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Fifth Circuit Holds that Contracts Are Deemed Rejected After 60 Days and No Longer Salable Estate Property Regardless of Whether the Trustee Knew of Their Existence



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Matter of Provider Meds L.L.C. [1] involved contract rejection and related issues the Fifth Circuit stated it and most circuits had not previously considered. Tech Pharmacy Services (TPS) held a patent on methods involving remote pharmaceutical dispensing (the IP). The OnSite entities provided dispensing machines for use in health facilities. In 2010, TPS sued OnSite in the Eastern District of Texas for infringement, which was resolved by agreement (the "Settlement License") confirming the validity of TPS's IP and granting OnSite a nonexclusive, *perpetual* license to use the IP in exchange for (1) a \$4,000 fee for each machine thereafter placed into service, and (2) quarterly reports identifying the new machines. The parties also agreed to mutual releases of all claims "which relate to or could have been claimed in the Litigation, or that relate to the [Patents] or any alleged infringement." The Settlement License was referenced on the court's docket (which later would become important to the Fifth Circuit's decision on appeal).

OnSite thereafter commenced chapter 11 cases in the Northern District of Texas, which later were converted to chapter 7s. Trustees were appointed for each of the debtors. More than 60 days after the commencement of the chapter 7 cases, the bankruptcy court approved three asset sales to OnSite's secured creditor, RPD. Notice of commencement of the cases was not given to TPS, and TPS was not served with the sale motions. The schedules did not include either TPS as a creditor or the Settlement License, and the Settlement License was not explicitly identified as an asset. RPD was unaware of the Settlement License's existence until just before entry of the third of the three sale orders. The sale agreements referred to the assets subject to the sale by category/description and provided that if any were executory contracts, such were included in the sale. Shortly thereafter, the nonselling OnSite debtors entered into a settlement with RPD, approved by the bankruptcy court, providing RPD with rights to "all remaining available [TPS] licenses (such as those acquired from [the selling OnSite debtors])." The sale and settlement motions in each bankruptcy case were filed after the expiration of the 60-day period provided under § 365(d)(1). Approximately one year later, TPS sought a declaration in Texas state court that the Settlement License had terminated. RPD intervened and removed the proceeding to the bankruptcy court.

The bankruptcy court ruled that the Settlement License had not been transferred to RPD and that RPD had no rights thereto. In affirming, the Fifth Circuit concluded that the Settlement License (1) was an executory contract because material obligations were due from each party (TPS not to sue for infringement so long as OnSite performed and OnSite was to pay the fees and provide the quarterly reports), (2) was deemed

rejected on the 61st day of the chapter 7 cases, prior to the sales (and settlement), and, (3) was not property of the OnSite estates at the time of the sales due to rejection. Thus, the chapter 7 trustees lacked power to transfer the License Agreement to RPD.

Provider Meds involves important mixed IP/bankruptcy matters. In ruling that the Settlement License was executory, the Fifth Circuit concluded that (1) TPS's obligation not to sue OnSite for infringement was material and not illusory, and (2) the Settlement License remained subject to termination for material breach despite it being "perpetual." RPD argued that the dismissal with prejudice and the mutual releases in the 2010 infringement lawsuit made TPS's obligation not to sue illusory because it already was precluded from suing. The Fifth Circuit disagreed, as under federal patent law the settlement resolved only pre-settlement matters and did not prevent suing for post-settlement infringement. In effect, TPS was not precluded from suing for breach of the settlement (*i.e.*, new machines put into service for which payment was not made or reports not submitted). On the same basis, the Fifth Circuit also did not agree with RPD's position that TPS's claim was precluded because the Settlement License was a "method license" and OnSite was using the same methods at issue in the pre-settlement infringement litigation.

The Fifth Circuit also rejected RPD's argument that the Settlement License was not executory because it was "perpetual" or, in effect, irrevocable. Rather, the Fifth Circuit noted that a "perpetual" license is not irrevocable unless it explicitly says it is perpetual *and also* irrevocable. "Perpetual" without irrevocable simply meant only that the license could not be revoked "at will" and still could be as a result of a material breach.

The Fifth Circuit also rejected RPD's arguments that the trustees should be relieved from the consequences of not having timely assumed the Settlement License due to (1) OnSite's failure to schedule the Settlement License, and (2) the trustees' unawareness of its existence. In rejecting these arguments, the Fifth Circuit referenced a trustee's duty to affirmatively investigate a debtor's assets and the absence in § 365 of any exception to deemed rejection based on lack of actual or constructive notice, and further observed that the Settlement License was a matter of public record in the 2010 infringement litigation.

Finally, the Fifth Circuit rejected RPD's argument that even if the Settlement License was rejected it remained a part of the OnSite estate and, thus, could be transferred to RPD pursuant to § 363; holding that the Settlement License after rejection was "abandoned," no longer part of the estate, and not part of the "property of the estate" over which the trustees had the power to sell to RPD.

From this case, the following should be kept in mind in these situations:

1. As a trustee or counsel to a trustee (or a debtor), a reasonably exhaustive search for all assets, liabilities, litigations and relations! Help especially of publicly available sources, should be conducted so that relevant deadlines can be met (or extended), as a failure to do so Center could result in the loss of value to the estate;
2. If diligence is not complete as a relevant deadline approaches, or if it will be completed too late to accommodate the time frame necessary to complete a sale of assets or other action, an extension of the deadline should be considered; and
3. Counsel for buyers should be appropriately skeptical and not rely solely on a trustee's or debtor's diligence to ensure that all important assets, contracts and relationships necessary to carry on the business are transferred consistent with the substantive and procedural requirements of the Bankruptcy Code.

In addition, and as a practical matter, assuming the importance of the IP and the Settlement License to the ongoing business, should the parties have pursued business rather than litigation solutions when the existence of the Settlement License was discovered at the tail end of the sale and settlement process? Such may very well have required the acceptance of further obligations or consideration from RPD, but, as is often the case, such may have been more beneficial in securing the property and avoiding the risk of litigation than the alternative.

[1] No. 17-11113 (5th Cir. Oct. 29, 2018) ("*Provider Meds*").