UNITED STATES BANKRUPTCY COURT
FOR THE WESTERN DISTRICT OF MICHIGAN

In re:

PRIVA TECHNOLOGIES, INC.,

Debtor.
_____/

Case No. DK 11-12574
Hon. Scott W. Dales
Chapter 7

OPINION AND ORDER

PRESENT: HONORABLE SCOTT W. DALES
Chief United States Bankruptcy Judge

## I. INTRODUCTION

The complexity and secrecy surrounding the encryption technology and related intellectual property at the heart of this contested matter, and the procedural ping-pong match between the bankruptcy and district courts, has unnecessarily obscured the relatively straightforward issue confronting the court: whether it should authorize the chapter 7 trustee to enter into a transaction involving property of the estate, and settle related controversies, over the objection of a creditor who holds a valid security interest in the subject matter of the transaction.

More specifically, Thomas C. Richardson, as chapter 7 trustee, seeks authority to amend and restate a post-petition agreement between Priva Technologies, Inc. ("Priva" or the "Debtor") and Cyber Solutions International, LLC ("CSI") to license intellectual property identified in the papers and at the hearing as the Secured Key Storage Integrated Circuit (collectively the "SKSIC") which the Debtor developed before and after it filed a chapter 11 bankruptcy petition. Through the Amended and Restated Design Service and Intellectual Property License Agreement (the "Amended License") the Trustee agreed to ratify and amend the original Design Service and Intellectual Property License Agreement (the "Original License") between the Debtor and CSI regarding the SKSIC and to take other steps designed largely to give CSI the benefits it expected

to receive under its original deal with the Debtor. In exchange, CSI agreed to waive its $5 million claim, pay $200,000.00 (after some post-approval due diligence), and remit royalty payments based upon CSI's projected sales of products incorporating the Tamper Reactive Secure Storage ("TRSS") technology, which, as part of the Amended License, the parties agreed is a modification or improvement derived from the estate's SKSIC technology. The secured creditor, Pro Marketing Sales, Inc. ("PMS"), challenges the transaction on the grounds that the Trustee did not exercise appropriate business judgment when he entered into the post-conversion Amended License, and —more important— acceded to CSI's argument that it owns the TRSS as an improvement under the terms of the Original License.

To effect the transaction, the Trustee initially filed two motions. First, he filed the Trustee's Motion to Assume Executory Contract, As Amended (the "Assumption Motion," DN 367), relying on 11 U.S.C. § 365,[1] followed a week later by the Motion to Approve Settlement (the "Settlement Motion," DN 373), invoking Fed. R. Bankr. P. 9019. Thereafter, with the court's permission, the Trustee amended the Assumption Motion to clarify that, in addition to § 365, he was relying on his authority under § 363(b) to "use, sell, or lease" property of the estate.[2]

The court conducted an evidentiary hearing over four days on August 18 and 19, 2014 in Kalamazoo, and October 1 and 2, 2014 in Grand Rapids. During the hearing, the court heard testimony from five witnesses: Messrs. Douglas Benefield and Richard Takahashi (on CSI's behalf), Messrs. Richard Hall and William Sibert (on PMS's behalf), and Mr. Thomas C. Richardson (for the bankruptcy estate). The court credits the testimony of each witness. In addition, the court admitted numerous exhibits, mostly (though not exclusively) documents that

[1] Unless otherwise indicated, statutory citations in this opinion refer to Title 11, United States Code.
[2] As used in this opinion, and unless otherwise indicated, the term "Assumption Motion" shall refer to the motion as amended on August 7, 2014.

CSI provided to the Trustee regarding the SKSIC and TRSS, and CSI's efforts to incorporate them into federal procurement plans.

After carefully considering the testimony and the documentary evidence admitted during the hearing, the court has determined to withhold its approval of the Trustee's proposed transactions.

## II. JURISDICTION

The court has jurisdiction over the bankruptcy case of the Debtor and the property of the Debtor's bankruptcy estate pursuant to 28 U.S.C. § 1334 because the United States District Court has referred the bankruptcy case and this particular contested matter to the United States Bankruptcy Court pursuant to 28 U.S.C. § 157(a), LCivR 83.2(a) (W.D. Mich.), and the Order of the Honorable Robert Holmes Bell dated January 23, 2014.

Contested matters like this one, involving a trustee's proposed use or sale of estate property and settlement of disputes to which the estate is a party, fall within the court's "core" authority. 28 U.S.C. § 157(b)(2)(A), (M), (N), and (O). To the extent the contested matter requires the court to evaluate the validity, extent, or priority of liens asserted against estate property, it also falls squarely within the court's core authority under 28 U.S.C. § 157(b)(2)(K). Therefore, and notwithstanding doubts engendered by the Supreme Court's opinion in *Stern v. Marshall*, __ U.S. __, 131 S. Ct. 2594 (2011), and similar appellate authority, the court will enter a final, appealable order resolving the contested matter.

