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Identifying and Keeping the Genie in the Bottle:
The Practical and Legal Realities of Trade Secrets in
Bankruptcy Proceedings

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Identifying and Keeping the Genie in the Bottle: The Practical and Legal Realities of Trade Secrets in Bankruptcy Proceedings

Abstract
Anyone who has been paid attention to developments in the world of business over the past quarter century can attest to the fact that intellectual property (IP) is a hot commodity. Indeed, in contrast to the companies that emerged out of the Industrial Revolution, the companies that have spawned as part of the so-called “Information Age” attribute much of their value and future prospects to intangible, rather than tangible, assets. Unfortunately, while bankruptcy courts have generally recognized the need to distinguish between tangible and intangible assets, particularly when determining whether a claim is secured or unsecured, they often fail to acknowledge the practical and legal differences between the various forms of IP. Not all forms of IP are created equal. Trade secrets, in particular, present a challenge for the bankruptcy courts because, by definition, they must be “secret.” Thus, the very act of identifying and attempting to place a value on trade secrets may result in the loss of such rights.

A number of recent articles have addressed the treatment of IP assets in bankruptcy proceedings. Typically, these articles focus on two important aspects of bankruptcy law as it relates to intellectual property generally: (1) how to perfect a security interest in intellectual property assets, i.e., “general intangibles” in the parlance of Article 9 of the Uniform Commercial Code (“the U.C.C”), and (2) the treatment of executory contracts involving intellectual property assets. While both of these issues are important, they are meaningless with respect to trade secrets unless the trade secrets continue to exist after the bankruptcy petition is filed. Thus, rather than jump to a discussion of security interests and executory contracts as they relate to trade secrets, this article begins with a discussion of trade secret law and how various trade secret issues may arise in the bankruptcy context. Because the nature of the relationships in which trade secrets are disclosed is a key aspect of trade secret law, the article then proceeds to explore the interests and objectives of the various players in a bankruptcy proceeding, including the debtor, the trustee, creditors, licensees, and other third parties. The article concludes with a discussion of the interests of the unsecured creditors, employees of the debtor, and the buyer of estate assets.

Keywords
Trade secrets, Bankruptcy

Disciplines
Bankruptcy Law | Intellectual Property Law
Identifying and Keeping the Genie in the Bottle: The Practical and Legal Realities of Trade Secrets in Bankruptcy Proceedings

Sharon K. Sandeen*

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I. INTRODUCTION

Anyone who has paid attention to developments in the world of business over the past quarter century knows that intellectual property ("IP") is a hot commodity. Indeed, in contrast to companies that emerged from the Industrial Revolution, many of the companies spawned during the Information Age attribute much of their value and prospects to intangible, rather than tangible, assets.\(^1\) Pursuant to IP theory, this shift in focus should have the desirable effect of encouraging more inventive and creative activity. From a practical point of view, it has created a situation where the value of a company can be more "smoke and mirrors" than real.

The ethereal nature of IP should be of particular concern to the parties to a bankruptcy proceeding because a principal focus in such cases is the identification and distribution of the assets of the debtor’s estate. If, as some companies represent to their shareholders, creditors, and others, IP rights make up a major portion of a company’s assets, then it is important for bankruptcy judges, trustees, and creditors to be able to identify, secure, and properly value such assets. Unfortunately, while bankruptcy courts and commentators have recognized the need to distinguish between tangible assets and IP rights, particularly when determining whether a claim against the bankruptcy estate is secured or unsecured,\(^2\) they often fail to acknowledge the practical and legal differences between the various forms of intellectual property.\(^3\)

Not all forms of IP are created equal.\(^4\) For instance, while existing patent rights and pending patent applications are documented in writings that are available over the Internet, the same cannot be said for copyrights, trademarks, and trade secrets.\(^5\) Trade secrets, in particular, present a challenge for bankruptcy courts because they do not


2. See notes 239-253 and 255-257 infra and accompanying text.

3. Lars S. Smith, Trade Secrets in Commercial Transactions and Bankruptcy, 40 IDEA: THE JOURNAL OF LAW AND TECHNOLOGY 549, 549-550 (2000) ("While much has been written about issues surrounding security interests in patents, trademarks and copyrights, trade secrets are often ignored or dealt with superficially.").


