-debtor party does not consent to assumption or assignment. This prohibition will generally include personal service contracts. Applicable non-bankruptcy law may also include government regulations barring assignment of particular contracts.

Inherent non-assignability is a major issue with intellectual property licenses. Courts have opined that contracts in which the debtor is licensee of a patent are
inherently non-assignable under federal common law absent the licensor’s consent.\textsuperscript{28} The Ninth Circuit reached the same conclusion for both copyright licenses and patent licenses.\textsuperscript{29} There have now been many cases addressing whether the licensee’s interest in a patent, copyright, or trademark license can be assigned. Some of those address whether exclusive as well as non-exclusive licenses are inherently non-assignable without consent.\textsuperscript{30} Federal common law holds that a trademark licensor’s consent is required to transfer or sublicense a trademark license, and thus, a trademark license is non-assignable in bankruptcy.\textsuperscript{31}

For debtors, trustees, and secured creditors, this “inherent non-assignability” is a major factor. As many high-tech and telecom bankruptcies involve liquidations, inherent non-assignability can be significant. Even liquidation of computer hardware can trigger an objection to transfer of software contained or included in the equipment.

However, although, hypothetically, a licensor may block assignment, that does not mean the licensor will not consent to assignment. Often, licenses contain conditional assignment rights that are much broader than the limited right to assign the license to affiliates or at the discretion of the licensor. Obtaining consent to assignment of the license is not only important for the licensee, but also for any secured lender relying on the existence of the license rights for its perceived collateral value.

**B. Practice Tips**

1. Be vigilant and object to the motion to assign the license or to a Chapter 11 plan providing for such an assignment.

2. Define in the license agreement what constitutes adequate assurance of future performance, such as net worth or capital requirements, performance benchmarks, non-compete clauses, and scope limitations. Provisions must be applicable to the original licensee as well as any permitted assignee.

**IV. Can an intellectual property license ever be assumed by a bankruptcy trustee or debtor in possession without consent? (The “Catapult” Problem)**

**A. General Principles**

Where the debtor licensee would like to continue to use the intellectual property in its own business, the licensee will seek to assume the license. In the majority of federal circuits, where assignment is prohibited without the consent of the licensor, the debtor in possession or trustee will be precluded from assuming the license, even though no assignment is contemplated.
Because of the presumption that a Chapter 11 debtor will reorganize and retain its assets, the mere filing of a Chapter 11 case alone arguably does not implicate the federal policy of “inherent non-assignability” of patent or copyright licenses, regardless of theoretical arguments that the bankruptcy filing creates a transfer to the bankruptcy estate. Generally, the creation of a bankruptcy estate does not of itself create a transfer to the trustee or debtor in possession, triggering anti-assignment concerns. However, 11 U.S.C. § 365(c) provides:

(c) The trustee may not assume or assign any executory contract or unexpired lease of the debtor, whether or not such contract or lease prohibits or restricts assignment of rights or delegation of duties, if—

(1)(A) applicable law excuses a party, other than the debtor, to such contract or lease from accepting performance from or rendering performance to an entity other than the debtor or the debtor in possession whether or not such contract, or lease, prohibits or restricts assignment of rights or delegation of duties; and

(B) such party does not consent to such assumption or assignment;

A literal reading of the statute leads to the so-called “hypothetical” test, which holds that if an executory contract may not be assigned to a third party under applicable non-bankruptcy law, then it cannot even be assumed by the trustee or debtor-in-possession for use by the reorganized debtor post-bankruptcy. It requires courts to decide whether, under applicable law, assignment to a third party would be forbidden. A less literal reading of the statute has led some courts to look to whether actual assignment will occur (the “actual” test). Until the split in the circuits regarding non-assumability of inherently non-assignable contracts is resolved by Congress or the U.S. Supreme Court, absent consent of the licensor, a Chapter 11 debtor in at least the Third, Fourth, Ninth, and Eleventh Circuits may not assume a copyright or patent license in which the debtor is licensee. The First and Fifth Circuits, on the other hand, follow the “actual” test. At least one bankruptcy judge in the Southern District of New York also follows the “actual” test, where the debtor in possession has no intent to assign the license.

Two factors are important in avoiding the potentially harsh effects of Section 365(c)(1). First, consent by the licensor avoids the problem. If the licensor has conditionally consented to assignment in the license itself, the license should be assumable and assignable, subject to satisfying the assignment conditions. Secondly, although Section 365(c)(1) may prohibit assumption or assignment without the licensor’s consent, it does not compel rejection at any specific date. This allows the estate to utilize the license during the potentially lengthy limbo period, unless the licensor can convince the court that rejection should be
compelled early.\textsuperscript{34}

It is important to note, however, that the Bankruptcy Court for the District of Delaware, at least, has held that the Catapult problem (see footnote 32) cannot be avoided by attempting to sell the license without assumption, because until assumed, an executory contract is not an asset of the estate and cannot be sold.\textsuperscript{35}

Even if the debtor in possession or trustee is able to overcome the restrictions of Section 365(c)(1) of the Bankruptcy Code, it still may not assume the license unless the bankruptcy estate provides cure or adequate assurance of prompt cure of any existing defaults (except unenforceable provisions discussed below), compensates the non-debtor party for loss resulting from the default and provides adequate assurance of future performance under Section 365(b)(1) and (f)(2)(B).

The term “adequate assurance” is not defined in the Code. However, most courts have held that the term was intended to be given a practical, pragmatic construction.\textsuperscript{36} Simply put, the test is whether the debtor has established a foundation that is non-speculative and sufficiently substantive to warrant the reasonable conclusion that the default will be cured and all obligations performed as required under the contract.\textsuperscript{37}

B. Practice Tips

1. To address case law prohibiting assumption of intellectual property licenses, the licensee will want the license to allow assumption or retention of the license in a bankruptcy proceeding, even when the license prohibits or restricts assignment. The licensor might limit any such “consent to assumption” provision to situations that do not involve an actual change of control over the licensee.

2. The debtor licensee will want to ensure that the licensor consents to assumption and assignment. Prior to filing for bankruptcy, the debtor should review all of its licenses to determine those that require licensor consent. If consent is required and licensors are unwilling, the debtor licensee may wish to consider alternatives to bankruptcy, and, if bankruptcy is necessary, whether a venue that applies the actual test is available.

3. The non-debtor licensor should be vigilant and object to a Chapter 11 plan or motion to assume the license to the extent that such an objection makes business sense. An assumption may actually be good for a licensor who wishes to have defaults cured rather than to deny ongoing use to the debtor in possession or trustee. In that case, the licensor should confirm that the cure amount to be paid in connection with assumption is accurate and is to be promptly paid.
V. What happens if a license is rejected by a trustee or a debtor in possession?

A. General Principles

1. Rejection is subject to the business judgment test.

Executory contract rejection is automatic in Chapter 7 liquidation cases, if the trustee does not assume the contract within 60 days or such further period as extended by court order. Except for automatic rejection in Chapter 7 cases, the bankruptcy court must approve a request by the debtor in possession or trustee to reject an executory contract. The standard generally followed is the so-called "business judgment" test. Under that test, rejection is a management decision within the reasonable business judgment of the debtor or trustee and will not readily be second guessed by the court.38

Although the business judgment test is typically construed as extremely deferential to the trustee or debtor in possession, where rejection would be provably detrimental to the estate or the benefits of rejection extremely speculative, the court may disapprove.39 Occasionally, some courts have also considered the disproportionate impact of rejection on the non-debtor party in comparison to any asserted benefit to the bankruptcy estate.40 Similarly, courts will refuse to allow rejection for an improper purpose.41

Section 365(n) of the Bankruptcy Code (as discussed infra) may limit the reasonableness of rejection. In Matusalem & Matusa of Florida, Inc., 158 B.R. 514 (Bankr. S.D. Fla. 1993), the debtor owned intellectual property, including a secret formula and a trademark.42 The debtor sought to reject a franchise agreement, pursuant to which the franchisee/licensee enjoyed the exclusive right to use certain secret processes and formulas for the manufacture of rum products, the exclusive right to use the name “Matusalem” and related names for the sale of those rum products, and the exclusive right to manufacture, distribute, and sell those rum products in Puerto Rico, the United States, and Central and South America. The franchisee paid an initial fee and had the obligation to pay royalties during the life of the agreement.43 The bankruptcy court found that the debtor had not been engaged in active business operations involving the distillation, distribution, or sale of rum products for about twelve years, yet the debtor was “seeking to begin a new speculative business venture by destroying its franchisee . . . and then operating a rum distillation and distribution company in the same manner as a managed health care business. The court is persuaded that this is not good business judgment.”44 Furthermore, the court found that “[e]ven if rejection were permitted, it would not automatically result in the termination of [franchisee’s] exclusive rights to manufacture and sell these products within its territorial area. . . Thus, rejection under § 365(n) would not deprive [franchisee] of its rights under the franchise agreement. It would, however, make the Debtor potentially liable for a rejection claim.”45 There would be no benefit to the estate,
and thus the court denied rejection.

2. Rejection of one license may constitute a default under another.

Even prior to the enactment of the current Bankruptcy Code, executory contracts and leases had to be assumed in their entirety. A debtor in possession or trustee could not pick and choose those portions that it wished to enforce and those portions that it wished to reject. However, the Ninth Circuit Bankruptcy Appellate Panel has held that a court may construe multiple obligations in an agreement as severable under state law, thus allowing assumption of specific obligations.

This requirement generally includes adherence to cross-default provisions. However, some courts have relied on equitable grounds in refusing to honor cross default provisions. Such courts analogize particularly onerous cross default provisions to unenforceable ipso facto and anti-assignment clauses.