## II. ANALYSIS

The following constitutes the court's findings of fact and conclusions of law in accordance with Fed. R. Civ. P. 52, made applicable in this contested matter by Fed. R. Bankr. P. 9014(c) and 7052.

### A. Background

Several years ago, the Debtor developed a useful microchip technology and related intellectual property but was unable to perfect its invention while staving off creditors outside of the bankruptcy court. On December 22, 2011, the Debtor filed a voluntary petition for relief under chapter 11 with an eye on reorganizing its business and monetizing this incipient microchip technology.

At the time of filing, substantially all of the Debtor's assets secured the claim of PMS. The Debtor proposed, and the court confirmed, a reorganization plan premised largely on the licensing of the Debtor's technology to CSI for the promise of substantial royalties over time. The Debtors' First Amended and Restated Combined Joint Plan of Reorganization and Disclosure Statement (the "Plan," DN 140), however, clearly preserved the security interest of PMS in the Debtor's technology, specifying that CSI's interest in that technology under the Original License was subordinate to the interests of PMS. The court entered a confirmation order on June 20, 2012, following a contested confirmation hearing.

Thereafter, the Debtor and CSI began their ultimately unhappy collaboration to develop the encryption technology in the SKSIC. Messrs. Benefield and Takahashi explained during the hearing that the U.S. Government contracted with the Debtor, prepetition, to develop the encryption technology into a microchip that could be deployed in numerous electronic devices

and other equipment, such as radios, cell phones, satellites, aircraft, and missile systems, among other items to meet government and military needs. Ultimately, CSI and the Debtor hoped that the technology would find its way into the commercial market where they projected staggering potential sales figures —in the billions of dollars.

Unfortunately, as the saying goes, it takes money to make money, and post-confirmation the Debtor continued to suffer cash shortages. Ultimately, it was unable to meet its obligations, straining its relationships with both PMS and CSI. The distrust among the parties likely dates back to the contested confirmation hearing, but grew more intense post-confirmation, as CSI came to believe that the Debtor and PMS conspired to deprive it of the benefits of the Original License, first by collusively purporting to terminate the license based upon, from CSI's viewpoint, a pretended breach by CSI, and then by attempting to effect a "friendly foreclosure" with the practical effect of impairing CSI's enjoyment of its license rights.

Indeed, the testimony established that the Debtor, acting through its board and president (Mr. Sibert), entered into an agreement to surrender the SKSIC to PMS. Pursuant to an Asset Transfer and Transition Funding Agreement (DN 313-1), PMS took possession of the SKSIC (and the computer servers containing the intellectual property) which it regarded as its collateral. As the court determined in a ruling on the parties' cross motions for summary judgment, the Debtor continued to enjoy an interest in the SKSIC post-surrender at the time the Debtor converted its case to a chapter 7 proceeding.[3]

Prior to conversion, the Debtor purported to terminate the Original License pursuant to which CSI was developing the SKSIC into a marketable product. CSI contended that the Debtor

[3] The court ruled that although PMS may have obtained possession of its collateral prior to the order for relief in the chapter 7 phase of the case, it did not dispose of the SKSIC and related property and therefore, pursuant to Article 9 of the Uniform Commercial Code, failed to terminate the Debtor's interest in the collateral. Pursuant to the express provision in the Debtor's Plan, all property in which the Debtor had an interest on the date of conversion re-vested in the chapter 7 bankruptcy estate. *See* Plan at § 5.1.2.

and PMS conspired to deprive CSI of the benefits of the Original License so that PMS could take the value of the collateral, and so that Mr. Sibert, might be relieved of his personal liability to PMS in connection with the original loan.

The controversy between CSI and PMS over the supposed termination of the Original License prompted CSI to sue PMS and the Debtor (pre-conversion) in the United States District Court for the Western District of Michigan. *See Cyber Solutions International, LLC v. Pro Marketing Services, Inc.*, Case No. 1:13-CV-867 (W.D. Mich.). The District Court, perceiving a relationship between the civil action and the bankruptcy proceeding, referred CSI's lawsuit and a pending motion for preliminary injunction to the bankruptcy court pursuant to 28 U.S.C. § 157(a).

At the behest of CSI, the bankruptcy court conducted an evidentiary hearing on the motion for preliminary injunction to restrain PMS from disposing of the SKSIC pending the outcome of the civil action. The Honorable Jeffrey R. Hughes conducted an evidentiary hearing and entered an order mostly granting the motion, and enjoining PMS from disposing of the SKSIC technology. Thereafter, the parties stipulated to withdraw the reference and the civil action returned to the United States District Court where the Honorable Joseph G. Scoville conducted a settlement conference which, to some extent, bore fruit but only with respect to CSI's claims against the Debtor, now represented by the Trustee.

