UNITED STATES BANKRUPTCY APPELLATE PANEL

OF THE TENTH CIRCUIT

IN RE LGX, LLC, Debtor.	BAP No. WO-05-008 BAP No. WO-05-009
CARGILL, INCORPORATED, Appellant, v. LYLE R. NELSON, Trustee, Plaintiff – Appellee, HINTON ECONOMIC DEVELOPMENT AUTHORITY, Defendant – Appellee.	Bankr. No. 02-21140-WV Adv. No. 03-01110-WV Chapter 7 ORDER ON MOTIONS FOR REHEARING January 13, 2006

Before CLARK, BROWN, and KARLIN[1], Bankruptcy Judges.

This matter comes before the Court on the Motion for Rehearing, filed by Appellant Cargill, Incorporated ("Cargill Motion"), and the Motion for Rehearing, filed by Appellee Lyle E. Nelson, trustee ("Trustee Motion"). Both parties assert errors in this Court's Order and Judgment, entered on October 31, 2005 (the "Judgment"). The Cargill Motion asserts that this Court erred in finding Cargill lacked standing to challenge the bankruptcy court's approval of the Settlement Motion. The Trustee Motion requests that this Court correct the statement in its

[1] Honorable Janice Miller Karlin, United States Bankruptcy Judge, United States Bankruptcy Court for the District of Kansas, sitting by designation.

opinion that the bankruptcy court found the Memorandum of Understanding was a rejected executory contract.

The Court concludes that the Trustee's Motion, which is unopposed, should be granted, and the Cargill Motion should be granted in part. The Judgment will be vacated and replaced with the Order and Judgment attached hereto.

Accordingly, it is HEREBY ORDERED that:

1. The Trustee Motion is GRANTED.
2. The Cargill Motion is GRANTED IN PART.
3. This Court's Judgment, entered October 31, 2005, is VACATED, and the following Order and Judgment is substituted in its place.

For the Panel:

Barbara A. Schermerhorn, Clerk of Court

By: Deputy Clerk

FILED
U.S. Bankruptcy Appellate Panel
of the Tenth Circuit
January 13, 2006
Barbara A. Schermerhorn
Clerk

NOT FOR PUBLICATION

UNITED STATES BANKRUPTCY APPELLATE PANEL

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IN RE LGX, LLC, Debtor.	BAP No. WO-05-008 BAP No. WO-05-009
CARGILL, INCORPORATED, Appellant, v. LYLE R. NELSON, Trustee, Plaintiff – Appellee, HINTON ECONOMIC DEVELOPMENT AUTHORITY, Defendant – Appellee.	Bankr. No. 02-21140-WV Adv. No. 03-01110-WV Chapter 7 ORDER AND JUDGMENT*

Appeal from the United States Bankruptcy Court
for the Western District of Oklahoma

Before CLARK, BROWN, and KARLIN[1], Bankruptcy Judges.

BROWN, Bankruptcy Judge.

Appellant appeals an order of the United States Bankruptcy Court for the Western District of Oklahoma approving a settlement of an adversary proceeding

* This order and judgment is not binding precedent, except under the doctrines of law of the case, res judicata, and collateral estoppel. 10th Cir. BAP L.R. 8018-6(a).

[1] Honorable Janice Miller Karlin, United States Bankruptcy Judge, United States Bankruptcy Court for the District of Kansas, sitting by designation.

pursuant to Federal Rule of Bankruptcy Procedure 9019 between the trustee and Defendant-Appellee Hinton Economic Development Authority ("HEDA"). For the reasons stated below, we remand for further findings.

I. Background

The debtor, LGX, LLC ("LGX"), owns a cocoa extraction plant in Hinton, Oklahoma. It pledged the plant, both its real and personal property, to secure financing for the plant's construction. HEDA acquired by assignment LGX's promissory note, mortgage and security agreement, pledging substantially all of LGX's assets. LGX filed for Chapter 7 bankruptcy protection on November 5, 2002. Lyle R. Nelson was appointed as the Chapter 7 trustee of LGX (the "Trustee").

A. Litigation Between LGX and Cargill & the MOU

Prior to its bankruptcy filing, LGX was embroiled in litigation with Appellant Cargill, Incorporated ("Cargill"). Cargill had initiated suit against LGX and its principal, Mr. Donald Hall ("Hall"), in the United States District Court for the Eastern District of Pennsylvania for patent infringement (the "Pennsylvania Litigation"). LGX asserted counterclaims of misappropriation of trade secrets, unfair competition, and breach of contract.