3. Section 365(n) provides special protection to licensees of intellectual property against the impact of rejection.

Because of the harsh impact of rejection, certain classes of non-debtor parties have been provided with protection under the Bankruptcy Code, mitigating the effects of rejection. For example, where the debtor is a lessor of real property or timeshare interests, the non-debtor lessee or timeshare lessee has the option of treating the lease or timeshare plan as terminated or, in the alternative, remaining in possession of the leasehold or timeshare interest for the balance of the term and any renewal periods, provided that the lessee or timeshare participant pay the rent reserved under the lease or moneys due under the timeshare agreement for the balance of the term, less any damages for future non-performance of obligations of the debtor. Special protection also exists for non-debtor real estate vendees.

In response to the harsh result in cases allowing rejection of intellectual property contracts, such as Lubrizol Enterprises, Inc. v. Richmond Metal Finishers, Inc., 756 F.2d 1043 (4th Cir. 1985), Congress amended Section 365 of the Bankruptcy Code to protect non-debtor licensees of intellectual property. In the event of rejection, the non-debtor licensee may elect to treat the contract as terminated or retain its license rights for the duration of the contract and any applicable extensions. If the licensee elects to retain its rights, it must make all royalty payments and waive claims and offset rights for prior non-performance. The licensee cannot, however, enforce obligations of the debtor to provide maintenance, technology updates or other services.

Care should be taken in drafting so that the royalty to be paid for retaining the intellectual property rights does not include payment for services no longer performed by the debtor after rejection or for post-petition, post-rejection improvements or modifications.
Buyers of intellectual property, even free and clear of liens, need to be aware that such a sale may be subject to the Section 365(n) rights of licensees, even if those licenses are not assigned under the purchase agreement.\textsuperscript{52}

If the licensee retains its rights, the trustee must continue to provide it with any intellectual property held by the trustee and not interfere with the licensee’s right to obtain the intellectual property from another entity.\textsuperscript{53} Section 365(n) also requires the trustee or debtor in possession to continue to provide the licensee with the intellectual property in the limbo period prior to rejection or assumption. For example, a licensee should be provided access to software source code held in escrow pursuant to a license even during the limbo period.\textsuperscript{54} Another consequence of the provision limiting retained rights to “…such rights as existed immediately before the case commenced…” is that the license must exist pre-petition. The license can not spring into existence post-petition pursuant to a pre-petition contract term.\textsuperscript{55} Also, the protected rights do not include the right to future intellectual property, coming into existence post-petition.

There are also some limitations on the range of intellectual property interests protected under Section 365(n). Section 101(35)(A) of the Bankruptcy Code defines intellectual property as including trade secrets, inventions and works of authorship protected under Title 17, but does not include trademarks. Thus, a non-debtor licensee of trademarks is not protected under §365(n) in the event of rejection of the license agreement. This is an important exclusion from Section 365(n) protections.\textsuperscript{56}

In the Seventh Circuit, a licensee of intellectual property may not be able to rely on Section 365(n) to afford it protection in the event of a sale free and clear of liens, claims and interests. In a case that addressed the right of a lessee of real property to retain its rights under the lease following a sale “free and clear,” the Seventh Circuit held that despite the protections granted by Section 365(h), the lessee’s interest was extinguished by a sale free and clear of interests under Section 363(f). It stated that “Congress authorized the sale of estate property free and clear of ’any interest,’ not ‘any interest except a lessee’s possessory interest.’” Section 365(h) grants certain protections to lessees of real property, allowing them to remain in possession for the balance of the lease term following a rejection of the lease by the debtor/landlord.\textsuperscript{57} By analogy, the Seventh Circuit’s logic could be equally applicable to the interest of a licensee of intellectual property to retain its rights under Section 365(n). At least one bankruptcy court has refused to follow the Seventh Circuit in the context of Section 365(h).\textsuperscript{58}

4. Rejection may impact rights of secured creditors in a license and prior transfers of interests in the intellectual property.

Rejection of an executory contract does not retroactively void the agreement; it merely excuses the bankruptcy estate’s future performance and creates a damage
claim for breach of performance. Non-executory aspects of an agreement are not disturbed. Asset transfers completed prior to rejection are not generally affected. Thus, the security interests perfected pre-petition survive regardless of later rejection of the lease or contract as to which the security interest was granted.\(^5\)

Similarly, rejection does not terminate the non-debtor party’s rights against non-debtor obligors or guarantors. Numerous courts have referred to Section 365(n) to support the holding that rejection of an executory contract is not the equivalent of termination of such contract. Section 365(n) demonstrates this distinction, because it plainly states that rejection does not result in termination unless the licensee elects to treat an interest as terminated.\(^6\)

**C. Practice Tips**

1. Draft the original license agreement to expressly refer to and state that it is subject to Section 365(n). The license agreement should also provide that the failure to perform continuing obligations constitutes a material breach of the contract excusing performance by the licensee, or otherwise define events constituting a material breach, so as to increase the likelihood that it will be considered an executory contract.

2. The license agreement should require the licensor to provide the licensee any intellectual property and any embodiment of that intellectual property held by the licensor, adequately described.

3. The license agreement should permit the licensee to provide the licensed intellectual property to third parties without violating non-disclosure or exclusivity provisions.

4. The license agreement should separate “royalty payments” made for the use of the intellectual property itself from the payments made for other services. Alternatively, the license may provide for reduction of royalty payments in the event of non-performance of maintenance, support and upgrade provisions by the licensor. Trademark royalties should be spelled out separately and reduced in the event of non-performance by the licensor.

5. The license agreement should require technology escrows and recovery of the escrowed materials during a bankruptcy case. In a technology escrow, the parties entrust essential information and data, such as source code, with a trusted third party.

6. The licensee may be able to create a disincentive to rejection through special termination fees or liquidated damage provisions accelerating payment of future royalties.
7. Whether a licensee or licensor, consider taking a security interest in the counterparty’s interest in the intellectual property.

8. A lender with a security interest in intellectual property should obtain from the licensor an agreement to provide the lender with notice and opportunity to cure defaults, as well as permission to take an assignment of the license and to further assign the license to an eventual purchaser. The lender might also seek agreement from the licensor to enter into a replacement license if the borrower’s license is rejected in bankruptcy. If a lender has been granted a security interest in the executory contract itself, this collateral is at risk in the event of rejection.

9. Be vigilant and prepared to object to a motion to reject the license, a motion to sell the underlying intellectual property free of liens and interests or the confirmation of a Chapter 11 plan so providing.

VI. Can assumption, assignment, and rejection issues be avoided by “ride through”?

A. General Principles

Some commentators have suggested the employment of a “ride through” strategy to avoid the potentially harsh effects of the “hypothetical test.”61 This strategy is premised on the fact that the Bankruptcy Code contains no formal requirement that a debtor in possession reject or assume an executory contract, and involves simply allowing the contract to “ride through” the bankruptcy without rejection or assumption, until it re-vests in the reorganized debtor.62

At least two bankruptcy courts have permitted the use of the “ride through” strategy with respect to an exclusive patent license. In In re Hernandez, 287 B.R. 795 (Bankr. D. Ariz. 2002), the court held that a license could "ride through" and become binding on the reorganized debtor. In doing so, the court applied a four factor test to determine whether a ride through should be permitted. The four factors are (1) the damage that other party to contracts would suffer, beyond compensation available under the Bankruptcy Code; (2) the importance of the contracts to the debtor's business and reorganization; (3) whether the debtor has had sufficient time to appraise its financial situation and potential value of its assets in formulating a plan; and (4) whether the exclusivity period has terminated. Hernandez, 287 B.R. at 806.63

Similarly, in In re JZ, LLC, Case No. 01-03545-TLM, ______ B.R. ___, 2006 WL 3782988 (Bankr. D. Id. Dec. 21, 2006), the court held that a license to manufacture and distribute a patented grinder “rode through” a completed Chapter 11 case.
Other commentators have been wary to suggest the “ride through” strategy, noting that in some circuits, the failure to formally assume an executory contract may be fatal, leaving the licensor with a post-confirmation argument that the license was rejected. Moreover, it is important to note that many contracts have ipso facto clauses, which although unenforceable under Section 365(e)(1), cannot be avoided except through the assumption of the contract. Thus, in most situations, “ride through” may not be possible. In particular, under the 2005 changes to the Bankruptcy Code, “ride through” is expressly not available to individual debtors who are lessees under unexpired personal property leases.

B. Practice Tips

1. Ensure that the license is definitively dealt with in the bankruptcy either through assumption or rejection in order to reduce uncertainty.

2. Consider “ride through” in circuits where the hypothetical test is employed.

VII. Conclusion

Knowledge of the impact of bankruptcy on intellectual property licenses is of importance to licensors, licensees, and secured lenders in maximizing the value of their intellectual property rights and collateral. The potentially harsh effects of anti-assignment restrictions and the prohibition on assumption of non-assignable contracts can be overcome by obtaining the prior consent of the licensor to assignment. Debtors in possession and trustees should also analyze what potential use can be made of existing license rights during the bankruptcy case even if, ultimately, the license must be rejected.

Licensors should keep in mind the benefits of moving early for assumption or rejection of the license, especially if it is uncertain whether post-petition use of the licensed rights will result in a priority administrative claim.

Licensees should maximize the protection against rejection provided in 11 U.S.C. § 365(n) and realize its limitations and restrictions. Trademark licenses are not protected under Section 365(n). Future improvements and modifications to patented inventions or copyrighted work created after the date of petition are not protected. Additionally, Section 365(n) provides no protection for license rights “springing into existence” after the date of the petition. Besides providing source code escrows or equivalent protections to fully take advantage of the rights provided under Section 365(n), licensees may also want to consider taking a security interest in the underlying intellectual property rights of the licensor to secure any actual damages resulting from rejection or non-performance of the license. Finally, to avoid litigation over the extent of royalty payments to be paid by the licensee for continued utilization of the license rights, the royalty being paid for the intellectual property should be specifically defined separately in the license from any
consideration being paid for other services or rights provided in the same contract.