The Agreement to Seek Recovery of Property and For Withdrawal of Claim (the "Settlement Agreement") contemplated that the Trustee would take steps to assume the Original License, as amended by the terms of the settlement reflecting the new reality that the Debtor was no longer operating, and to approve the Settlement Agreement and the controversies between CSI and the bankruptcy estate, including those related to CSI's proof of claim in the amount of

approximately $5 million dollars. Accordingly, the District Court entered two orders, again, referring some portion of the civil action to the United States Bankruptcy Court to permit the Trustee to gain the authority to consummate the Settlement Agreement and modification of the Original License. *See* Case No. 1:13-CV-867, Order dated Dec. 2013; Order of Reference dated Jan. 23, 2014. After several more months, the Trustee filed the Assumption Motion and the Settlement Motion. As originally presented, the Assumption Motion characterized the transaction as an assumption of an executory contract under § 365. After the court expressed some doubt about whether § 365 applied to a post-petition agreement, the Trustee, with the court's permission, amended the Assumption Motion to include a request for authority to use the SKSIC technology under § 363 by again licensing it to CSI.[4] The Settlement Motion sought approval of the Settlement Agreement.

B. The Property at Issue and the Trustee's Theories

1. In General

Much of the difficulty in this contested matter stems from not knowing what property is at issue in the transaction and what, precisely, the Trustee intends to do with that property, namely whether to assume the Amended License under § 365, or to sell or license the intellectual property that is the subject of the Amended License.

For example, as noted above, the Trustee styled the original Assumption Motion as one seeking authority to assume (and amend) the Original License. Thereafter, in response to the court's inquiries, the Trustee filed his amended Assumption Motion, which includes (as before) a

[4] The court granted the Trustee's request to recharacterize the contested matter but for reasons explained on the record, refused to permit the Trustee to sell the SKSIC technology "free and clear" under § 363(f). Pursuant to the court's order granting the motion to amend, the Trustee filed an amended motion in conformance with the court's ruling. *See* Trustee's Amended Motion to Assume Executory Contract, as Amended, or, in the Alternative, to Sell Property of the Estate (DN 451).

request for (i) authority to assume an executory contract under § 365, or (as an alternative) (ii) permission to sell or use the underlying technology under § 363(b).

The alternatives set forth in the amended Assumption Motion seem, at first blush, inconsistent. The notion of licensing property, as opposed to selling it suggests that the licensor (here, the estate) retains an interest in the property to be licensed (as CSI's counsel argued during opening arguments). The Trustee's motion papers, however, suggest that if the court approves the transaction, the estate will effectively part with all interest in the SKSIC technology and the improvements. *See* Assumption Motion at ¶ 41

Similarly confusing, in his closing oral argument, Trustee's counsel attempted to clarify his position that the estate retains no interest in the second generation of the SKSIC (*i.e.*, the TRSS), and that the Trustee is not attempting, therefore, to transfer that property through the Assumption Motion or Settlement Motion because it is not estate property. Yet, the Amended License contemplates just such a transfer, albeit perhaps in the nature of a quit claim. *See* Amended License at § 4.2

Even after nearly four days of trial, in view of the shifting theories and the seeming inconsistency between the Trustee's oral arguments and his motion papers, it remains less than clear exactly what the Trustee is trying to achieve. Nevertheless, the court will attempt to identify the property at issue before considering the Trustee's legal theories.

2. <u>The Property at Issue</u>

The Trustee contends that the only property at issue is the SKSIC, the first generation of the intellectual property the Debtor originally licensed to CSI in connection with the Plan. CSI and the Trustee value the SKSIC at somewhere between $0 and $200,000.00. However, if this

were an accurate estimate, it is unlikely that CSI would be willing to pay $200,000.00 *and* share a percentage of its sales derived from the TRSS, a stream of payments with a present value of approximately $3.8 million, according to the Trustee.[5] The Honorable David E. Nims was fond of quoting an ancient truth: "the worth of a thing is the price it will bring." Through the years, the court has found this axiom to be generally reliable.

Notwithstanding the Trustee's and CSI's characterization of the transaction as limited to the SKSIC technology, the court finds that a more plausible interpretation of the transaction, and one consistent with the language of the Amended License itself, includes three closely-related property rights held by the estate: (1) its residual interest in the SKSIC technology; (2) its rights under the Original License; and (3) its claim to ownership of the TRSS improvements under the Original License.[6]

Although the question of ownership of the TRSS under non-bankruptcy law is debatable, the Trustee is not asking this court to determine the ownership issue. Instead, by entering into the Amended License, he is simply agreeing not to claim ownership because he does not regard that

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[5] This estimate assumes that CSI's sales projections come to fruition. It does not reflect any discount for the risk that sales will not materialize when or as predicted.