The parties arrived at a tentative settlement of the Pennsylvania Litigation, which they embodied in a Memorandum of Understanding ("MOU"). The MOU provided, in part:

> 1. Cargill, Incorporated hereby grants to defendants a covenant not to sue under U.S. patents 5,281,732 and 5,739,364 (collectively, "the Franke patents") with respect to the manufacture, use and sale of cocoa products pursuant to a process covered by any one or more claims of either or both of the Franke patents. This covenant is limited to products produced by defendants' facility in Hinton, Oklahoma as presently configured or with improvements or increases in capacity. Cargill further acknowledges that the defendants' facility in Hinton, Oklahoma, as presently configured, does not

infringe U.S. Patent No. 6,066,350.[2]

. . . .

4. Cargill will immediately and diligently assist defendants in approaching Henry Franke for the purpose of obtaining a license from Franke to defendants to utilize the available subject matter of the Franke patents outside of cocoa and cocoa products.[3]

The MOU further provided that Cargill would pay HEDA $1 million, plus up to an additional $3 million in royalties on any revenues Cargill might generate from its future use of the two patented manufacturing processes at issue. The parties expressly conditioned the MOU on entering into a "more formal agreement," which had not occurred by the time of LGX's bankruptcy filing.

B. Litigation Between the Trustee and HEDA & the Settlement Motion

At the time of the filing of LGX's Chapter 7 petition, LGX owed HEDA approximately $8.5 million. Shortly after the bankruptcy filing, HEDA filed for relief from stay to foreclose on HEDA's collateral, which included the plant and essentially all of LGX's assets. The Trustee and creditor Atkins Benham Constructors, Inc. ("Benham"), which held an unsecured claim for approximately $487,000, opposed HEDA's stay relief motion. The Trustee also filed an adversary proceeding (the "Adversary") against HEDA, seeking equitable subordination, avoidance of HEDA's secured claim as a preferential transfer, and disallowance of HEDA's claim in its entirety. Due to the commencement of the Adversary, the bankruptcy court denied HEDA's stay relief motion without prejudice.

The Trustee and HEDA later entered into a settlement of the Adversary. The most pertinent aspects of this settlement, as it was later revised, provide for:

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[2] Memorandum of Understanding at 1, *in* Appellant's Appendix at 01197.

[3] *Id.* at 01198.

1. Relief from stay granted to HEDA to foreclose on its collateral;

2. Dismissal of the Adversary;

3. HEDA's assignment to the Trustee of its rights under the MOU;

4. The Trustee's assignment to HEDA of 30% of his net recovery under the MOU, up to $250,000;

5. HEDA's assignment to Benham of 50% of its recovery from the Trustee under the MOU;

6. The Trustee's grant to HEDA of a "Quitclaim License" to:

> utilize certain intellectual and proprietary property rights and patent rights at the former LGX plant in Hinton Oklahoma relating to the design, construction and operation of [same] arising from:
>
> a) The Operating Agreement creating LGX and the amendments thereto;
> b) LGX's interest in U.S. Patent Application No. 09/845,709 Liquified Gas Extraction Process;
> c) Rights granted to LGX by virtue of the MOU [the covenant not to sue]; and
> d) Any improvements to existing processes and technology developed by employees and agents of LGX in the course of designing, constructing and operating the former LGX plant in Hinton, Oklahoma,
>
> and said license shall include the right of HEDA, its successors and assigns to expand, alter or increase the capacity of the former LGX plant in Hinton, Oklahoma[;][4]
>
> and

7. On entry of a final order approving the settlement, HEDA's payment to the Trustee of $5,000.

The Trustee filed a Motion to Compromise Controversy and Settle Pending Suit/Adversary and Brief In Support (the "Settlement Motion"), maintaining that, due to the anticipated complexity and expense of the Adversary, which would involve multi-state discovery, it would be in the best interests of creditors for the estate to "pursue and force compliance with" the terms of the MOU in the

[4] First Revised Settlement Term Sheet ¶ 7, *in* Appellant's Appendix at 704-05.

Pennsylvania Litigation. Cargill objected to the Settlement Motion, claiming among other things that the proposed settlement was not in the best interests of creditors insofar as the MOU was unenforceable. On January 28, 2005, the bankruptcy court entered its Order granting the Trustee authority to enter into the Settlement (the "Order").[5]

II. Discussion

Cargill objects to the Settlement Motion on numerous grounds. We limit our focus here to one particular objection, the Trustee's grant of the Quitclaim License in the settlement. Cargill asserts that the Quitclaim License is an impermissible transfer of a right under a patent.[6] According to Cargill, since the Quitclaim License is a part of the overall settlement, the settlement cannot be approved.[7]

The United States patent statutes grant a patent owner the exclusive right to make, use, sell, and offer for sale the patented invention for a limited period of time.[8] A patent has the "attributes of personal property."[9] Therefore, its ownership may be transferred by an assignment. An assignee may freely transfer

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[5] This Order incorporated by reference the court's findings and conclusions that it had orally set forth on the record on January 21, 2005. Order, *in* Appellant's Appendix at 1084-85.