2 For example, in In re Valley Media, Inc., 279 B.R. 105, 143 (Bankr. D. Del. 2002) (holding that vendors of copyrighted compact discs, DVDs, and VHS tapes could block post-petition distribution of the copyrighted material where license was terminated pre-petition).
3 In re AGI Software, 199 B.R. at 860 (granting declaratory judgment against non-debtor licensee that no rights existed under Section 365(n) where debtor licensor terminated license pre-petition).
4 See, e.g., In re Waterkist Corp., 775 F.2d 1089 (9th Cir. 1985) (possession of leasehold premises coupled with state anti-forfeiture laws may allow debtor to assume purportedly terminated lease).
6 11 U.S.C. § 544(a)(1), (b)(1); In re World Auxiliary Power Co., 303 F.3d 1120 (9th Cir. 2002) (holding that strong-arm power could not avoid security interest in unregistered copyrights as UCC filing was sufficient to perfect); In re Peregrine Entert., Ltd., 116 B.R. 194 (C.D. Cal. 1990) (holding that secured creditor’s interest in registered copyrights could be avoided using strong-arm powers where no filing was made with the United States Copyright Office).
7 In re Valley Media, Inc., 279 B.R. at 138 (citing In re West Electronics, Inc., 852 F.2d 80, 82 (3rd Cir. 1988)).
8 See, e.g., In re Computer Communications, Inc., 824 F.2d 725 (9th Cir. 1987) (substantial damages awarded against non-debtor party where, absent court order, the non-debtor party purported to exercise an “at-will” contract termination provision); see also In re Redpath Computer Servs., 181 B.R. 975 (Bankr. D. Az. 1995). But see In re Lucre, Inc., 339 B.R. 648, 657 (Bankr. W.D. Mich. 2001) (holding that non-debtor party’s performance under executory contract cannot be compelled by debtor pending assumption where defaults by debtor exist).
9 See In re Valley Media, Inc., 279 B.R. at 137.
12 See, e.g., In re Dant & Russell, Inc., 853 F.2d 700, 707 (9th Cir. 1988); In re Coast Trading Co., 744 F.2d 686 (9th Cir. 1984); Union Leasing Co. v. Peninsula Gunite, Inc., 24 B.R. 593 (Bankr. 9th Cir. 1982); see also In re National Refractories & Minerals Corp., 297 B.R. 614, 618 (Bankr. N.D. Cal. 2003) (noting that requirement of benefit to estate in Dant & Russell has been superseded by statute in Section 365(d)(3) as to unexpired leases of non-residential real property).
13 See, e.g., In re Kmart Corp., 293 B.R. 905 (Bankr. N.D. Ill. 2003) (software provider’s post-petition software modifications for use in store that never opened were of no value to estate).
14 See In re DAK Indus., 66 F.3d 1091 (9th Cir. 1995).
16 See, e.g., In re Tobago Bay Trading Co., 112 B.R. 463, 466-67 (Bankr. N.D. Ga. 1990) (lease provision prohibiting tenant’s liquidation sale was invalid); In re Garnas, 38 B.R. 221 (Bankr. D.N.D. 1984) (non-renewal of insurance policy based on debtor’s financial problems); In re B. Siegel Co., 51 B.R. at 164 (“terminable at will” provision in insurance policy surprisingly interpreted as unenforceable ipso facto clause within the scope of Section 365(e)(1)).
17 In re Footstar, Inc., 337 B.R. 785 (Bankr. S.D.N.Y. 2005) (holding that non-debtor party to executory contract was not entitled to enforce ipso facto clause where debtor did not intend to assign license.)


See, e.g., In re Rovine Corp., 5 B.R. 402 (Bankr. W.D. Tenn. 1980) (covenant not to compete sufficient); Lubrizol Enters. v. Richmond Metal Finishers, Inc., 756 F.2d 1043 (4th Cir. 1985) (technology licensor's duty to defend intellectual property rights, indemnify licensee and maintain confidentiality sufficient); In re Select-A-Seat Corp., 625 F.2d 290 (exclusive licensor's duty not to further license held sufficient). But see In re Stein & Day, Inc., 81 B.R. 263 (Bankr. S.D.N.Y. 1988) (non-debtor author's duty to indemnify publisher and offer future books for publication insufficient); see also In re Monument Record Corp., 61 B.R. 866 (Bankr. M.D. Tenn. 1986) (employment contract in which non-debtor artists had no further obligation to record).


See, e.g., In re Standor Jewellers West, Inc., 129 B.R. 200, 201-02 (Bankr. 9th Cir. 1991) (lease provision requiring remittance to lessor of proceeds of assignment deemed invalid under Section 365(f)); In re Peaches Records & Tapes, Inc., 51 B.R. 583, 590 (Bankr. 9th Cir. 1985); In re Vista VI, Inc., 35 B.R. 564, 567-68 (Bankr. N.D. Ohio 1983) (invalidating provision requiring tenant to operate under specific tradename).


27 See, e.g., In re West Electronics, Inc., 852 F.2d 79 (non-assignable government contract); In re Pioneer Ford Sales, Inc., 729 F.2d 27 (1st Cir. 1984) (franchise agreement where state law prohibited transfer without manufacturer's consent); In re Braniff Airways, Inc., 700 F.2d 935 (5th Cir. 1983) (restricted airport gate slots); In re Nitec Paper Corp., 43 B.R. 492 (S.D.N.Y. 1984) (special low rate electricity supply contract).


29 Harris v. Emus Records Corp., 734 F.2d 1329 (9th Cir. 1984) (citing patent cases by analogy); Everex Systems, Inc. v. CadTrax Corp. (In re CFLC, Inc.), 89 F.3d 673 (9th Cir. 1996) (non-exclusive pre-paid patent license not assignable in bankruptcy); In re Catapult Entert., 165 F.3d at 749-50 (non-exclusive patent license).


34 See, e.g., In re Valley Media, 279 B.R. 105.
41 See, e.g., In re Waldron, 785 F.2d 936 (11th Cir. 1986) (bad faith dismissal of Chapter 13 by bankruptcy attorney filed for purpose of rejecting unprofitable option agreement); In re Noco, Inc., 76 B.R. 839 (Bankr. N.D. Fla. 1987) (solvent debtors filed case to reject covenant not to compete; franchise agreement had also been substantially performed and was therefore non-executory).
42 Note that defining a trademark as intellectual property conflicts with Licensing by Paolo, Inc. v. Sinatra (In re Gucci), 126 F.3d 380 (2d Cir. 1997).
43 See 158 B.R. at 516.
44 Id. at 521.
45 Id. at 522.
47 In re Pollock, 139 B.R. 938 (Bankr. 9th Cir. 1992).
49 See, e.g., In re Sambo’s Restaurants, Inc., 24 B.R. 755 (Bankr. C.D. Cal. 1982) (court refused to enforce cross-default provisions applying to 10 separate leases of restaurant properties to the debtor); In re Wheeling-Pittsburgh Steel Corp., 54 B.R. 772 (Bankr. W.D. Pa. 1985) (court refused to enforce cross-default provisions in four insurance policies tied to delinquent fifth policy), aff’d, 67 B.R. 670 (W.D. Pa. 1986); see also In re Madison’s Partner Group, Inc., 67 B.R. 633 (Bankr. D. Minn. 1986) (court required showing of “special consideration” furnished by Lessor to enforce cross-default tied to contract to which debtor was not a party).
51 See Encino Business Mgmt. v. Prize Frize, Inc. (In re Prize Frize, Inc.), 32 F.3d 426 (9th Cir. 1994).
52 In re Cellnet Data Sys., 327 F.3d at 252 (requiring purchaser of intellectual property rights from debtor to comply with rejected license obligations while debtor remains entitled to royalty payments from licensee).
53 See In re El Int’l., 123 B.R. 64, 66 (Bankr. D. Id. 1991) (holding that license was treated as terminated with damages calculated as if license were breached pre-petition where licensee did not affirmatively elect to retain benefits).
56 In re Gucci, 126 F.3d at 394 (concluding that trademarks are not intellectual property for the purposes of Section 365(n)).
57 Precision Indus., Inc. v. Qualitech Steel SBQ, LLC, 327 F.3d 537, 548 (7th Cir. 2003).
62 As explained by the Fifth Circuit, “If an executory contract is neither assumed nor rejected, it will ‘ride through’ the proceedings and be binding on the debtor even after a discharge is granted, thus allowing the non-debtor's claim to survive the bankruptcy.” In re National Gypsum Co., 208 F.3d 498, 504 n.4 (5th Cir. 2000) (citing Federal's, Inc. v. Edmonton Inv. Co., 555 F.2d 577, 579 (6th Cir. 1977)).
63 The test employed by the court was originally set out by the Second Circuit in Theatre Holding Corp. v. Mauro, 681 F.2d 102 (2d Cir. 1982), to determine whether a debtor should be allowed to delay the assumption or rejection of an executory contract. See In re Adelphia Communications Corp., 291 B.R. 283, 292 (Bankr. S.D.N.Y. 2003) (noting that Theatre Holding factors were developed and applied to unexpired lease of non-residential real property prior to amendment of Section 365(d)(4) shortening time to assume or reject this type of lease, but that otherwise determination of enlargement of time is left to court’s discretion).
64 See, e.g., David R. Kuney, Intellectual Property Law in Bankruptcy Court: the Search for a More Coherent Standard in Dealing With a Debtor’s Right to Assume and Assign Technology Licenses, 9 Am. Bankr. Inst. L. Rev. 593, 636 (citing Sea Harvest Corp. v. Rivierra Land Co., 868 F.2d 1077, 1079 (9th Cir. 1989) (the statutory presumption of rejection, unless the debtor or trustee acts affirmatively to assume a lease, protects the estate from unexpected liability)).
WORKING CAPITAL ADJUSTMENT ISSUES ENCOUNTERED IN ASSET SALES OF INSOLVENT COMPANIES - A (SELLER’S) PERSPECTIVE

By Sheryl E. Seigel, Vice-Chair, Use and Disposition of Assets Subcommittee

Going concern sales of insolvent companies are often done under pressure, within a restricted time frame and with the input of stakeholders other than the seller and buyer. The end result sometimes is a purchase agreement that is clear as to the stated purchase price and other deal terms, but has ambiguities relating to post-closing adjustments that can materially affect the final consideration to be paid. Increasingly, it seems that post-closing adjustment provisions are providing fertile grounds for disputes. Even so, these critical provisions within a purchase agreement do not always draw the attention that they merit at the time the agreement is being negotiated.