[6] By the Trustee's own admission, and as set forth in the Amended License, the first category of property (the original SKSIC technology) is clearly at issue. *See* Assumption Motion at [unnumbered] Recital ¶¶ 2, 7 & 8; §§ 1.10, 1.11, & 2.1. Moreover, because the Trustee is seeking to amend and assume the Original License, clearly the second category is at issue. *See, e.g.*, Assumption Motion at ¶¶ 7-10, and *passim.* With respect to the third category of related property, the TRSS, the court's review of the Assumption Motion and the Amended License makes clear that the transaction includes the "Improvements" to, or "subsequent generations" of, the SKSIC. *See, e.g.*, Assumption Motion at ¶ 22 ("Although the Trustee agrees with CSI that the License Agreement is valid, executory and enforceable, CSI and Trustee disagree on the extent to which royalties are due under the License Agreement for subsequent generations of the SKSIC technology."); Amended License at [Unnumbered] Recital ¶¶ 7 & 9 (noting dispute about the TRSS and explaining that the agreement resolving the dispute); §§ 1.8 (definition of "Improvements"), 2.3 (giving licensee "exclusive title to all Improvements"), 4.2 (confirming CSI's title to the Improvement and assigning to CSI "all right, title, and interest in and to any and all Improvements . . ."). In other words, the Trustee is relinquishing ownership of the TRSS, or at least confirming that the estate will not be claiming the TRSS if the court approves the Amended License. Significantly, the Debtor granted PMS a security interest in "Copyright Licenses," a term that includes the "granting of any right in any derivative work based upon any Copyright . . ." *See* Security Agreement dated as of April 16, 2009 at p. 1, § 1 (attached to PMS's proof of claim). The Debtor's, and therefore the Trustee's, authority to grant CSI any interest in the TRSS is itself subject to PMS's security interest (assuming, as seems likely, that the TRSS is a derivative work).

aspect of the property to be included within the bankruptcy estate.[7] He is simply agreeing to settle any TRSS-related controversy with CSI, and asking the court to apply the usual settlement standards under *Protective Committee for Independent Stockholders of TMT Trailer Ferry, Inc. v. Anderson*, 390 U.S. 414 (1968).

3. The Trustee's Legal Theories

The Trustee relies on three legal theories in support of the transactions under review, each of which depends, ultimately, on the exercise of his business judgment: (1) assumption of an executory contract under § 365; (2) entry into a contract for the licensing (or sale) of the SKSIC technology under § 363; and (3) entry into a settlement under Fed. R. Bankr. P. 9019.

Regardless of the exact theory, the Trustee is entitled to considerable deference in the exercise of his business judgment, provided, of course, that the proposals are lawful and otherwise consistent with the Trustee's authority under the Bankruptcy Code. This is the familiar "business judgment rule" that applies regardless of the specific theory upon which the Trustee and the court may ultimately rest. *See Ford Motor Credit Co. v. Weaver*, 680 F.2d 451, 461 (6th Cir. 1982) ("The measure of care, diligence and skill required of a trustee is that of an ordinarily prudent man in the conduct of his private affairs under similar circumstances and with a similar object in view."); *In re Batt*, 488 B.R. 341, 353 (Bankr. W.D. Ky. 2013) (a trustee's decisions are somewhat protected by the business judgment rule which protects a disinterested trustee so long as any decision falls within the range of what an informed businessman would have rationally decided under the circumstances); *In re Levine*, 287 B.R. 683, 688 (Bankr. E.D. Mich. 2002)

[7] The court suspects that PMS and CSI had hoped to entice the court to resolve the question of ownership in connection with this contested matter, but the court regards it as unnecessary and unwise to do so given the manner in which the Trustee has presented the proposed transaction and the limited extent of bankruptcy jurisdiction, especially in cases involving disputes between two creditors, the resolution of which will not affect the estate. Another court with broader jurisdiction, perhaps the District Court, may decide whether the TRSS belongs to CSI free and clear of, or subject to, PMS's security interest.

(test to approve a settlement is whether the trustee's decision is consistent with his fiduciary obligations to the estate, the duty of loyalty and the duty of care).

a. Assumption Under § 365

At first, the Trustee and CSI relied on § 365[8] as authority for the Trustee to assume the Amended License, but in opening argument during the trial they reluctantly conceded that the theory was "on the back burner." By the time of closing arguments, neither mentioned § 365, and the court regards the argument as abandoned.

