IN THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF TEXAS
FORT WORTH DIVISION

U.S. BANKRUPTCY COURT
NORTHERN DISTRICT OF TEXAS
ENTERED
TAWANA C. MARSHALL, CLERK
THE DATE OF ENTRY IS
ON THE COURT'S DOCKET

IN RE:	§	
	§	
ESTILL MEDICAL TECHNOLOGIES, INC.,	§	
	§	
DEBTOR.	§	CASE NO. 4-01-48064-DML-11

Memorandum Opinion

Before the court is Eagle Equity I, L.P.'s Motion for Reconsideration, Additional Findings of Fact, and/or Conclusions and/or New Trial with Respect to the Court's Memorandum Opinion Entered on September 12, 2003 (the "Motion"), filed by Eagle Equity I, L.P. ("Eagle") on September 22, 2003. The court received a response from Estill Medical Technologies, Inc. ("Debtor") on October 14, 2003. The court's Memorandum Opinion of September 12 (the "Prior Opinion") had directed the parties to set a hearing to quantify Eagle's unsecured claim. *See* Prior Opinion p. 10. On November 18, 2003, the court held a hearing to consider the Motion and receive evidence in connection with quantification of Eagle's claim. At that time, and at the May 19, 2003, hearing preceding the Prior Opinion, the court heard testimony from a number of witnesses[1] and received into evidence numerous exhibits.

Based on its initial review of the Motion, and after considering the proceedings on November 18, the court granted the Motion in part by Memorandum Order of January 7, 2004 (the "Memorandum Order"). In the Memorandum Order the court directed that the parties set a third hearing to determine whether Eagle had so relied on the disclosure statement disseminated

[1] Lawrence Steinberg ("Steinberg"), principal of Eagle; Charles Newby ("Newby"), a financial officer of Debtor; and George Burrell ("Burrell"), a former employee of Debtor, testified at the November 18 hearing. Steinberg and Newby also testified on May 19.

to Debtor's creditors with the Plan (as defined in the Prior Opinion) as to preclude Debtor from challenging Eagle's claim[2] of an ownership interest in Debtor's "Technology" (as defined in the First and Second Royalty Agreements hereinafter described). On February 23, 2004, the court received further testimony from Steinberg and Newby on this limited issue.

This matter falls within the court's core jurisdiction pursuant to 28 U.S.C. §§ 1334(a) and 157(b)(2)(B) and (O). This Memorandum Opinion supplements the Prior Opinion. By this Memorandum Opinion the court intends to dispose of issues remaining from the Prior Opinion or raised by the Motion or in the Memorandum Order. Together with the Prior Opinion, this Memorandum Opinion constitutes the court's findings of fact and conclusions of law. FED. R. BANKR. P. 7052 and 9014.

I. Issues

The court must decide (1) whether, as urged in the Motion, Eagle has an ownership interest in Debtor's Technology; and (2) if not, what claim Eagle has under the Plan. Resolution of these matters has caused considerable difficulty: Eagle and Debtor entered into a novel relationship for which the court has found no precedent. Debtor's Plan, the accompanying disclosure statement, and prior proceedings in this case offer few hints and no explicit guidance as to the post-confirmation legal consequences of the parties' relationship. Eagle insists it is

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[2] Debtor has argued to the court that Eagle may not now assert issue preclusion, having failed to do so in its initial response to Debtor's objection to Eagle's claim. *See* FED. R. CIV. P. 8(c), *incorporated by* FED. R. BANKR. P. 7008. Federal Rule of Bankruptcy Procedure 7008 does not, however, apply in a contested matter. *See* FED. R. BANKR. P. 9014(c). In any case, both because of the court's disposition of this matter and because the court must look to the Plan (and associated documents) to determine Eagle's rights, any issue under Federal Rule of Civil Procedure 8 need not be addressed.

entitled to, *i.e.*, has purchased, a royalty interest, in perpetuity, in Debtor's Technology. Debtor characterizes Eagle as an investor or, at most, an unsecured creditor.