When a debtor is insolvent and its operating funding may be restricted, purchase agreements are often negotiated in a matter of days in an extremely pressured environment. Part of the consideration being paid very often relates to working capital assets, the value of which does not remain constant. There are tensions, of course, in arriving at the amount to be paid for such assets on closing. The seller wants to receive value for those assets that exist on closing, including any new value it has generated by operating the business until closing (and, conversely, recognizes that it will not be reimbursed for a deterioration in asset value, should that occur). The buyer does not want to overpay for the assets it is buying and may be working toward maintaining a particular net asset value that it has targeted to be there on closing and upon which it has based the offered purchase price.

In a perfect world, sellers would try to negotiate a deal that provides for a fixed and non-adjustable purchase price paid in its entirety on closing. The uncertainty inherent in fixing a
final price weeks or months before a deal is closed, particularly in the case of an insolvent
business whose performance has not been constant, would cause a buyer to very conservatively
value, or perhaps undervalue, the working capital assets, deflating the purchase price to such a
degree as to make this an unattractive option. Hence, the need for a post-closing mechanism that
adjusts the purchase price.

Ideally, the adjustment mechanism should reflect the intentions and expectations of both
parties. Often purchase agreements will include a seemingly simple and straightforward working
capital adjustment mechanism. This compares an estimated closing date calculation or base upon
which the purchase price paid on closing is calculated, with a final calculation done post-closing.
It then provides for payment of the difference to the seller or buyer, as the case may be. When
settling the amount of the post-closing adjustments to be paid, however, even well-intentioned
parties may discover that they have very different views of what should be the final result. These
difficulties can become further complicated if the purchase agreement is silent or unambiguous
on key matters and if the process for resolving disputes that do arise is also open for
interpretation or dispute.

The inherent challenge in preparing and negotiating post-closing adjustment clauses is
that there is no one-size-fits-all solution. As a result, recourse to precedent is often not enough.
Another challenge is that these provisions typically incorporate accounting concepts and
terminology as to which the lawyers drafting the agreement may have basic, but not in-depth,
knowledge. Often these provisions do not address adequately – or at all – some of the issues that
arise when the parties finally turn their minds, post-closing, to the settlement of the post-closing
adjustments.
This failure can be the result of a number of factors, including time constraints, the lack of input from accountants, and the lack of critical input from business people and in-house counsel at the seller. Sometimes the momentum to get a deal signed dominates negotiations, with the business people preferring to leave contentious or unsettled issues to be worked through at a later date.

By engaging from the start with the seller’s accountants and business people, so that they are attuned to the techniques a buyer may use to try to dispute the final calculation of the working capital adjustment, counsel may become alerted to potential areas of concern. This will permit counsel to draft an agreement that can address some of the more significant issues that may generate disputes, thereby reducing the prospects for prolonged battles over the post-closing adjustments and generating a more favourable outcome if it becomes necessary for these disputes to be determined by third parties.

The Use and Disposition of Property Subcommittee will be presenting a program entitled, “Just When you Think the Deal is Done...Strategies for Minimizing Post-Closing Adjustment Disputes and Other Tribulations” on Friday March 16, 2007. Among the topics we will cover are:

- Understanding underlying dynamics and tensions affecting the seller and buyer and how this impacts on their objectives in approaching purchase price adjustments.
- Identifying issues that may give rise to disputes in resolving purchase price adjustments, including issues surrounding the use of the GAAP standard in many working capital adjustment clauses.
- Strategies for drafting purchase agreements that will minimize disputes and improve results.

The program will have a practical orientation and for this reason our panel includes two non lawyers: **Gerard L. Yarnall** of Deloitte Financial Advisory Services who is an accountant with considerable expertise in dealing with post-closing adjustment disputes; and **Charles F. Mueller**
of Raytheon Corporation, who can provide a unique client-side perspective. Gerry and Charlie each have a wealth of experience when it comes to selling businesses and have encountered their fair share of post-closing adjustment disputes. Rounding out the panel will be Carmen H. Lonstein of Bell Boyd & Lloyd LLP and Sheryl E. Seigel of Lang Michener LLP who will provide insight into some of the issues and challenges that lawyers face in drafting and interpreting purchase price adjustment provisions. Moderating the panel will be Steven Cousins of Armstrong Teasdale LLP. The panel will lead a discussion that deals with issues and alternatives facing professionals in negotiating, drafting and interpreting purchase price adjustment clauses and review some of the real life problems that occur when purchase agreements are interpreted and litigated by parties with very different goals and agendas. We anticipate and will encourage participation among those attending the program in order that all of us may share our collective experience and wisdom in tackling these issues.

This is a topic that affects bankruptcy and non-bankruptcy business lawyers alike, so feel free to pass along information about our program to others at your firm who may be attending. We look forward to you joining us in D.C.

For more information about this program, please feel free to contact Sheryl E. Seigel by email at <ssseigel@langmichener.ca> or by telephone at 416-307-4063.
HOW TO COMPLETE A PROOF OF CLAIM:  
A PRIMER FOR NON-BANKRUPTCY PRACTITIONERS  

by Margaret M. Anderson and Folarin S. Dosunmu 
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Come to the ABA Business Law Section Meeting and learn how to properly file a proof of claim. On Friday, March 16, 2007 from 2:30-4:00 p.m., the Panel will explore the 5 W’s (and one H) of proofs of claim: What is a proof of claim? Who may file a proof of claim? When must a proof of claim be filed? Where do I file my proof of claim? Why does a proof of claim need to be filed? How do you properly file a proof of claim and its accompanying exhibits? Bankruptcy practitioners will also share their knowledge on common errors made in filing proofs of claim and successful methods to remedy those errors. The program will be directed to both non-bankruptcy practitioners and bankruptcy practitioners alike.

Questions Frequently Asked by Non-Bankruptcy Practitioners

**What Is a Proof of Claim?**

A proof of claim is a written statement, usually filed by a creditor, describing the reason for and amount of the debt allegedly owed by the debtor to the creditor. Official Form B10, which is used in completing a proof of claim, is available at the websites of most bankruptcy courts. 11 U.S.C. §§ 501 and 502 and the Federal Rules of Bankruptcy Procedure (“FRBP” or “Bankruptcy Rules”) 3001, 3002, 3003, 3005, 3006, 3007 and 3008 govern the manner in which creditors and equity security holders present their claims or interests to the bankruptcy court. There are varying rules depending on the respective chapter in which the debtor seeks protection. The different rules for filing, allowance and disallowance will be highlighted in our program to reflect the different bankruptcy chapters: Chapter 7 (liquidation); Chapter 9 (municipality debt
adjustment); Chapter 11 (reorganization); Chapter 12 (family farmer/family fisherman debt adjustment); and Chapter 13 (individual debt adjustment).

Who May File a Proof of Claim?

11 U.S.C. § 501 and FRBP 3001 generally governs who may file a proof of claim. Usually, creditors file proofs of claim against the debtor. However, § 501 of the Bankruptcy Code, does allow for the trustee, the debtor or any entity liable to the creditor for the debt owed by the debtor to file a proof of claim if the creditor fails to do so.

In a Chapter 7 or 13 case, an unsecured creditor must file a proof of claim in order to participate in the claims adjudication process. In a Chapter 9 or 11 case, any creditor or equity security holder whose claim or interest is not scheduled by the debtor or is scheduled as disputed, contingent, or unliquidated, must file a proof of claim within the time set by the court. FRBP 3003.

When Must a Proof of Claim Be Filed?

In cases under Chapter 7, 12, and 13, a proof of claim must be filed within ninety days after the first date set for the meeting of creditors required by § 341(a) of the Bankruptcy Code. FRBP 3002(c). There are certain specifically defined exceptions to FRBP 3002(c), including exceptions for claims of governmental units and for claims resulting from the rejection of executory contracts and unexpired leases.

In a case under Chapters 9 and 11, a proof of claim must be filed by the time set by the court. FRBP 3003(c)(3). The court sets the time upon a debtor’s motion or the motion of another party in interest. Once that motion is granted and a bar date is set, the debtor sends a Notice of Bar Date, which is a notice to all creditors and parties in interest of the last day to timely file a proof of claim.
**Where Do I File My Proof of Claim?**

One should generally review the Notice of Bar Date. A Notice of Bar Date may instruct a creditor to send the proof of claim to a bankruptcy claims agent or may simply require that the proof of claim be filed electronically via ECF filing with the respective bankruptcy courts. Additionally, a Notice of Bar Date will specify the address to which the proof of claim must be sent if one is using regular mail or an overnight courier. Generally, filing proofs of claim by fax is not permitted.

**Why Should I File a Proof of Claim?**

A proof of claim should be filed in order to assert and preserve a creditor’s right to share in a distribution of the assets of the bankruptcy estate. Note, however, that, by filing a proof of claim, a creditor submits itself to the bankruptcy court’s jurisdiction and waives its right to a jury trial. *In re Ha-Lo Industries*, 326 B.R. 116 (Bankr. N.D. Ill. 2005) (the filing of any claim against the estate makes any litigation against the claimant part of the claims allowance process, thereby subjecting the creditor to the bankruptcy court’s equitable powers and waiving its right to a jury trial). If that entity is a governmental unit, it has waived its right to assert a sovereign immunity defense as an objection to the claim. 11 U.S.C. § 106(b).