In any event, if the Trustee has not intended to abandon his reliance on § 365, the court finds that the statute does not apply to post-petition agreements, such as the Original License, notwithstanding a footnote to the contrary in *In re Tex. Wyo. Drilling, Inc.*, 486 B.R. 746, 754 n.19 (Bankr. N.D. Tex. 2013). *See In re Cannonsburg Environmental Associates, Ltd.*, 72 F.3d 1260, 1265 (6th Cir. 1996) (*citing Ballas v. Revco D.S., Inc. (In re Revco D.S., Inc.)*, No. 93-3597, 1994 WL 376884, at *2 (6th Cir. July 18, 1994) (unpublished *per curiam*) and other cases for the proposition that "[s]ection 365 does not apply to postpetition contracts. . .").[9]

To the extent the Assumption Motion relies on § 365 to assume what is undeniably a post-petition contract, the court will deny it.

[8] It appears from the statements of counsel and the Amended License itself that CSI was endeavoring to preserve whatever benefits might have been available to it as licensee under § 365(n). *See* Amended License at § 7.2.

[9] Although § 348(c) specifies that § 365(d) shall "apply in a case that has been converted under section 706, 1112, 1208, or 1307 of this title, as if the conversion order were the order for relief," the same section makes clear that, in most other respects, conversion "does not effect a change in the date of the filing of the petition, the commencement of the case, or the order for relief." *Compare* 11 U.S.C. § 348(a) & (d). Moreover, if the Trustee and CSI are correct that the Original License is subject to assumption, it also follows that it is subject to rejection, which under § 502(g) would give rise to a prepetition claim (since the estate has never "assumed" the Original License under § 365 or under the plan). This, of course, is inconsistent with the premise of the Sixth Circuit's decision in *Cannonsburg* that the breach of a post-petition contract gives rise to an administrative claim.

b. Use of Estate Property Under § 363(b)

At the heart of the proposed transaction lies the Trustee's proposed use or sale of intellectual property including the SKSIC. Whether the nature of the transaction is either an outright sale or a more limited use or licensing of the estate's intellectual property rights, the Trustee has been less than clear. In addition, he has been equally unclear in describing precisely what he is selling or licensing. Thus, the transaction, as well as the extent of PMS's security interest in the subject of the transaction and whether the Trustee is adequately protecting that interest, has been unnecessarily difficult to evaluate. *See* 11 U.S.C. § 363(p) (assigning burdens of proof).

The Trustee purports only to be leveraging the original SKSIC, arguing that he is not proposing through the Amended License or the Settlement Agreement to transfer the TRSS to CSI. This is so because, according to the Trustee, CSI already owns the TRSS as an improvement under the terms of the Original License. As noted above, the Trustee is compromising whatever claim he has to the TRSS, in the nature of a quit-claim.

Similarly, looking at the transaction as a perpetual license, the fact that the SKSIC, by its nature, like most technologies, is susceptible to obsolescence also makes the arrangement look more like a sale: as a practical matter, the estate will retain no meaningful interest other than the right to payments over time. Indeed, the Trustee has characterized the transaction at times as a "sale," including in his motion papers. *See* Amended Assumption Motion at ¶ 41 ("Approval of the Amended License Agreement would effectively result in the sale of the SKSIC technology to CSI.").

On the other hand, CSI sought to downplay the sale-like nature of the transaction during its opening statement, perhaps hoping to maximize the benefits it perceives as available under §

365(n), or to minimize the protections available to PMS as a secured creditor, such as credit bidding under § 363(k) or other rights under the Uniform Commercial Code ("UCC"), both of which might put control of the SKSIC and perhaps TRSS in different hands.

Adding to the confusion is the fact that the SKSIC is apparently less valuable than the improvements to the SKSIC —the TRSS.[10] Remarkably, despite the Trustee's and CSI's protestations to the contrary, the role of the TRSS in this proceeding has had signal importance, exciting more objections, argument, and general controversy than one would expect about property purportedly not at issue.

At the hearing, PMS argued that the SKSIC and related property rights are subject to its security interest, and that the Plan specifically preserved its rights in the SKSIC. Indeed, the Plan explicitly preserves PMS's security interest as it needed to do in order to pass muster under § 1129(b)(2)(A)(i)(I). Moreover, PMS argued that the SKSIC is fully-encumbered and, citing the United States Trustee's Chapter 7 Trustee Handbook, that the Trustee should not be administering it. *See also* 11 U.S.C. § 554(a) (abandonment of property that is of "inconsequential value and benefit to the estate").