The court did not directly address the ownership issue in the Prior Opinion, holding, rather, that Eagle had an unsecured, unliquidated claim. In reviewing the record while considering its ruling on the Motion, the court found that, while neither the Plan nor Debtor's disclosure statement discussed the agreements between Debtor and Eagle, Exhibit C to the disclosure statement included projections reflecting post-confirmation payment by Debtor of royalties.

Because Eagle claims its interest is correctly characterized as a royalty, the court determined it appropriate to establish whether Eagle relied on Exhibit C's reference to royalty payments in interpreting its treatment under the Plan.[3] Based on Steinberg's testimony, the court now finds that Eagle in fact relied on statements by its own counsel and the sporadic, post-petition payment of royalties by Debtor in concluding that Eagle's royalty interests would survive confirmation. Though Steinberg testified he also relied on Exhibit C, he was evasive in responding to questions respecting that reliance and unable to recall specifically reviewing the relevant portion of Exhibit C. The court finds Steinberg's testimony respecting reliance on Exhibit C not credible and concludes that, in determining Eagle's rights, the court may consider the text of the Plan without any concern that Exhibit C to the disclosure statement rendered the

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[3] That Eagle relied on Exhibit C would not necessarily mean that Debtor was *bound* by Exhibit C's inclusion of royalty payments in its projections. The Plan established the post-confirmation rights of the parties, as would a contract. *Official Creditors Comm. of Stratford of Tex., Inc. v. Stratford of Tex., Inc. (In re Stratford of Tex., Inc.)*, 635 F.2d 365, 368 (5th Cir. 1981). Only if Eagle relied on Exhibit C as describing the effect of the Plan would the court consider the disclosure statement or parol evidence in construing the Plan. Given the court's determination that Eagle was not misled by Exhibit C, however, the court need not pursue that inquiry further.

terms of the Plan ambiguous from Eagle's perspective.[4] Having disposed of this concern, the court may now proceed to decide the issues before it.

II. Discussion

The facts surrounding Eagle's relationship with Debtor are set forth in the Prior Opinion. *See* Prior Opinion pp. 1-4.[5] The court adopts the defined terms in the Prior Opinion. For the reasons that follow, the court denies the Motion, holds Eagle had no property right that survived confirmation, and quantifies Eagle's claim in the amount Eagle paid for its royalty interest.

A. Eagle's Royalty Rights

First, Eagle's interest in Debtor's Patent Application is described as a "royalty." *See* United States Department of Commerce Patent and Trademark Office Form PT0 1619A, filed by Eagle on August 26, 1999. Yet, the royalty granted by Debtor to Eagle is *not* defined in terms of a share of the prospective patent. Rather, the royalty is characterized as a right to a share of Debtor's sales of products produced pursuant to the patent. *See* First Royalty Agreement, dated June 15, 1999, Art. I; Second Royalty Agreement, dated July 30, 1999, Art. I. Indeed, the Royalty Agreements grant to Eagle an interest in sales by Debtor even if no patent were ever

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[4] Statements by Eagle's former counsel, even if not hearsay as offered to the court, would hardly support a conclusion by Steinberg that the terms of the Plan accommodated continuation of the royalty payments. As to post-petition, pre-confirmation royalty payments, these would not be indicative, let alone dispositive, of Eagle's treatment under the Plan.

On March 1, 2004, Eagle filed a motion asking that the court reopen its record to consider testimony of John Turner, former counsel to Eagle. By Memorandum Order of even date, the court denies that motion.

[5] The court notes the royalty payments to Eagle under each Royalty Agreement were to be initially $.20 per unit and then $.08 per unit; the Prior Opinion is corrected accordingly. *See* Prior Opinion p. 2.

granted to Debtor. *See* preamble recitals to the Royalty Agreements.[7] Thus, if Eagle acquired an interest in property, it was an interest in future accounts receivables.

Second, Eagle's status visa-a-vis reorganized Debtor is established by the Plan. The Plan serves as a contract among parties in interest and adjusts both property rights and the debtor-creditor relationship according to its terms. The only rights Eagle can have under the Plan are as an unsecured creditor.