**How Do I Complete the Proof of Claim Form?**

First, review the official form for a proof of claim. The definitions and instructions may also be found on the relevant court’s website. Review the following suggestions regarding completing such forms. The numbers correspond to the numbers on the attached sample official claim form.

Complete the name of the court where the case is pending, the name of the debtor (box (1)) and the case number (box (2)). Please note, however, that it is extremely important to review the Notice of Bar Date. The Notice of Bar Date will instruct whether a proof of claim
must be filed against every debtor in a jointly-administered, multi-debtor proceeding and will provide the case number for each debtor. Usually, when a debtor files for bankruptcy, its respective related entities also file bankruptcy petitions. The cases are usually consolidated for administrative purposes; however, in most instances, proofs of claims are still required to be filed in each of the debtor’s respective cases. Some practitioners err on the side of caution and file a proof of claim against every debtor unless it is known that a particular debtor is absolutely not liable to the creditor.

Next, fill in the name of the creditor (box (3)) and the address to which notices should be sent (box (4)). If an account number is available, include it in box (5); however, that box may be left blank, if ample identifying information is included in the exhibit to the proof of claim. It is important to note, however, that, if you first file an unliquidated claim that is later superseded by an amended claim, you must check box (6) on the amended claim.

The instructions attached to the official proof of claim form provide excellent guidance on the completion of box (7). Check the appropriate box and if you select “other”, it is recommended that you also include the phrase “see attachment” or “see exhibit.” This will allow you to provide further information on what “other” means in the exhibit attached to the proof of claim. Boxes (8) and (9) can also be completed with “see attachment” or “see exhibit.” Just be sure to include in your exhibit the date or dates that the debt was incurred.

The Instructions attached to the official proof of claim form contain definitions of the terms “Unsecured Nonpriority Claims”, “Unsecured Priority Claims” and “Secured Claims”. Briefly, an unsecured nonpriority claim (box (10)) is a claim that is neither entitled to priority nor secured. A claim is secured (box (11)) if the relevant creditor holds collateral (e.g., a lien on or security interest in property of the debtor) that gives that creditor the right to be paid from that
property before creditors who do not have collateral. The most common types of unsecured claims that are entitled to priority are listed in box (12). Box (13) represents the sum of the amounts listed in boxes (10), (11) and (12), respectively.

**How Do I Complete the Exhibit to the Proof of Claim?**

Identify on your exhibit the name of the entity filing the proof of claim and the name of the debtor.

Identify the relationship between the creditor and the debtor by specifically identifying the contract or agreement from which the debt arose.

Be sure to include the date the debt was incurred. If the debt arises from an entered judgment, provide a brief description of the underlying case and the date on which judgment was entered. Also, include the court’s order as an additional attachment.

Expressly reserve the right to amend and supplement the proof of claim. Expressly reserve your right to setoff, to protect the creditor if the debtor later asserts a claim against the creditor.

Include in the exhibit to your proof of claim any other information that relates to or is important in identifying and establishing the creditor’s claim against the debtor. If the documents are voluminous, say so in the exhibit and state that the documents are available upon request. In fact, some courts do not allow you to attach more than five pages worth of supporting documentation when submitting a proof of claim. *See, e.g.*, Local Rule 3001(c) of the United States Bankruptcy Court for the Southern District of Florida.

Remember, the more information provided to support your proof of claim, the more information the debtors will have in deciding whether to allow, disallow, or object to your proof of claim. It is important to review the local rules for the court in which he debtor’s case is
pending, the Notice of Bar Date, if applicable, and the definitions attached to Official Form B10 when completing a proof of claim.

Come to the ABA Business Law Section 2007 Spring Meeting and learn how to properly file a proof of claim and what to do when a claim is not properly filed. Additional topics to be discussed at the Spring Meeting include: What if the debtor objects to the proof of claim? What if a proof of claim is not timely? How do I amend a proof of claim? What if my claim is not allowed? What is an informal proof of claim? How do I know if I have a secured claim? What is a § 502(h) claim? What claims are not enforceable in bankruptcy?

See you in March.
IN RE JSJF CORPORATION: STATUTORY CAP ON LANDLORD’S CLAIM IS NOT A CRITERION FOR ALLOWANCE

by Christopher M. Alston, Foster Pepper PLLC, Seattle, Washington

The Ninth Circuit Bankruptcy Appellate Panel recently clarified in In re JSJF Corporation, 344 B.R. 94 (B.A.P. 9th Cir. 2006), that the cap imposed by 11 U.S.C. § 502(b)(6) upon a landlord’s claim for rejection damages may limit the claim, but does not speak to whether a claim should be allowed or disallowed.

First, some background: The landlord obtained a state court judgment for damages against debtor-tenant JSJF Corporation for breach of lease. A few days later, JSJF filed its chapter 11 petition in the Central District of California. The landlord’s pending state court motion for an award of attorneys’ fees was stayed. Subsequently, the landlord filed several proofs of claim. Its first proof of claim was timely filed and asserted a claim for a “civil judgment of attorney fees and costs” in the amount of $133,807.53, the same amount asserted in the stayed state court motion. JSJF objected to the claim on the grounds that it was for attorneys’ fees, not “rent reserved.” The bankruptcy court sustained JSJF’s objection and disallowed the claim because it was not for “rent reserved” under § 502(b)(6).

The Honorable Philip Brandt – an active member of the Business Bankruptcy Committee of the ABA’s Section of Business Law – authored the opinion of the Panel, which reversed the bankruptcy court’s ruling on this issue, finding that § 502(b)(6) does not limit lessors solely to claims for “rent reserved.” That section, the “landlord’s cap,” limits the amount of a lessor’s claim for lease termination damages:

(b) ... if [an] objection to [the] claim is made, the court, after notice and a hearing, shall determine the amount of such claim in lawful currency of the United States as of the date of the filing of the petition, and shall allow such claim in such amount, except to the extent that –
(6) if such claim is the claim of a lessor for damages resulting from the termination of a lease of real property, such claim exceeds –

(A) the rent reserved by such lease, without acceleration, for the greater of one year, or 15 percent, not to exceed three years, of the remaining term of such lease, following the earlier of –

(i) the date of the filing of the petition; and

(ii) the date on which such lessor repossessed, or the lessee surrendered, the leased property; plus

(B) any unpaid rent due under such lease, without acceleration, on the earlier of such dates.


The Panel initially noted that § 502(b)(6) establishes a three-part test for determining what charges are “rent reserved.” To be capped, the charge must be: (1)(a) designated as “rent” or “additional rent” in the lease; or (b) provided as the tenant’s/lessee’s obligation in the lease; (2) related to the value of the property or the lease thereon; and (3) properly classifiable as rent because it is a fixed, regular or periodic charge. In re McSheridan, 184 B.R. 91, 99-100 (B.A.P. 9th Cir. 1995).

In support of its position, JSJF relied on two bankruptcy court decisions where the court sustained a debtor’s objection to a lessor’s claim for attorney fees under § 502(b)(6). In re Pacific Arts Publ’g, Inc., 198 B.R. 319, 322-23 (Bankr. C.D. Cal. 1996); In re Edwards Theatres Circuit, Inc., 281 B.R. 675, 683-84 (Bankr. C.D. Cal. 2002). The Panel concluded that those courts appear to have read McSheridan as being about claims allowance or disallowance, but it is not. McSheridan concerns which portions of a lessor’s claim are limited by § 502(b)(6).
The Panel did not read § 502(b)(6) to limit lessors’ claims only to those items which fall within the cap; rather, the Panel focused on the section’s plain language. Under § 502(a) a claim is “deemed allowed” unless objected to, and § 502(b) directs the bankruptcy court to allow the claim “except to the extent ... if such claim is the claim of a lessor for damages resulting from the termination of a lease of real property, such claim exceeds” the formula set out in § 502(b)(6). 344 B.R. at 101.

Following McSheridan, the Panel noted that a lessor may have an uncapped claim for something other than damages resulting from the termination of a lease. “If the total claim is greater than the formula would permit, it is in the lessor’s interest (and contrary to the debtor’s and other creditors’) that the cap not apply--that is precisely the import of McSheridan.” Id.

The Panel concluded that the "landlord’s cap" of § 502(b)(6) “may limit the amount of a lessor’s claim, but is not a criterion for its allowance: it becomes significant only if the claim otherwise allowable under non-bankruptcy law exceeds the cap calculated under the statute.” Id. The Panel remanded back to the bankruptcy court for determination of whether the cap applies to some or all of the claim under McSheridan, and, if so, for the calculation of the proper capped claim amount.
ZOMBIE CONTRACTS: Can A Contract Once Deemed Rejected Be Revived By Conversion Under 11 U.S.C. §348(c)?

It is a question of statutory construction and of statutory interplay, but, also, maybe, of metaphysics: where do executory contracts and unexpired leases go when they are rejected? Do they die and vanish forever, except as a foundation for rejection damages? Or are they actually in a type of suspended animation, waiting to live again through conversion of the original case?

In a two-sentence holding, without detailed analysis as to the court's underlying reasoning, a bankruptcy court in New York recently held that conversion of a case from chapter 7 to chapter 11 revived a contract that would otherwise have been deemed rejected by operation of 11 U.S.C. §365(d)(1), making it property of the estate and available for assumption or (another) rejection in the succeeding chapter 11 case. In In re Helm, 335 B.R. 528 (Bankr. S.D.N.Y. 2006), the court appeared to acknowledge that the contract at issue had not been assumed by the trustee in the prior chapter 7 case within the statutory period; nonetheless, the court held that "pursuant to [11 U.S.C.] § 348(c) [footnote omitted] a conversion operates to revive the Debtor's right to assume or reject an executory contract . . . ." Id. at 538.