Evidently in an effort to counter PMS's argument that the property is fully-encumbered, the Trustee attempted to argue that the SKSIC is severable from the Original License as well as the Amended License, and from the modifications or improvements to the SKSIC. With respect to this last point regarding the TRSS, the Trustee analogized the improvements to an "accession," a concept borrowed from the UCC. *See C Tek Software, Inc. v. New York State Business Venture Partnership (In re C Tek Software, Inc.)*, 127 B.R. 501 (Bankr. D.N.H. 1991)

[10] Credible testimony from Messrs. Takahashi, Benefield, and Sibert confirm that the SKSIC suffered from shortcomings later corrected through the efforts of the Debtor and CSI before the case converted to chapter 7.

(under former version of UCC Article 9, security interest in original software did not attach to derivative work in the nature of an accession).

When the court, however, inquired about another UCC concept —"proceeds"— and specifically whether the Original License and the Amended License constituted proceeds of the SKSIC, Trustee's counsel responded, in effect, that both licensing agreements were just the vehicles through which the Trustee would be paid for the SKSIC, not proceeds.[11] This statement, however, only confirms that pursuant to the UCC, the Original License and the Amended License are proceeds of the SKSIC technology, which was (and remains) PMS's original collateral.

Under Michigan's version of the UCC, applicable to the Original License pursuant to the Debtor's chapter 11 plan,[12] the term "proceeds" means:

> (i) Whatever is acquired upon the sale, lease, *license,* exchange, or other disposition of collateral.
>
> (ii) Whatever is collected on, or distributed on account of, collateral.
>
> (iii) Rights arising out of collateral. . . .

M.C.L. § 440.9102(1)(kkk) (emphasis added). Clearly, the Debtor acquired its rights under the Original License when it initially agreed to license the SKSIC technology to CSI under the Plan. As a matter of Michigan law, "the attachment of a security interest in collateral gives the secured party the rights to proceeds provided by section 9315." M.C.L. § 440.9203(6). Section 9315, in

[11] The *C Tek* opinion, rendered in 1991, did not consider whether the secured party's lien attached to the derivative work as proceeds, presumably because the prior UCC definition of proceeds was much more limited than the current version. The former version generally required a sale or disposition of the collateral in order for proceeds to exist, and the latter now includes any "rights arising out of collateral," without requiring any "disposition."

[12] Under the Plan, Michigan law generally governs the construction and implementation of the Plan and "any agreements, documents and instruments executed in connection with the Plan." *See* Plan at § 1.4. The Original License was executed in connection with the Plan. Under PMS's security agreement, however, the parties chose Illinois law. Both states define "proceeds" similarly. *Compare* M.C.L. § 440.9102(1)(kkk) with I.L.C.S. § 5/9-102(a)(64). The different choices are immaterial given the similarity in both definitions.

turn, provides that "a security interest attaches to any identifiable proceeds of collateral." The court has no difficulty concluding that both the Original License and the Amended License are identifiable proceeds of the SKSIC. Furthermore, the Bankruptcy Code generally protects a secured party's prepetition right to proceeds, including post-petition proceeds:

> if the debtor and an entity entered into a security agreement before the commencement of the case and if the security interest created by such security agreement extends to property of the debtor acquired before the commencement of the case and to proceeds, products, offspring, or profits of such property, then such security interest extends to such proceeds, products, offspring, or profits acquired by the estate after the commencement of the case to the extent provided by such security agreement and by applicable nonbankruptcy law . . .

11 U.S.C. § 552(b). PMS's security agreement, which is attached to its proof of claim, extends to proceeds of the SKSIC collateral including the Original License and, if approved, the Amended License. Consequently, the payments that the Trustee hopes to receive under the Amended License would be the proceeds of proceeds, and therefore subject to PMS's security interest.

As noted above, the Trustee stated that the present value of the stream of payments promised under the Amended License is $3,845,000.00, slightly more than the $3,439,709.00. that PMS claims as due, taking into account post-petition interest and attorney fees as Mr. Hall testified. The court, however, cannot accept the Trustee's present value calculation uncritically as the true value of the three bundles of property at issue in the Amended License because the Trustee's present value calculation fails to account for the contingent nature of the 2% royalty payments,[13] and other setoffs contemplated in the Amended License.