Neither the Plan nor Debtor's disclosure statement makes any reference to Eagle's royalty interest.[8] Article 2 of the Plan states "[t]his Plan is intended to deal with all Claims against the Debtor or property of the Debtor of whatever character . . . ." *See* Plan, Art. 2, "Plan Intent." *See also* Plan, Art. 6, ¶ 6.01 (providing "all property of the Debtor's estate . . . shall vest in, or remain the property of Reorganized Debtor free and clear of all Claims") and ¶ 12.01 ("No creditor *or party in interest* herein shall be entitled to any payment from the Debtor's estate or from any

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[7] It is notable that the Second Royalty Agreement includes a representation by Debtor to Eagle that it is the *sole owner* of the Technology, *see* Second Royalty Agreement, Art. V, ¶¶ 5.2 and 5.3(c), and that both Royalty Agreements specify that the parties are not partners. *See* First and Second Royalty Agreements, Art. VIII, ¶ 8.3. These provisions are inconsistent with a claim by Eagle of a property right that would survive bankruptcy. If Eagle received an interest in the Technology under the First Royalty Agreement, Eagle would have known that the representation made in paragraph 5.2 of the Second Royalty Agreement was false. *See* Second Royalty Agreement, Art. VIII, ¶ 8.1. Further, the absence of a business relationship that would give Eagle rights in property nominally owned by Debtor eliminates the only other arguable position the court can discern that Eagle held a property right that would survive bankruptcy.

[8] In paragraphs 8 and 9 of the Motion, Eagle seems to suggest that, through no fault of its own (and perhaps due to the court's laxity), Eagle was misled into concluding its "valuable property right" survived the bankruptcy process. Leaving aside the questionable suggestion that the court should guide parties in the formulation of their bankruptcy strategies, Eagle received notice of the Plan and the hearing on confirmation. Prior to that time, Eagle had filed an *unsecured* claim (the "Future Royalty Claim") to evidence its rights under the Royalty Agreements. Surely, had Eagle expected its "rights" to survive, Eagle was by the time of the confirmation hearing aware the "rights" were not recognized in the Plan. That the court raised the issue of whether Eagle had such a property right at the hearing preceding the Prior Opinion after entry of the Confirmation Order is hardly reason to overlook Eagle's failure to raise the issue during the process leading to confirmation of the Plan.

assets of the estate except as provided herein.") (emphasis added). These provisions of the Plan support the conclusion that Eagle's rights in the Technology, whatever they may have been, were extinguished at confirmation.

The Plan divides claims and interests into classes. *See* Plan, Art. 2, ¶ 2.02. None of these classes specifically addresses Eagle or refers to entities entitled to royalties. The court determined in the Prior Opinion that Eagle was not an equity owner. *See* Prior Opinion p. 10. The only class into which Eagle can fall, therefore, is the unsecured creditor class, a catchall for claims which are neither secured nor entitled to priority status. *See id.*

The Plan and the Confirmation Order clearly provide, in accordance with sections 1141(b) and (c) of the Bankruptcy Code,[9] that the property of the estate thereafter vested in Debtor "free and clear of all claims and interests of creditors[] [and] equity security holders . . . ." *See* Code § 1141(c). Given the terms of the Plan, *see* Plan, Art. 2, "Plan Intent" *supra*, and given that "'claim against the debtor' includes claim against property of the debtor," *see* Code § 102(2), it is clear that Eagle is to be treated under the Plan as an unsecured creditor. At a minimum, Eagle should have known its "property interest" was at risk if the Plan was confirmed. The court, when entering the Confirmation Order, certainly had no reason to believe that Debtor's Technology, the central asset of Debtor's estate and the key to feasibility of Debtor's restructuring, was subject to an ownership interest held by Eagle.

The issue of Eagle having such an ownership interest could have been and should have been raised during the confirmation process. It is black letter law that such an issue is disposed of through confirmation of a plan if not raised before entry of the confirmation order. *See*

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[9] 11 U.S.C. §§ 101-1330 (2004) (hereafter referred to as the "Code").