**Background to Helm Case**

The Debtors in Helm were Mark Levon Helm – one-time drummer and vocalist for the group "The Band" – and his wife, although the contract at issue was Mr. Helm's alone. That contract was with Royalty Recovery, Inc. ("RRI"), which promised to collect royalties owed to the Debtor, in exchange for a 40% cut of any amounts recovered (50% if litigation was necessary). Helm moved in the chapter 11 case to reject the RRI contract, arguing that he could collect unpaid royalties much more cheaply than under the terms of the RRI contract and that rejection, therefore, was a proper exercise of his business judgment. RRI claimed that the
contract was not executory, because Helm owed no performance under the contract and merely awaited payment from RRI, less RRI's 40% commission. The two principal issues in the case were (1) whether or not the contract was executory at all and, therefore, subject to rejection under 11 U.S.C. §365; and (2) if the contract were executory, whether rejection should be authorized, as a proper exercise of the Debtor's business judgment. The court found that the royalty-collection contract was executory and granted the motion to reject.

You Can't Raise a Cane Back Up, but Maybe You Can Revive a Rejected Contract

Although a subsidiary matter, the court's holding on "revivification" contains the greatest potential for mischief. The procedural posture of the case frames the issue. The Debtors filed their voluntary joint case on June 1, 2005, under chapter 7 of the United States Bankruptcy Code, 11 U.S.C. §§101 et seq. (the "Code"). That filing constituted an order for relief under the Code; it also set running the time period of Code §365(d)(1), which provides that any executory contract or unexpired lease of residential real property or of personal property not assumed or rejected by the chapter 7 trustee within 60 days after the order for relief is deemed rejected. That 60-day period may be extended for cause, provided that the court fixes such an extended date "within such 60-day period".¹

On August 8, 2005, the court converted the Debtors' chapter 7 case to one under chapter 11; pursuant to Code §365(d)(2), a debtor has until confirmation of a plan of reorganization (unless the court shortens such time) to assume or reject the same types of contracts and leases subject to the 60-day period described in Code §365(d)(1). Code §348(c) addresses the effect of conversion on Code §365(d); section 348(c) provides that Code §365(d) applies in a converted case "as if the conversion order were the order for relief." Therefore, if the 60-day period

¹ Many courts and local rules of bankruptcy procedure provide that a court need not actually rule on a motion to extend this time period within the period itself, so long as the motion to extend was filed within the period.
applicable in Helm's prior chapter 7 case had not run as of conversion to chapter 11, there would have been little question that the RRI contract survived the chapter 7 case and became property of the estate in the succeeding chapter 11 case and, therefore, subject to assumption or rejection up to the date of plan confirmation.

However, sixty days after the June 1, 2005, order for relief in *Helm* was July 31, 2005. The chapter 7 trustee of the Debtors' estates did not assume the RRI contract or seek an extension of time to do so by that date. Therefore, the RRI contract was deemed rejected as of July 31, 2005, eight days before the conversion to chapter 11, and the Debtor, in fact, made that argument in asking the court for an order of rejection.

The court dealt with the argument in a brief two sentences, citing only Code provisions, but no case law. The court's entire discussion of this issue is as follows:

> It has been argued by Debtor and Levon Helm Studios that the Agreement was automatically rejected when not assumed by the Chapter 7 trustee within sixty days of the bankruptcy filing and prior to the conversion of this case to a case under Chapter 11. See 11 U.S.C. § 365(d)(1). [Footnote quoting the cited provision.] [RRI] is correct, however, when it argues that pursuant to § 348(c) [footnote quoting Code §348(c)] a conversion operates to revive the Debtor's right to assume or reject an executory contract, subject to certain exceptions not at issue here.

*Helm*, 335 B.R at 538.

**The Court's Reasoning: A Few Guesses**

Because the court allowed the RRI contract to be rejected in any event, it may not be surprising that the treatment of the revivification issue is so cursory. Some possible analytical subtexts of the court's holding, and brief critiques thereof, are the following:

1. **Language of Code §348(c) As a Bankruptcy "Reset" Button:** It is, perhaps, not impossible to read Code §348(c) as meaning that the conversion order is to be treated as though it were the *original* order for relief, and that the debtor is therefore to be treated as owning all of
the property it owned immediately prior to the date of that original order for relief, in the condition in which such property existed at that time. In other words, the Helm court may have viewed Code §348(c) like a "bankruptcy case reset button", which effectively allows the debtor to do its case over again under the new chapter.

Among the problems with that reading of Code §348(c) are that (a) it goes beyond the strict language of the provision, which may also be read as merely explaining how to calculate time periods in Code §365(d) that run from the entry of an order for relief; and (b) it appears at odds with those cases that hold that, if a debtor has lost its right to possession of property under a lease, or to demand performance under an executory contract, before the commencement of a bankruptcy case, then the interest of the debtor in such a lease or contract does not become property of the estate. For example, if the debtor or trustee has lost the right to possess property prepetition, that right would not become property of the estate. Yet, under the above-described analysis of the court's reasoning in Helm, after losing that right through a rejection, the right would nonetheless revive and become part of the debtor's estate in the converted case.

Further, a rejection is deemed a breach of a contract or lease as of immediately before the petition date. Code §365(g). If a lease or contract entitles the non-debtor party to treat it as terminated upon breach, and if the non-debtor party has done everything necessary to so terminate it post-rejection and pre-conversion, why is there any contract or lease to become property of the estate upon conversion?

(b) Lack of Reliance on Deemed Rejection: It appears that neither the Debtor nor RRI had relied to its detriment on the deemed rejection of the contract at issue. The Helm court might rule differently – as might future courts – in a situation in which the non-debtor party has changed its position in reliance on such rejection – by, for example, reletting a premises,
redirecting production on account of the deemed rejection of a supply contract, or recovering leased personal property and leasing it to another lessee. It is to be hoped that that will be the case; however, nothing in the court's opinion in Helm or in the language of Code §348(c) upon which it appears to have relied makes that distinction.

(c) **Rejection Is Not Termination**: Courts have held that rejection, while it does constitute a breach of the affected contract or lease, does not effect a termination of such contract or lease. *See, e.g.*, Code §365(g); *Stoltz v. Brattleboro Housing Authority (In re Stoltz)*, 315 F.3d 80 (2d Cir. 2002) (deemed-rejected lease is not terminated, but is abandoned by estate and subject to termination under nonbankruptcy law). Perhaps the Helm court had this distinction in mind and reasoned that the contract at issue, although deemed rejected, was not thereby terminated, and, if not so terminated before conversion, still existed as of the conversion date to become property of the estate.

While this argument has more appeal than the others advanced above, the Helm court appeared to treat the rejected – and therefore breached – contract as though it were pristinely unaffected by the deemed rejection, that is, as though the deemed rejection had never happened. Although a rejection may not be a termination, a rejection is still a rejection, and, in general, once rejected, a contract or lease is not available for subsequent assumption. This problem is not immediately evident in the Helm case, because the Debtor sought to reject the RRI contract, but nothing in the court's brief holding on this issue suggests that Helm could not have assumed the contract, if he had so desired. Furthermore, the court does not explain whether the contract entered the chapter 11 estate subject to the breach created, under Code §36(g), by the deemed rejection (*see* item (c) below).
**Questions Raised by Helm Ruling**

Among the questions the *Helm* ruling raises, but does not answer, are the following:

(a) *Obligations of/Effect on Non-Debtor Parties:* Code §365(d)(1) applies, not just to executory contracts, but also to leases of personal and residential real property. Suppose a landlord or an equipment lessor, in reliance on a deemed rejection under Code §365(d)(1), relets its premises, or arranges with the chapter 7 trustee to retrieve leased equipment and, then, leases that equipment to another party. If the debtor then converts its case to one under chapter 11 (or chapter 13, to which Code §365(d)(2) also applies) and chooses to treat such leases as revived:

--- is the equipment lessor obligated to recover the equipment and return it to the debtor?

--- must the landlord evict its new tenant and allow the debtor back into the premises?

--- if the lessor/landlord cannot do so, will it be liable for damages to the debtor or for sanctions for violation of the automatic stay?

(b) *"Active" – As Opposed to Deemed – Rejections, Effected by Motion and Court Order:* The *Helm* court seems to rely on the language of Code §348(c), which makes the conversion order a new "order for relief". There appears, then, to be no principled reason to distinguish, under that language and the court's holding, between (i) "deemed" rejections for failure to act during a statutory time period and (ii) rejections effected upon motion and authorized by court order. Are court-ordered rejections subject to "reversal" because the conversion creates a new "order for relief"? If not, what is the analysis for distinguishing them?

(c) *Can Contracts and Leases Previously Deemed Rejected Under Chapter 7 Be Assumed in a Subsequent Chapter 11?:* The contract at issue in *Helm* was ultimately rejected, so the case gives us no specific guidance on this question, but the court also gives us no reason to believe that the RRI contract could not have been assumed, had the Debtor so desired.

However, in general, a debtor's estate takes property as the estate find it, with whatever limitations or impairments go along with it. See, e.g., *Board of Trade v. Johnson*, 264 U.S. 1, 44 S. Ct. 232, 68 L. Ed. 533 (1924). If the conversion order is treated as a new order for relief under chapter 11, the contract should, arguably, enter the chapter 11 estate tainted with the breach that resulted, under Code...
§365(g), from the deemed rejection. That breach may be constitute a non-curable default under the revised version of Code §§365(b)(1)(A) and 365(b)(2)(D), preventing assumption of the contract or lease in the chapter 11 case. (See "Assumption and Rejection of Executory Contracts and Unexpired Leases Under the BAPCPA" in these materials.)

(d) Treatment of Leases of Nonresidential Real Property: Code §365(d)(4) also contains a deadline – applicable in chapter 7 and chapter 11 – within which the debtor must assume or reject a lease of nonresidential real property. \(^2\) If such a lease is deemed rejected under Code §365(d)(4), the trustee or debtor in possession is required to "immediately surrender that nonresidential real property to the lessor".