5. J. Thomas McCarthy, MCCARTHY ON TRADEMARKS AND UNFAIR COMPETITION § 2.7 (4th ed. 2008) (While copyrights and trademarks are likely to exist in some tangible form, contrary to popular belief, they need not be registered with federal authorities to be valid).
always exist in tangible form and, by definition, they must be kept secret. Thus, the very act of identifying and attempting to place a value on them may result in the loss of such rights.

A number of articles have addressed the treatment of IP assets in bankruptcy proceedings. Typically, these articles focus on two important aspects of bankruptcy law as it relates to IP: (1) how to perfect a security interest in IP assets, i.e., “general intangibles” in the parlance of Article 9 of the Uniform Commercial Code (the “U.C.C.”), and (2) the treatment of executory contracts involving IP assets. Rather than focus on a discussion of security interests and executory contracts as they relate to trade secrets, this article takes a broader approach by examining additional trade secret related issues that may arise in a bankruptcy proceeding.

The analysis of how trade secrets are treated in bankruptcy begins in section II with a discussion of the intersection of bankruptcy and trade secret law. The article then explores the interests and objectives of the various players in a bankruptcy case. In order of involvement, section III examines the interests of the debtor. Next, in section IV, the interests of the bankruptcy trustee (including a debtor in possession) are discussed. Given that the interests of the debtor and trustee may vary depending upon whether the bankruptcy petition is filed under chapter 7 (liquidation), chapter 11 (reorganization), or chapter 13 (individual), the differing laws and rules applicable to each chapter are discussed where appropriate.

Beginning with section V, the article explores the interests of creditors and other third parties. Befitting their special status, section V focuses on secured creditors and addresses how to perfect security interests in trade secrets. Because bankruptcy debtors are often the licensors of trade secrets, section VI examines bankruptcy proceedings through the eyes of a licensee. It is in sections III and VI where the treatment of executory contracts involving trade secrets is discussed. As will be seen,

6. See NORTON, supra note 4, §177:14, at 177-19.
7. Id.
9. See supra note 8.
10. According to section 1107 of the Bankruptcy Code, a debtor in possession in a Chapter 11 proceeding has the same rights, powers, and duties of a trustee, other than the right to compensation under section 330. 11 U.S.C. § 1107(a) (2000). Thus, the debtor in possession wears two hats: that of the debtor and of the trustee. Unless otherwise noted, reference in this article to the bankruptcy trustee will include the debtor in possession.
courts have yet to fully examine many of the issues concerning trade secrets that can arise in a bankruptcy proceeding.

II. THE TRADE SECRET BANKRUPTCY INTERFACE

Although the term "intellectual property" is now a fixture of the American lexicon, it is not a term that is well understood by the public or by many lawyers and judges. In general, it refers to four bodies of law: patent, copyright, trademark, and trade secret law. Patent and copyright law both find explicit support in the U.S. Constitution and are exclusively governed by federal law.\(^\text{14}\) Trademark law, although often compared to patent and copyright law, does not share the same constitutional origins or purpose.\(^\text{15}\) Rather, it developed at common law as part of the law of unfair competition and is currently governed by a mix of common law and state and federal statutes.\(^\text{16}\) Trade secret law is more akin to trademark law because it too developed at common law.\(^\text{17}\) As originally conceived, the purpose of trademark and trade secret law was not to protect property per se, but to prevent competitors from engaging in activities that exceed the bounds of legitimate competition.\(^\text{18}\)

Unfortunately, although patent, copyright, trademark, and trade secret law have distinct jurisdictional roots and purposes, they are often lumped together in bankruptcy cases as if they form one amorphous asset.\(^\text{19}\) This is a mistake. Because the law governing each of the four different types of IP protects different (albeit sometimes overlapping) subject matter, has differing requirements for protection, requires different documentation, provides protection for different lengths of time, and gives the owner different rights, they each require separate attention. This is particularly true of trade secrets because the failure to exercise reasonable efforts to protect the trade secrets will result in their loss.\(^\text{20}\)