Osherow v. Ernst & Young, LLP (In re Intelogic Trace, Inc.), 200 F.3d 382 (5th Cir. 2000); *Eubanks v. FDIC*, 977 F.2d 166 (5th Cir. 1992); *Republic Supply Co. v. Shoaf*, 815 F.2d 1046 (5th Cir. 1987). There is no question that the Fifth Circuit's test for determining whether a claim is barred by the doctrine of *res judicata* is met in the instant case. *See In re Intelogic Trace, Inc.*, 200 F.3d at 386 (setting forth the following elements necessary for application of *res judicata*: "the parties must be identical in both suits, the prior judgment must have been rendered by a court of competent jurisdiction, there must have been a final judgment on the merits and the same cause of action must be involved in both cases"); *Eubanks*, 977 F.2d at 169 (same); *Shoaf*, 815 F.2d at 1051 (same).

As to any argument that *res judicata* should not operate against Eagle to Debtor's benefit, as was true in *Eubanks*, it cannot be said that here, as there, a claimant was blind sided by lack of disclosure. In the case at bar the very absence of disclosure of the Eagle/Debtor relationship should have alerted Eagle to its peril. If the failure of Debtor to mention Eagle in its disclosure statement (and the terms of the Plan) did not catch Eagle's attention, it cannot be because Eagle, like the lender in *Eubanks*, was unaware of the matter warranting disclosure. For all Eagle's concern about its "valuable property right," it made no visible effort to protect it until the court on May 19, 2003, suggested such a right might exist.

The fact of the matter is that Eagle *did* protect what rights it had *vis-à-vis* Debtor. Eagle and Debtor were parties to a contract.[10] In the Royalty Agreements the parties provided that Eagle

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[10] It is unclear whether the Investment Agreement and the Royalty Agreements should have been considered a single agreement, *see Nat'l Union Fire Ins. Co. v. Turtur*, 892 F.2d 199, 204 (2nd Cir. 1989) (stating that two documents executed at the same time may be considered one agreement if the parties so intended); *In re T&H Diner, Inc.*, 108 B.R. 448, 454 (D.N.J. 1989) (finding lease and purchase agreement inextricably intertwined), or whether any of the agreements remain executory under section 365 of the Code (though it is clear Debtor still owed performance,

was entitled to specific performance of the agreement, *see* Royalty Agreements, Art. 8, ¶ 8.9, but specific performance is not generally enforceable against a debtor under the Bankruptcy Code. *Cf. Leasing Serv. Corp. v. First Tenn. Bank Nat'l Assoc.*, 826 F.2d 434, 436 (6th Cir. 1987) (explaining that the legislative purpose underlying section 70b, the predecessor to Code § 365 under the Bankruptcy Act of 1938, "was to solve the problem of *assumption of liabilities, i.e.,* excusing or requiring future specific performance by the bankrupt") (emphasis in original) *and Eastover Bank for Savings v. Sowashee Venture (In re Austin Dev. Co.)*, 19 F.3d 1077, 1082 (5th Cir. 1994) (determining that rejection of a contract relieves estate and nondebtor from *future* performance obligations) (emphasis in original) *with In re West Chestnut Realty of Haverford, Inc.*, 177 B.R. 501, 506 (Bankr. E.D. Pa. 1995) (limiting nondebtor in its claim for breach resulting from debtor's rejection of contract to treatment accorded to debtor's general unsecured creditors, "*unless specific performance is available to the non-debtor party under applicable state law*") (emphasis in original). Rather, this court concludes a party to a contract with a debtor which the debtor does not assume is entitled to a claim for damages, not equitable relief. *See In re Mirant Corp.*, 299 B.R. at 163 (agreeing that the effect of rejection of an executory contract is a breach which gives rise to a claim for damages); *In re CVA Gen. Contractors, Inc.*, 267 B.R. 773,