Suppose such a lease is deemed rejected 121 days after the order for relief, but the trustee or debtor in possession does not surrender the premises during the next week, and, on the eighth day, the case converts. Does the debtor or trustee then receive a new 120-day period as tenant within which to assume or reject? While it is true that the language regarding immediate surrender of the leased property does not appear in Code §§365(d)(1) or 365(d)(2) – and that fact distinguishes subsection 365(d)(4) from subsections (d)(1) and (d)(2) – the Helm court appeared to rely primarily on the language of Code §348(c), which makes the conversion order a new "order for relief"; it does not appear, therefore, that the "immediately surrender" language is necessarily enough to dictate a different result.

(e) Administrative Expense Claims for "Gap" Period: Code §365(d)(3) requires timely payment of rent under a lease of non-residential real property until such lease is assumed or rejected. Such rent has, at minimum, the status of an administrative expense claim, and some courts have held that it even has a superpriority over ordinary administrative claims.

If a lease of non-residential real property is deemed rejected on the 121st day after a voluntary case is filed under chapter 7, and then revived a month later upon conversion to chapter 11, does the lessor have an administrative claim for the "gap" period between the deemed rejection and the conversion?

If the non-debtor party to any executory contract or unexpired lease incurs unusual expenses in connection with reviving the contract or lease, are those entitled to administrative priority or general unsecured status? Or are they claims against the estate at all?

\(^2\) Formerly, that deadline was also 60 days from the entry of an order for relief. However, the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, which became fully effective on October 17, 2005, lengthened the initial 60-day period under Code §365(d)(4) to 120 days, extendable for cause for up to 90 days, but no further absent consent of the lessor.

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SAFEGUARDING YOUR FEES:

A DEFENSE MANUAL FOR ATTACKS
ON DISINTERESTEDNESS

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I. INTRODUCTION.

In order to be employed under § 327(a)\(^2\), a professional must establish that 1) it does not
hold an interest adverse to the estate; 2) it does not represent an interest adverse to the estate; and
3) it is a disinterested person under § 101(14). While most courts and attorneys generally
understand whether they hold an "adverse" interest, there is a serious question as to what facts
may render a law firm "disinterested" or "not disinterested". What if you have subtenants who
lease space from your law firm who also represent parties adverse to your clients? What if your
firm engages "contract attorneys" on a limited basis, and one of those attorneys also represents a
party adverse to your client? How far do you need to search to determine whether you are
making the proper disclosures in your employment application? This paper examines those

\(^1\) Weinstein, Weiss & Ordubegian LLP specializes in bankruptcy matters, business reorganization and
debtor-creditor relations. The firm has wide-ranging experience in litigation and appeals arising from these practice
areas.

\(^2\) Unless otherwise indicated, all section references are to the United States Bankruptcy Code, title 11 of the
United States Code.
questions and considers how a professional may manage challenges to its disinterestedness.

II. **DISCLOSURE -- DISCLOSURE -- DISCLOSURE.**

A law firm must disclose in its employment application all connections to a debtor. Not only are such disclosures required, disclosure is one of your best defenses against disinterestedness-based attacks on your fees. After all connections are disclosed, disinterestedness is ruled upon, and an employment order is entered, objectors are precluded from later challenging disinterestedness on any of the grounds disclosed in the employment application. Although the employment order is a non-final order and not subject to immediate appeal, the Ninth Circuit has held that a retained professional may keep compensation for services rendered in reliance on that employment order, even though the order might be successfully challenged at the end of the professional's engagement, when the order becomes final.

Two separate-but-related proceedings in the bankruptcy case of S.S. Retail Stores Corporation illustrate the Ninth Circuit's approach. In the first of these proceedings, the United States Trustee ("UST") objected in the bankruptcy court to the debtor's application to retain Gibson, Dunn & Crutcher ("GDC") as general bankruptcy counsel, on the ground that an attorney at GDC, Lawrence Calof ("Calof"), was not disinterested. The bankruptcy court found that, even if Calof individually were not disinterested, that status could not be imputed to his firm, GDC, as a whole. The bankruptcy court authorized the debtor to retain GDC as counsel. *United States Trustee v. S.S. Retail Stores Corp. (In re S.S. Retail Stores Corp.),* 211 B.R. 699, 700 (B.A.P. 9th Cir. 1997) ("S.S. Retail I"). On appeal, the Ninth Circuit determined that the
employment order was not a final order for appellate purposes and dismissed the UST's appeal for want of jurisdiction. *Stanley v. S.S. Retail Stores Corp. (In re S.S. Retail Stores Corp.)*, 162 F.3d 1230 (9th Cir. 1998).

Two years and almost $290,000 in fees and expenses later, GDC had taken the debtor's case through to a final decree. The UST, now with an appealable final order on GDC's employment and compensation, appealed to the United States District Court, which dismissed the UST's appeal on grounds that were affirmed by the Ninth Circuit in *S.S. Retail Stores Corp. v. Ekstrom (In re S.S. Retail Stores Corp.)*, 216 F.3d 882 (9th Cir. 2000) ("S.S. Retail II"). The UST argued that GDC had never been disinterested (and that the bankruptcy court and BAP has therefore been wrong on that score), never should have been employed, voluntarily provided services despite the risk that the employment order would ultimately be overturned, and, thus, should disgorge all its fees. *Id.* at 883-84

The Ninth Circuit emphatically rejected the UST's arguments:

In the present case, there are numerous factors weighing in favor of holding that it would be inequitable to require [GDC] to disgorge the bankruptcy court's award of fees and expenses. As a preliminary matter, [GDC] at all times fully disclosed that Calof had acted as the Debtor's assistant secretary up until two weeks before the Debtor filed its bankruptcy petition. Calof was never involved in [GDC's] representation of the Debtor during the bankruptcy case. Furthermore, there was no showing nor even any allegation that [GDC] acted improperly while serving as the Debtor's counsel. To the contrary, all the evidence indicates that [GDC] performed its services superbly. The creditors' committee never objected to [GDC] acting as the Debtor's counsel, nor did it raise any issue of impropriety. *Id.* at 885. The appellate panel also noted that the UST had never sought a stay of the GDC employment order, an action that would have alerted GDC to the risk it bore in rendering services to the debtor. *Id.* Although the UST argued that, by continuing to provide services to debtor, GDC assumed the risk that it might ultimately lose on the issue of disinterestedness, the
Ninth Circuit disagreed:

The rule the UST would have us adopt would be harsh and would create a difficult ethical dilemma for counsel. It would require a law firm to abandon its client wherever the UST objected to its employment, even though that employment had the blessing of two orders of the bankruptcy court and a decision of the BAP, albeit a BAP decision that was vacated because the order appealed from was not then final.

Ibid.

Accordingly, under the Ninth Circuit's reasoning in S.S. Retail II, if a law firm makes the proper disclosures and, based upon those disclosures, it obtains an employment order that is not stayed pending appeal, a later challenge to the firm's compensation on disinterestedness grounds should not succeed, even if there were objections to the initial employment application. This result also suggests the importance of making continued disclosure throughout the case, if and as counsel becomes aware of circumstances that were not disclosed before the entry of the employment order.

The next question, then, is what type of disclosures are required.

III. STANDARDS FOR EMPLOYMENT UNDER § 327(a).

Section 327 provides, in relevant part:

(a) Except as otherwise provided in this section, the trustee, with the court's approval, may employ one or more attorneys, . . . that do not hold or represent an interest adverse to the estate, and that are disinterested persons, to represent or assist the trustee in carrying out the trustee's duties under this title.

Thus, under § 327(a), a law firm for a trustee (1) cannot hold an interest adverse to the estate; (2) cannot represent an interest adverse to the estate; and (3) must be a disinterested person under § 101(14).

The term "adverse interest" is not defined in the Bankruptcy Code. *In re AOV Industries, Inc.*, 797 F.2d 1004, 1011 (D.C. Cir. 1986) (the Code does not define "adverse interest"). As one court has phrased it, to "hold" an "adverse interest" means:

   to possess or assert any economic interest that would tend to lessen the value of the bankruptcy estate or that would create either an actual or potential dispute in which the estate is a rival claimant.


2. "Represent" An Adverse Interest.


3. "Disinterested".

Section 101(14) (as amended by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005) defines a "disinterested person" as a person who:

(A) is not a creditor, an equity security holder, or an insider;

(B) is not and was not, within 2 years before the date of the filing of the petition, a director, officer, or employee of the debtor; and

(C) does not have an interest materially adverse to the interest of the estate or of any class of creditors or equity security holders, by reason of any direct or indirect relationship to, connection with, or interest in, the debtor, or for any other reason.

Case law makes clear that § 101(14)(C) (formerly § 101(14)(E)) refers to a professional's personal holdings, investments, and the like. *Bank Brussels Lambert v. Coan (In re AroChem Corp.)*, 176 F.3d 610, 629 (2d Cir. 1999), citing *In re BH&P, Inc.*, 949 F.2d 1300,
1310 n.12 (3d Cir. 1991). It does not refer to a professional's representations.

Section 101(14)(E) [now 101(14)(C)] states that an entity is not disinterested only when it has an interest materially adverse to the estate, creditor or equity holders. (Emphasis Added). Unlike the adverse interest requirement in § 327(a), § 101(14)(E) does not state that a person who represents an interest adverse to the estate, creditor or equity holders is not disinterested. Thus, Congress clearly knew the difference between holding and representing an interest and chose not to include representing an interest in the definition of a non-disinterested person under § 101(14)(E).