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15. See Trade-Mark Cases, 100 U.S. 82, 85, 93, 99 (1879).
16. McCARTHY, supra note 5.
17. See generally ROGER MILGRIM, MILGRIM ON TRADE SECRETS § 1.01[1] (2002). See also Wolfe v. Tuthill Corp., 532 N.E.2d 1, 2 (Ind. 1998) (finding that the UTSA “merely articulates the common law”).
18. McCARTHY, supra note 5, at § 5.2, “Development of trademarks in Anglo-American common law” (noting that trademark infringement and unfair competition have their roots in common law notions of fraud and deceit); see also JAMES POOLEY, TRADE SECRETS, § 1.02[2] (2000) (“Ethics in business is one of the two primary policy concerns (along with encouragement of invention) that underlie trade secret law.”).
19. See, e.g., In re Amica, Inc. 135 B.R. 534 (Bankr. N.D. Ill. 1992); In re American Motor Club, Inc., 119 B.R. 394 (Bankr. E.D.N.Y. 1990); see also Smith, supra note 3, at 549-50 (“While much has been written about the issues surrounding security interests in patents, trademarks and copyrights, trade secrets are often ignored or dealt with superficially. Most articles focus on federally created and protected intellectual property.”).
In the following subsections, the unique nature of trade secrets is discussed in relation to the various stages of a bankruptcy proceeding.

A. Stage One: The Filing of a Petition in Bankruptcy and the Creation of the Bankruptcy Estate (Are Trade Secrets "Property" for Purposes of Bankruptcy Law?)

A bankruptcy proceeding is commenced in one of two ways: voluntarily by the debtor or involuntarily by creditors. Generally, when a bankruptcy petition is filed a new entity—the "bankruptcy estate"—is created consisting of the debtor's property "wherever located and by whomever held." The key to understanding what is in the bankruptcy estate depends upon what the Bankruptcy Code means by property. Although property is not explicitly defined in the Bankruptcy Code, section 541(a) sets forth a litany of seven categories of property interests that are part of the estate including "all legal or equitable interests of the debtor in property as of the commencement of the case." Nowhere in this litany is there a specific reference to IP or trade secrets. In the absence of such reference, the obvious question is: Are trade secrets property for purposes of bankruptcy law? This is not just an academic question but, as is discussed in the remainder of this article, one that can have significant ramifications for the outcome of a bankruptcy case.

Whether trade secrets are property for any purpose, let alone bankruptcy law, is a topic that has occupied the attention of legal scholars and the judiciary for well over one hundred years. The reason for the debate centers on the unfair competition roots

21. George M. Treister, et al, FUNDAMENTALS OF BANKRUPTCY LAW, § 3.02 (6th ed. 2006) (citing 11 U.S.C. §§ 301, 303 and noting that pursuant to § 302 a case may also be filed jointly by a debtor and the debtor's spouse) [hereinafter FUNDAMENTALS IN BANKRUPTCY].
23. 11 U.S.C. § 541(a). As explained in Fundamentals of Bankruptcy Law. The concept of an "interest" for the purpose of this section is not limited. It may be title or the fee if in nontechnical terms the debtor owns the property; a limited or life estate; a leasehold interest; a contract right; a lien if the debtor is a secured creditor of someone else; a mere possessory right; or any other kind of interest that derives from the debtor's relationship to property.
24. In Fundamentals of Bankruptcy Law, the statement is made that the characterization of a debtor's books, papers, or other recorded information is an academic exercise because, in any event, the debtor is required by the Bankruptcy Code to turnover all of its records. Id. However, as will be seen, trade secrets and other "proprietary information" of a debtor do not always exist in a tangible or documented form and thus, their characterization as property or not will determine if they are a part of the bankruptcy estate. See infra Part II.A.
25. See MILGRIM, supra note 17, at § 2.01 (arguing that trade secrets are no less property than copyrights but acknowledging the historical debate); E.I. du Pont de Nemours Powder Co. v. Masland, 244 U.S. 100, 102 (1917) ("The property may be denied, but the confidence cannot be. Therefore the starting point for the present matter is not property or due process of law, but that the defendant stood in confidential relations with the plaintiffs, or one of them."); POOLEY, supra note 18,
of trade secret law and the required elements of a claim for relief.  