[6] *See Hilgraeve Corp. v. Symantec Corp.*, 265 F.3d 1336, 1346 (Fed. Cir. 2001); *In re Access Beyond Techs., Inc.*, 237 B.R. 32, 45 (Bankr. D. Del. 1999); *Metabolite Labs., Inc. v. Lab. Corp. of Am. Holdings*, 370 F.3d 1354, 1369 (Fed. Cir. 2004), *petition for cert. filed*, 73 U.S.L.W. 3298 (U.S. Nov. 3, 2004). Combined, these three patent cases support the proposition that patent licenses are essentially non-assignable covenants not to sue under the conferred grant of right.

[7] *See Debbie Reynolds Hotel & Casino, Inc. v. Calstar Corp., Inc. (In re Debbie Reynolds Hotel & Casino, Inc.)*, 255 F.3d 1061, 1065 (9th Cir. 2001) (settlement approval resting on an erroneous interpretation of law is, *per se*, an abuse of discretion).

[8] 35 U.S.C. § 271(a) (establishing infringement of patent).

[9] *Id.* § 261.

his or her acquired rights.[10]

A patent owner may also grant a license to the patented invention. "A license differs most fundamentally from an assignment in the respect that a licensor retains legal title to the patent."[11] Licenses also differ in that the ability to assign a license is not addressed in the patent statutes. In the absence of a statute, federal courts have "fashioned a rule of federal common law to apply in cases concerning transfers of patent licenses. It is now well settled that a licensee has only a personal and not a property interest in the patent that is not transferable, unless the patent owner authorizes the assignment or the license itself permits assignment."[12]

A trustee's ability to assign a patent license is limited by 11 U.S.C. § 365(c), which prevents assignment 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.[13]

Bankruptcy courts have held that federal common law preventing the non-consensual assignment of patent licenses constitutes "applicable law" that

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[10] *Id.*

[11] *Superbrace, Inc. v. Tidwell*, 21 Cal. Rptr. 3d 404, 407 (Cal. Ct. App. 2004) (quotation omitted).

[12] *Id.* (citing *Everex Systems, Inc. v. Cadtrak Corp.*, 89 F.3d 673, 679 (9th Cir.1996) (regarding nonexclusive licenses); *In re Hernandez*, 285 B.R. 435 (Bankr. D. Ariz. 2002) (applying same logic to exclusive licenses)); *see also Unarco Industries, Inc. v. Kelley Co., Inc.*, 465 F.2d 1303, 1306 (7th Cir. 1972) ("The long standing federal rule of law with respect to the assignability of patent license agreements provides that these agreements are personal to the licensee and not assignable unless expressly made so in the agreement."); *In re Access Beyond Techs., Inc.*, 237 B.R. 32, 45 (Bankr. D. Del. 1999).

[13] 11 U.S.C. § 365(c).

prohibits a debtor's assumption and assignment of the license over a patent owner's objection under § 365(c)(1).[14]

This Court previously concluded *sua sponte* that Cargill did not have standing to raise this issue on appeal, referring to patent US 6,569,480 for a "liquefied gas extraction process," held in the names of inventors Donald R. Hall, Michael R. Hall, Michael Moser, and L.V. Benningfield, Jr. (the "Hall Patent"). Cargill argues that it is not asserting rights under the Hall Patent, but that its objection stemmed from the Trustee's attempt to assign the Debtor's rights under the MOU in what are referred to as the "Franke Patents." Cargill further asserts that it has rights under the Franke Patents and, therefore, it has standing to object to the Quitclaim License aspect of the Settlement Motion. Unfortunately, the record on appeal does not support this assertion.

The Franke Patents are not part of the record before this Court. Nor does the record contain any assignment of rights under the Franke Patents to Cargill. Paragraph 1 of the MOU, in which Cargill grants LGX and Hall a covenant not to sue under the Franke Patents, lends some support to Cargill's claim to rights under the Franke Patents. But, paragraph 4 of the MOU, in which Cargill represents that it will assist LGX and Hall in approaching Mr. Franke to obtain a license to utilize the subject matter of the Franke Patents outside of cocoa and cocoa products, calls into question the extent of Cargill's interest in the Franke Patents. Thus, the record is not clear that Cargill has standing to raise the issue of nonassignability of the Franke Patents.

It appears that Cargill expressly raised the issue of nonassignability of the patent rights before the bankruptcy court, but the court made no findings in this regard. The matter will therefore be remanded to the bankruptcy court for further

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[14] *Access Beyond Techs., Inc.,* 237 B.R. at 45; *In re Patient Educ. Media, Inc.*, 210 B.R. 237 (Bankr. S.D.N.Y. 1997).

findings.

III. Conclusion

This matter is REMANDED to the bankruptcy court for further findings as to: (1) Cargill's standing to raise an objection to the Quitclaim License; (2) if Cargill has standing, whether the Quitclaim License constitutes an impermissible transfer of a right under a patent; and (3) if it is an impermissible transfer, whether the Settlement Motion can be approved despite an illegal provision contained within it.