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and provisions such as Articles VI and VII of the Royalty Agreements suggest remaining potential for performance to be required of Eagle). However, as Eagle acquired no ownership to Debtor's intellectual property (and does not qualify for the rights preserved by section 365(n) of the Code), the status of the agreements between the parties is immaterial. *See In re San Francisco Bay Exposition*, 50 F. Supp. 344, 347 (N.D. Cal. 1943) (finding that, whether or not contract is characterized as executory and subject to disaffirmance, "the obligation to pay the debt still exists"). Whether they were executory or not, Eagle holds only an unsecured claim for Debtor's failure to render the expected performance. *See Mirant Corp. v. Potomoc Elec. Power Co. (In re Mirant Corp.)*, 299 B.R. 152, 163 (Bankr. N.D. Tex. 2003) (explaining that breach of an executory contract "gives rise to claim for damages which is . . . treated similarly to all other unsecured claims); *Century Indem. Co. v. NGC Settlement Trust (In re Nat'l Gypsum Co.)*, 208 F.3d 498, 505 (5th Cir. 2000) (same).

777 (Bankr. W.D. Tex. 2001) (opining that "[t]he Fifth Circuit wisely held that rejection has an important but appropriately narrow function: it relieves the estate and nondebtor parties from *future* performance obligations and, by accomplishing a breach, it triggers a dischargeable, unsecured, pre-petition claim against the estate") (emphasis in original) (citing *In re Austin Dev. Co.*, 19 F.3d at 1082). Assuming the agreements of the parties were executory contracts, because Debtor rejected the Royalty Agreements and the Investment Agreement, *see* Plan ¶¶ 9.01, 1.24 and 1.30, Eagle became entitled to a claim for damages. *See In re Mirant Corp.*, 299 B.R. at 163; *In re Austin Dev. Co.*, 19 F.3d at 1082; *In re CVA Gen. Contractors, Inc.*, 267 B.R. at 777. In short, regardless of any recording with the Patent Office or the use of the term "royalty," Eagle is entitled to no greater rights against Debtor than any other disappointed party to a contract with a debtor.

B. Quantification of Eagle's Claim

In its Prior Opinion, the court determined Eagle was a creditor (under the Royalty Agreements), not an equity owner. Today, the court holds that Eagle's claim arises by reason of a contract (whether or not executory) between the parties. It now only remains for the court to quantify Eagle's claim arising from Debtor's failure to perform as promised.

Eagle has offered projections of Debtor's sales, supported by the testimony of Steinberg and Burrell (though the parties disagree about the interpretation of Burrell's testimony), and has urged that the court calculate its damages based on these projections. The projections, however, date back to 1999. Not only does Debtor's history between 1999 and the Petition Date belie the projections, sales of Debtor's products during chapter 11 and subsequent to entry of the

Confirmation Order demonstrate that the projections are so optimistic and so divorced from reality as to be useless as a measure of damages.[11]

Alternatively, Eagle argues its damages should be measured by the "put" in Article IV of the Royalty Agreements. *See* Royalty Agreements, Art. IV, "Put Rights." This would entitle Eagle to a claim equal to the "Initial Return" as defined in the Royalty Agreements, *i.e.*, a total of $500,000 less royalties paid. As Eagle has received only $2,139.70 in royalties,[12] this would result in a Future Royalty Claim totaling $497,860.30.

Eagle attempts to recharacterize its put option as a liquidated damages provision. Even if such a recharacerization were appropriate, the put option was not exercisable until mid-2002 (June 30 or July 31, depending on which Royalty Agreement). To consider the put option as surviving the filing of Debtor's bankruptcy case would require the court either to ignore the plain language of section 502(b) of the Code[13] or treat the agreements between Debtor and Eagle as executory. If the court adopts the latter view, Debtor's rejection of its agreements with Eagle equates to an anticipatory breach of those agreements as of the Petition Date. *See Stewart Title Guar. Co. v. Old Republic Nat'l Title Ins. Co.*, 83 F.3d 735, 741 (5th Cir. 1996) (explaining that rejection of executory contract is deemed to have occurred on the day immediately prior to commencement of the bankruptcy). *See also* Code § 365(g) (same); 3 COLLIER ON BANKRUPTCY ¶ 365.09 (15th ed. rev. 2003) (same). Thus, Debtor's obligations under the Royalty Agreements

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[11] Nor are the projections offered by Eagle consistent with the projections provided in Exhibit C to Debtor's disclosure statement.