Like patents, copyrights, and trademarks, the metes and bounds of trade secrets are defined, not by rules that are applicable to tangible personal property, but by the scope and limits of trade secret law. Unlike claims related to personal property, claims for relief under trade secret law are not solely dependent upon how the asserted property interest is affected. They are also dependent upon the nature of the relationship that exists between the trade secret owner and the defendant. In this respect, trade secret law has more to do with preventing wrongful and unfair actions than protecting property. This limitation on the scope of trade secret law is not an antiquated feature of the law that can be ignored but is a feature of trade secret law that prevents it from being preempted by patent law.


27. See Ruckelshaus v. Monsanto, 467 U.S. 986, 1002 (1984) ("Because of the intangible nature of a trade secret, the extent of the property right therein is defined by the extent to which the owner of the secret protects his interest from disclosure to others.").

28. It is for this reason that Pamela Samuelson noted that trade secret law has generally resisted characterizing trade secrets as property. See Samuelson, supra note 25, at 365; see also NORTON, supra note 4, at § 177:14 (noting the there is no "absolute property right" in trade secrets). But see MILGRIM, supra note 17, at § 2.01 (noting that "[t]he property right in anything is always a relational right, i.e., the right that an owner may have vis-a-vis the world.").

29. See Menell, supra note 8, at 735; see also In re Uniservices, Inc., 517 Fed. 2d 492, 496 (7th Cir. 1975) (noting the need to balance a debtor's property interests in information with the right of individuals to engage in business.).

Despite the historical origins of trade secret law, there are aspects of trade secrets that are property-like in nature. By virtue of the value that is placed on trade secrets, they are often the subject of purchase and sale agreements, license agreements, confidentiality and non-compete agreements, and security agreements. Because they can and have been bought, sold, licensed, and used as security, many courts have treated them as a form of personal property. In the case of *Ruckelshaus v. Monsanto Co.*, for instance, the U.S. Supreme Court treated the trade secrets of Monsanto as property for purposes of determining if they had been taken without just compensation in violation of the Fifth Amendment. The decision was based, in part, upon a bankruptcy case in which the court applied state law to determine whether the bankruptcy estate had a property interest in the debtor's trade secrets. However, while *Ruckelshaus* supports the assertion that information that qualifies for trade secret protection under the law of Missouri is property for purposes of the Fifth Amendment, it cannot be cited for the proposition that trade secrets are property for all other purposes. To determine whether something is property under bankruptcy law requires the application of state law and bankruptcy principles.

At the time of *Ruckelshaus*, the predominant law governing trade secrets was described in the *Restatement (First) of Torts*. Today, the predominant law is the Uniform Trade Secrets Act (the UTSA) which has been adopted in substantial part by


32. *Ruckelshaus, 467 U.S. at 1003-04 (applying Missouri law).

33. *Id. at 1002 (citing In re Uniservices, 517 F.2d at 496 (applying the pre-Uniform Trade Secret Act trade secret principles of Indiana)).

34. Because the decision in *Ruckelshaus* is based upon an expansive reading of the word "property" as used in the Fifth Amendment, it is conceivable that its definition is not coextensive with the concept of property that is used in the Bankruptcy Code. See *id. at 1003-04* (noting that the finding of a property interest was only "to the extent that Monsanto has an interest in its health, safety, and environmental data cognizable as a trade-secret property right under Missouri law"). This question was answered with respect to the meaning of "property" under U.S. securities law in the case of *Carpenter v. United States, 484 U.S. 19, 28 (1987)* (where the Court recognized the property right of the *Wall Street Journal* in the contents of a columnist's work).