As such, the concept of "vicarious disqualification" does not exist in any of the applicable provisions of the Bankruptcy Code. _S.S. Retail Stores I_, 211 B.R. at 703 ("the Code does not provide for disqualification of an entire law firm based on the non-disinterestedness of one of its attorneys"). _Accord, Gray v. Memorial Medical Center, Inc._, 855 F. Supp. 377, 379 (S.D. Ga. 1994) ("to impute disqualification between an of counsel attorney and a firm, the attorney should be more than a de minimus of counsel") (quotations omitted); _In re Timber Creek, Inc._, 187 B.R. 240, 244 (Bankr. W.D. Tenn. 1995) (rejecting _per se_ rule of imputing disqualification of one partner to an entire firm and finding that the court must consider the "totality of the particular facts and circumstances"); _In re Creative Restaurant Management, Inc._, 139 B.R. 902, 910-914 (Bankr. W.D. Mo. 1992) (finding that Congress could have created a _per se_ rule vicariously disqualifying a law firm based on the lack of disinterestedness of one member but did not, and the absence of such a provision in § 327(a) precludes the court from creating an automatic disqualification rule).  

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3 The _Creative Restaurant_ court identified an important contrast between § 327(a) and Fed. R. Bankr. P. 5002. If, as the Rule requires, a single attorney in a law firm is disqualified from serving as a trustee or examiner
In *S.S. Retail I*, the UST objected to the debtor-in-possession's proposed employment of Gibson, Dunn, on the ground that one of the law firm's partners was not disinterested. The UST argued that one attorney's disqualification effectively disqualified his entire firm. In response, the BAP declared that "[w]ith respect to section 327, the Code is silent [as] to disqualification of an entire firm based on non-disinterestedness of an attorney", and therefore, vicarious attribution was not the law. *S.S. Retail I*, 211 B.R. at 704.

Accordingly, there is no automatic, all-inclusive, *per se* imputation of disinterestedness. But an attorney must be mindful that courts are free to determine whether a law firm is disinterested or not, based on an "abuse of discretion" standard.

A. **The "Of Counsel/Contract Attorney" Relationship.**

There is a serious question regarding the extent to which a law firm may be deemed not "disinterested" based on relationships with attorneys who may be loosely associated with the law firm, but not on a regular basis. Many law firms will designate attorneys as "of counsel", signifying to the world that the attorney is associated with it, but on different terms from other "members", "partners" or "associates". "Of Counsel" is an imprecise term. It is not a term of art, and its mere usage does not establish the nature, scope and detail of the actual lawyer-to-lawyer relationship at issue. *See In re Dergance*, 218 B.R. 436, 437 (Bankr. N.D. Ill. 1998) ("of counsel" can include a "retired or semi-retired member of a law firm, or outside attorney that only does occasional or special legal work for the firm"). *See also* Wren and Glascock, *The Of Counsel Agreement* 12 (ABA Publishing 2005) ("[b]ecause there are so many

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because he or she is related to the bankruptcy judge making the appointment, Rule 5002 specifically prohibits the employment of that attorney's entire law firm. No similar language exists in § 327(a). 139 B.R. at 913

It is wise for law firms to fully disclose in their employment applications the relationship between the firm and any attorney that has a connection to the firm. One critical purpose of the disclosure, and hence one critical effect of the employment order, is to show to what extent the "of counsel" attorney is attached (or detached, as the case may be) from the firm. By making this disclosure, parties will be on notice and have the opportunity to question whether the firm must look beyond its own internal walls to determine disinterestedness. At the very least, this type of disclosure may be enough to permit the firm to rely on the employment order under *S.S. Retail II*.

**B. Limiting Representation.**

Even if a law firm is not disinterested in one respect, it is possible that an attorney may be employed on discrete issues in the case (or excluded from employment on a discrete issue in the case). In those situations, an attorney's employment may be limited under § 327(a) to areas in which he or she does not hold an adverse interest and is disinterested.\(^4\) Section 327(a) speaks only against present conflicting representation. The section says that "the trustee, with the court's approval, may employ one or more attorneys . . . that do not hold or represent an interest adverse to the estate, and that are disinterested persons" (emphasis added).

The statute is written in the present tense, meaning it bars conflicting representations that exist concurrently with the engagement by an estate. *AroChem Corp.*, 176

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\(^4\) Do not confuse this concept with § 327(e), which permits an attorney to be employed for a "special purpose", even if the attorney is not disinterested. Section 327(e) is limited to attorneys who represented the debtor pre-petition.
Not every conflict is automatically disqualifying. See e.g., United States Trustee v. First Jersey Securities, Inc. (In re First Jersey Securities, Inc.), 180 F.3d 504, 509 (3d Cir. 1999) (recognizing important distinctions between "actual" conflict, "potential" conflict and "appearance of conflict of interest" and ramifications of each); In re Marvel Entertainment Group, Inc., 140 F.3d 463, 476 (3d Cir. 1998) (same); BH&P, 949 F.2d at 1315-17 (same); In re Wheatfield Business Park LLC, 286 B.R. 412, 421 (Bankr. C.D. Cal. 2002) (while "actual" conflict is disqualifying, the significance of "potential" conflicts is left to the judgment of the court); Nisselson v. Wong (In re Best Craft Gen. Contractor & Design Cabinet, Inc.), 239 B.R. 462, 470 (Bankr. E.D.N.Y. 1999) (firm's non-disclosure of a potential conflict did not warrant the purging remedy of disqualification, where undisclosed facts did not evidence any actual conflict of interest, and thus were harmless).

To be disqualifying, the conflict must be present, concrete and material. BH&P, 949 F.2d at 1315-17 (courts have declined bright-line tests for disqualification, relying instead on the facts and circumstances of each case); Star Broadcasting, 81 B.R.at 844 (same); In re N.S. Garrott & Sons, 63 B.R. 189, 192 (Bankr. E.D. Ark. 1986) (attorneys can bear technical conflicts without being disqualified). To be disqualifying, a conflict also must be material. In re Guy Apple Masonry Contractor, Inc., 45 B.R. 160, 164 (Bankr. D. Ariz. 1984). Mere imaginings about things that could develop in the future are not enough. TWI International, 162 B.R. at 675 ("merely hypothesizing that conflicts may arise is not a sufficient basis to warrant the disqualification of an attorney") (internal quotation marks omitted) (emphasis added).
IV. THE CONTINUING SUBSISTENCE OF THE EMPLOYMENT ORDER MAY ENTITLE A FIRM TO ITS FEES, EVEN IF DISINTERESTEDNESS IS DRAWN INTO QUESTION LATER.

Even if a court determines that a firm is not disinterested, the firm may still be awarded fees if it has relied on an employment order. The Bankruptcy Appellate Panel of the Ninth Circuit has held that, in such circumstances, even if the order were to be reversed later, counsel would be entitled to be paid, in the Court's discretion, for valuable services performed. First Interstate Bank of Nevada, N.A. v. CIC Investment Corp. (In re CIC Investment Corp.), 192 B.R. 549, 552 (B.A.P. 9th Cir. 1996) ("CIC II").

In an earlier proceeding in the CIC case, the debtor-in-possession had obtained an employment order authorizing general counsel's engagement over a bank's objection. Six months later, the order was reversed when the BAP found that counsel was not disinterested. First Interstate Bank of Nevada, N.A. v. CIC Investment Corp. (In re CIC Investment Corp.), 175 B.R. 52 (B.A.P. 9th Cir. 1994) ("CIC I"). CIC II concerned an order approving payments to counsel for services rendered prior to reversal of the employment order. CIC II, 192 B.R. at 551-52. Since counsel in CIC II had obtained and relied on an employment order, it was not precluded from being paid, even where it was later determined that counsel never was disinterested. Rather, the bankruptcy court could look favorably upon work properly performed and order compensation, so long as the facts that negated disinterestedness did not cause counsel to render tainted services. Id. at 553-54.

V. PROPER DISCLOSURE AND PROTECTING YOUR FEES.

As a general matter, insufficient disclosures may provide an independent basis to preclude fees. Neben & Starrett, Inc. v. Chartwell Fin. Corp. (In re Park-Helena Corp.), 63 F.3d
877, 882 (9th Cir. 1995) (treatment of fees where there is a failure of disclosure is discretionary). But just as not every conflict is disabling, not every failure to disclose is a basis upon which to preclude fees. See Movitz v. Baker (In re Triple Star Welding, Inc.), 324 B.R. 778, 793 (B.A.P. 9th Cir. 2005) (inaudient non-disclosures in an employment application can be excused); CIC I, 175 B.R. at 54 ("[t]he bankruptcy court may excuse the original failure to disclose"); In re Begun, 162 B.R. 168, 175 (Bankr. N.D. Ill. 1993) (inaudient failure to disclose does not result in denial of compensation); Elias v. Lisowski Law Firm, Chtd. (In re Elias), 215 B.R. 600, 608 n.1 (B.A.P. 9th Cir. 1997) (recognizing that applicant must disclose all connections under Rule 2014 "to the best of the applicant's knowledge"); Wheatfield Bus. Park LLC, 286 B.R. at 418-19 (Rule 2014 requires an application to disclose, "to the best of the applicant's knowledge, all of the person's connections with the debtor, creditor, [and] any other party in interest . . .").

VI. WHEN DO YOU FORM A RELATIONSHIP?

Consider the stray call you receive from a potential client (usually at 3:00 p.m. on a Friday). She briefly explains to you the difficulty she is having collecting from a business, and she believes that business may be filing bankruptcy soon. You offer legal assistance, but the potential client never calls you back. You then receive a call from the failing business who wants to engage you as the debtor's counsel. Do you have an actual conflict of interest, or are you not disinterested, by virtue of your prior contact with one of the debtor's creditors?

relationship cannot be created by the unilateral declaration of one party to the putative relationship, but only by evidence of an express or implied contract.

Moreover, even if an attorney-client relationship is formed, a former client may be deemed to have waived the right to object to an attorney's representation of an opposing party if she knowingly refrains from asserting that objection. Trust Corp. of Montana v. Piper Aircraft Corp., 701 F.2d 85, 87-88 (9th Cir. 1983). Hence, disclosure of any possible connections will always be your safest bet and your biggest shield from attack.

VII. CONCLUSION.

When in doubt, disclose, and disclose often.