[13] *See In re Nellson Nutraceutical, Inc*. 2007 WL 201134 (Bankr. D. Del. 2007) (A higher discount rate should be applied when there is uncertainty associated with the introduction of technology that is new and untried in the market without any established sales and which carries inherent risks); *In re American HomePatient, Inc.*, 298 B.R. 152, 176 (Bankr. M.D. Tenn. 2003) ("discount rate is the rate of return to the [lender] to compensate for the time value of money and the risk inherent in the investment of their money"); *In re Future Energy Corp.*, 83 B.R. 470,

Obviously, the royalty payments depend upon future sales of products using the TRSS technology, but as the Trustee conceded on cross-examination, he has not seen a single document evidencing a purchase order or sales contract between CSI and any of its customers, or between CSI's resellers, 3A, Inc. or Scientific Research Corporation, and any prospective purchaser. The court also notes that the Debtor, based largely on CSI's sales projections, predicted during the confirmation more than two years ago that it would have conservatively received $4,081,000 in royalty fees by now under the Original License. *See* PMS Exh. A, p. 6. These sales have not materialized, undermining CSI's track record in forecasting sales, or at least illustrating the uncertain nature of sales projections given this type of property.

The court notes that based upon Mr. Sibert's and Mr. Benefield's testimony, the original SKSIC had a few shortcomings which Hewlett Packard detected through its rigorous testing, but it is also true (at the time of confirmation) that the parties to the Original License understood modifications and improvements might be necessary, yet still projected substantial and imminent royalties. *See* Original License at § 5.2.

Mr. Benefield testified that he and his associates have gone to great lengths to induce the Department of Defense (and a veritable alphabet soup of government intelligence and defense agencies) to include TRSS-related specifications in their respective procurement regulations. Indeed, Mr. Benefield gave the court considerable insight into the labyrinth of intelligence community-related contracting and microchip development. It takes years to develop the relationships and the regulations that are the harbinger of ultimate commercial success, and Mr. Benefield impressed the court as a knowledgeable and skilled player in this arena. But this same

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500 (Bankr. S.D. Ohio 1988) ("A projected stream of income in the future has a discounted present value based upon an interest factor, to account for the time value of money, and a risk factor, to account for the possibility that the projected stream of income may never be realized.").

testimony also confirmed the highly speculative nature of the undertaking, dependent on many moving parts inside and outside the government.

In addition, it would not be unreasonable to assume that, given the nature of software technology, the TRSS, like the SKSIC, is at risk of becoming obsolete if, for example, another entity or even CSI "builds a better mousetrap" in the roughly ten-year term of the Amended License. Indeed, during the third day of trial, counsel for CSI and the Trustee expressed some urgency in completing the hearing given the wasting nature of the assets and the risk of obsolescence. This risk also suggests that any meaningful calculation of the true value of the payment stream under the Amended License should take into account factors beyond simply the time value of money —factors reflecting the uncertainty inherent in reducing to money the emerging and fast-changing technologies.

Moreover, under the Amended License, the estate is agreeing either to defend CSI's title to the TRSS against any legal challenges by PMS, or suffer an offset against royalty payments due from CSI for CSI's own defense costs in the event the estate does not take appropriate action or is unsuccessful. *See* Amended License at § 10.3. There is considerable risk that CSI will incur substantial additional legal fees, perhaps in connection with the civil action now pending before Judge Bell, or in connection with its patent application, that would further reduce the royalty payments, even if sales materialize as projected.

Any realistic valuation of the projected stream of payments (and, derivatively, the value of PMS's collateral) must reflect these risks. Based on the evidence at trial, the court doubts that the Trustee has better than a fifty-fifty chance of seeing the projected royalties. If the court were to conclude that the Trustee's receipt of the projected royalty was just as likely as not —that

there was a 50% chance of success— the court would apply a 50% discount factor and thus bring down the Trustee's projected payment to about $1.9 million.

PMS's proof of claim establishes that, as of the petition date, it had a claim in the amount of $2,508,539.38 —greater than the $1.9 million value that the court charitably assigned to the future royalty payments under the Amended License. *See* Fed. R. Bankr. P. 3001(f) (proof of claim constitutes prima facie evidence of validity and amount of claim).[14] Accordingly, there is no equity in the property at issue in the Trustee's proposed transaction above the value to which PMS is entitled under its loan documents and the Plan.

In view of the court's finding that the subject matter of the transaction is fully encumbered in favor of PMS, the Trustee cannot sell, license, or use the property and subject the secured creditor to risks that the estate, under the circumstances, is only willing to bear because it has nothing to lose.

This conclusion obviates the need to discuss the Trustee's adequate protection proposal at length, except to say that it is unfair to require the holder of a security interest to wait while the estate throws the dice using the lender's fully-encumbered collateral in hopes of receiving contingent payments a few years hence. This is especially so in this matter, considering that PMS has awaited payment during the nearly three years this case has been pending so far. The court regards as wholly inadequate the Trustee's proposal to escrow uncertain royalty payments during some unspecified portion of time while he considers an objection to PMS's claim.