35. *Ruckelshaus, 467 U.S. at 1001* ("we are mindful of the basic axiom that '[p]roperty interests ... are not created by the Constitution. Rather, they are created and their dimensions are defined by existing rules or understandings that stem from an independent source such as state law."). (citations omitted); see also NORTON, supra note 4, § 177:14, at 177-21. In the bankruptcy context, see *Butner v. United States, 440 U.S. 48, 55 (1979)* (holding that property interests are generally created by state law). Some states have adopted statutes that specifically define trade secrets as property. See, e.g., *Credentials Plus, LLC v. Calderone, 230 F. Supp.2d. 890, 903 (N.D. Ind. 2002)* (quoting the law of Indiana); *In re Estate of Kuba, 660 F. Supp. 1069, 1074 (N.D. Ind. 1986)* (quoting the law of Indiana).

36. RESTATEMENT (FIRST) OF TORTS §§ 757-59 (1939).
45 of the 50 United States. The UTSA provides that a broad range of information can qualify for trade secret protection. This includes classic business secrets such as customer lists, methods of manufacture, and formulas but may also include computer code and negative know-how. The UTSA does not explicitly classify trade secrets as “property” but instead focuses on defining the meaning of a trade secret and the circumstances under which trade secrets can be misappropriated.

To qualify for trade secret protection, information must satisfy three conditions: (1) it must be secret, i.e., not generally known or readily ascertainable; (2) it must derive independent economic value from its secrecy; and (3) it must be the subject of efforts that are reasonable under the circumstances to maintain its secrecy. Due to the strict requirements for trade secret protection, proprietary and confidential information that many businesses claim to own may not qualify as trade secrets.

For example, although absolute secrecy is not required, the failure of a putative trade secret owner to limit the dissemination of its trade secrets can mean that no protection is afforded.


In its discussion of the trade secret/bankruptcy interface, Norton Bankruptcy Law and Practice erroneously states that “the most commonly accepted definition of a trade secret is that found in the Restatement of Torts, section 757, comment b.” Norton, supra note 4, at § 177:14, at 177-19. See also Milgrim, supra note 17. What this statement fails to recognize is that the scope and meaning of trade secrets was consciously altered by the drafters of the UTSA. See Sharon K. Sandeen, A Contract by Any Other Name is Still a Contract—Examining the Effectiveness of Trade Secret Clauses to Protect Databases, 45 IDEA: THE INTELL. PROP. L. REV. 119, 126-32 (2005) (explaining the limits of modern trade secret law).

38. Unif. Trade Secrets Act (1986) § 1 ("'Trade secret' means information, including a formula, pattern, compilation, program, device, method, technique, or process.").

39. Milgrim, supra note 17, at §§ 1.09[3], [5][b].

40. "For liability to exist under this Act, a Section 1(4) trade secret must exist and either a person's acquisition of the trade secret, disclosure of the trade secret to others, or use of the trade secret must be improper under Section 1(2). The mere copying of an unpatented item is not actionable." Unif. Trade Secrets Act, Prefatory Note.

41. Id. at § 1 (defining "trade secret"). Although the Restatement (First) of Torts definition of trade secrets and its "six factor test" continue to be cited with favor by courts and commentators, the drafters of the UTSA consciously chose to change the definition of trade secrets and, thus, in states that have adopted the UTSA, it is error to rely upon the Restatement (First) definition. See Sandeen, supra note 37, at 129-130.