[12] *See* Debtor's December 1, 2003, letter brief, p. 4.

[13] Section 502(b) states, in pertinent part, "the court . . . shall determine the amount of the claim as of the date of the filing of the petition . . . ."

and, concomitantly, the put option became ineffective long before the put option could be exercised.

Debtor argues that most of what Eagle "bought" pursuant to the Investment Agreement was Debtor's common stock. Though the Investment Agreement clearly provides that the 250,000 shares of stock were sold to Eagle at a price equal to par ($.01 per share), *see* Investment Agreement § 1.1, Debtor argues the stock was valued at approximately $2.50 per share[14] in other roughly contemporaneous transactions. Debtor consequently reasons that Eagle's receipt of 250,000 shares of stock more than fairly compensated Eagle for its $250,000 advance, regardless of what Eagle did or did not receive under the Royalty Agreements.

The court does not accept this method of eliminating Eagle's damages. There was no regular market in Debtor's stock. The Investment Agreement clearly states the price the parties assigned to the stock, and there is no suggestion that the Investment Agreement and Royalty Agreements were other than arms-length transactions. Of the $250,000 advanced by Eagle, $2,500 was for stock and the balance was attributable to Debtor's expected performance of the Royalty Agreements.

Finding neither the projections offered by Eagle nor the reasoning proposed by Debtor a satisfactory means for quantifying Eagle's claim, the court, instead, concludes the best analysis is that applicable to a disappointed purchaser from a bankrupt. As noted above, Eagle, in fact, sought to buy a portion of Debtor's future receivables. Absent recourse to specific performance, had Eagle advanced money to purchase a tangible piece of property, which piece of property the

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[14] Debtor actually points to evidence that the stock was priced at $2.50-$5.00 per share. *See* Debtor's December 1, 2003, letter brief, p. 4 n.15; Debtor's December 5, 2003, letter brief response, pp. 1-2.

seller, by reason of bankruptcy, did not deliver, a proper measure of damages would be the lost purchase price. *See Northwestern Nat'l Cas. Co. v. McNulty*, 307 F.2d 432, 434 (5th Cir. 1962) (affirming well-established principle that "where there has been harm only to the pecuniary interests of a person, compensatory damages are designed to place him in a position substantially equivalent" to that position occupied had no harm occurred). *See also Foley v. Parlier*, 6 S.W.3d 870, 884 (Tex. App.–Fort Worth 2002, no pet.) (concluding that the proper measure of damages for breach of contract is that which is necessary to make party whole); *JHC Ventures, L.P. v. Fast Trucking, Inc.*, 94 S.W.3d 762, 775 (Tex. App.–San Antonio 2002, no pet.) (finding that a party is entitled to only one remedy if that remedy makes it whole).

The court concludes this is the most logical measure for Eagle's claim. Eagle paid to Debtor $247,500 to buy a portion of Debtor's accounts receivables in perpetuity. Debtor did not deliver (under the Plan) what Eagle purchased.[15] Eagle is thus entitled to the return of its purchase price. That entitlement – a right to payment – constitutes a general, unsecured claim in Debtor's bankruptcy case to be so satisfied under the Plan.

III. Conclusion

For the reasons stated, the Motion must be **DENIED**. Eagle is a general unsecured

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[15] Debtor argues amounts paid as royalties to Eagle should be offset against Eagle's claim. Arguably, post-petition payments could even be offset against Eagle's recovery under the Plan. The court, however, concludes that any offset should apply to what Eagle *bought*, not what it *paid*. As Eagle bought an interest in receivables in perpetuity (or at least up to $500,000, the put amount) the court sees no logical basis for reducing Eagle's claim.

creditor in this case. Eagle's claim hereby allowed is in the amount of $247,500.

It is so **ORDERED** this 26th day of March 2004.

DENNIS MICHAEL LYNN
UNITED STATES BANKRUPTCY JUDGE