[14] Under the loan documents attached to the proof of claim, PMS is entitled to simple, annual interest on the principal debt at the rate of 16%, plus attorneys fees. Mr. Hall credibly testified that PMS's claim, with interest and attorneys fees, is approximately $3,439,709.00 as of the hearing on the Trustee's motions. Crediting this testimony, even if the court were to find that the Trustee had a 90% chance of realizing the projected royalties, the amount of PMS's claim would nevertheless exceed the value of the royalty payments after applying the present value discount and a 10% reduction to reflect even a modest risk associated with the projected royalties. As noted above, however, the court believes the chances of seeing the royalty payments are at most "even money."

c. Business Judgment Rule

Although, the Trustee argued that the court should review his decision to enter into the transaction under the business judgment rule, the court is not satisfied that the highly-deferential rule should be applied to transactions involving fully-encumbered property. Undoubtedly, although taking a gamble using another's property would bestow a benefit on the estate, the business judgment rule does not trump existing property rights or statutory protections.

Even assuming, *arguendo*, that the SKSIC and related property are not fully-encumbered, given the nature of the property at issue, it is surprising that the Trustee's report of his due diligence did not name a single technology consultant (other than CSI's agents) who offered advice in evaluating the property. Furthermore, when asked on cross-examination whether he consulted with legal counsel versed in intellectual property matters, the Trustee simply replied that the firm he retained (Miller Johnson) has intellectual property lawyers, in effect assuming the court would infer that he consulted, albeit indirectly, with the unnamed specialists when deciding, for example, whether to refrain from asserting a right to the TRSS as a derivative work. Given the nature of the subject matter, imbued with complicated copyright and patent overtones, simply reviewing the Original License and crediting CSI's report that it paid for improvements falls short, in the court's view, of good business judgment in deciding to quit claim property that the Trustee himself contends promises to generate millions if not billions of dollars in sales.

Similarly, the court shares the Trustee's and Mr. Sibert's belief that CSI's pre-conversion relationship with the Debtor, the Original License, and the TRSS makes CSI the most likely purchaser or licensee. The likelihood that CSI is the most appropriate suitor, however, in no way excuses the Trustee from exposing the property and the transaction to the marketplace as a means of testing the value to the estate of the proposed transaction. Based upon the Trustee's

own testimony and the documentary evidence, including PMS Exh. Y, the court finds that the Trustee's efforts to consider alternative purchasers postdated the filing of the Assumption Motion and Settlement Motion. Good business judgment, naturally, would require such investigation to take place in advance of seeking the court's approval.

Moreover, relying on CSI, as the prospective purchaser or licensee, to inquire of its competitor (Maxim) whether the latter were interested in purchasing the SKSIC, and to do so in a way that the court regards as less than transparent, is not a substitute for due diligence by the estate's disinterested representative. In effect, the Trustee enlisted CSI to ask a competitor to vie for the very technology that CSI has a vested interest in keeping for itself. This is not indicative of due diligence. The court credits the Trustee's testimony that he and his counsel spent hundreds of hours trying to understand the technology, the competing interests, and the proposed transaction, but qualitatively, the due diligence falls short of what the court requires of a fiduciary under the circumstances.

Moreover, presumably at the behest of CSI, structuring the transaction as a private sale effectively shut out other bidders, including PMS who might have offered a credit bid under § 363(k). The process employed to dispose of the estate's supposed interest in the property was wholly inadequate and inconsistent with the rights of PMS as the holder of security interests ratified in the Plan as condition of confirmation.

The court finds that the Trustee did not exercise appropriate, independent, business judgment in marketing the SKSIC and related property, or quit-claiming the TRSS under the Amended License.

## IV. CONCLUSION & ORDER

Because the court finds that the SKSIC, the Original License, and the Amended License are fully encumbered, and because this is the only property the Trustee is purporting to license, sell, or use, and because the Trustee failed to establish that he exercised appropriate business judgment, the court will deny the Assumption Motion and the Settlement Motion.

NOW, THEREFORE, IT IS HEREBY ORDERED as follows:

1. The Assumption Motion (DN 367) is DENIED; and
2. The Settlement Motion (DN 373) is DENIED.

IT IS FURTHER ORDERED that the Clerk shall serve a copy of this Opinion and Order pursuant to Fed. R. Bankr. P. 9022 and LBR 5005-4 upon John T. Piggins, Esq. and Thomas P. Sarb, Esq., attorneys for the Trustee; Daniel G. Kielczewski, Esq., attorney for Cyber Solutions International, LLC; Erik H. Olson, Esq., John A. Smietanka, Esq. and Thomas Rosseland, Esq., attorneys for Pro Marketing Sales, Inc.; and Dean E. Rietberg, Esq., attorney for the United States Trustee, and deliver a copy to the Honorable Robert Holmes Bell.

**IT IS SO ORDERED.**

**Dated October 24, 2014**

Scott W. Dales
United States Bankruptcy Judge