42. See Norton, supra note 4, § 177:14, at 177-20 – 177-21 ("Similar to, but distinctive from, trade secrets may be confidential or proprietary research or development information which does not rise to the level of the judicial definition of a "trade secret" but nevertheless represents real effort which is deserving of protection."). It is also clear that a person's general knowledge and skill, even if acquired while in the employ of one company, does not constitute protectable trade secrets. See In re Dana Corp, No. 06-10354, 2007 Bankr. LEXIS 3923, at *20-21 (S.D.N.Y. Nov. 6, 2007). See also Reed Roberts Assoc. v. Strauman, 40 N.Y.2d 303, 307-09 (NY 1976); Marietta Corp. v. Fairhurst, 301 A.D.2d 734, 736-38 (N.Y. 2003).
trade secrets ever existed or that they were quickly lost.\textsuperscript{43} Even if a secret is known only within a company, it may be shared with too many people within a company to qualify for trade secret status.\textsuperscript{44} Similarly, even if information is a closely guarded secret within a company, it may have no economic value outside of that company and, therefore, will fail to satisfy the economic value requirement of the UTSA.\textsuperscript{45} Finally, although information may have been a trade secret at one time, it can lose its trade secret status at any time through no fault of the owner of the information, such as if the secret is reverse engineered or discovered through independent research and thereafter disseminated to the public.\textsuperscript{46}

From the perspective of an ongoing business enterprise, the distinction between trade secrets and mere confidential information may make little practical difference until it initiates a lawsuit for trade secret misappropriation. Then, it must plead and prove the existence of trade secrets. The distinction will also mean a great deal to the parties involved in bankruptcy proceedings because the characterization of the information will determine how it is administered.\textsuperscript{47} If information constitutes trade secrets, then the trustee (or the debtor in possession) should take reasonable steps to

\textsuperscript{43} MILGRIM, supra note 17, at § 1.07[2], n.11 (explaining that while absolute secrecy is not generally required, relative secrecy is a question of fact "within the sound discretion of the trier of fact"); id. at § 2.01[2] (describing trade secrets conceptually as "evaporating" or "disappearing" property rights, for example, when a trade secret becomes generally known, or a trademark "disappears" as it becomes used generically, or when an owner of a patent loses his or her "monopoly" to make, use, or sell a patented invention after the patent grant expires). \textit{See also} Rockwell Graphics Sys., Inc. v. DEV Indus., 925 F.2d. 174, 195 (7th Cir. 1991) (examining whether the plaintiff tried "hard enough" to keep its information secret).

\textsuperscript{44} MILGRIM, supra note 17, at § 1.04 ("If trade secrets are readily accessible to employees not having a legitimate employment need for them, the secrecy element required for protection might be impaired"); Pub. Relation Aids, Inc. v. Wagner, 37 A.D.2d 293, 296-97 (N.Y. 1971) (finding no trade secret status for a matter that almost all employees knew to be secret, instead of few selected employees having the need to know and even if the matter was "ingenious"). \textit{See also} Roger Norman Coe, \textit{Keeping Trade Secrets Secret}, 76 J. PAT. & TRADEMARK OFF. SOC'Y 833, 835 (1994) (explaining that "a practice inside a company may be so commonly practiced in that company that employees assume that everyone in the industry knows the same information and that no trade secret exists"); Michael A. Epstein & Stuart D. Levi, \textit{Protecting Trade Secret Information: A Plan for Proactive Strategy}, 43 BUS. LAW. 887, 904-05 (1988) (advocating for informing employees of trade secrets and using written company policies to make employees aware that they have access to trade secrets).

\textsuperscript{45} See, e.g., Buffets, Inc v. Klinke, 73 F.3d 965, 968-69 (9th Cir. 1996).

\textsuperscript{46} MILGRIM, supra note 17, at §§ 1.05[5] (discussing reverse engineering), 1.07 (discussing secrecy). \textit{See also} E.I. duPont deNemours & Co. v. Christopher, 431 F.2d 1012, 1015 (5th Cir. 1970) ("[t]he may use his competitor's secret process if he discovers the process by reverse engineering applied to the finished product; one may use a competitor's process if he discovers it by his own independent research"); Kewanee Oil Co. v. Bicron Corp., 416 U.S. 470, 476 (1974); Chicago Lock Co. v. Fanberg, 676 F.2d 400, 404 (9th Cir. 1982).

\textsuperscript{47} \textit{See infra} Parts III and VI (discussing, among other things, executory contracts involving the licensing of trade secrets should be handled differently from executory contracts involving the licensing of mere confidential and proprietary information).
ensure that the information remains secret. If the information does not qualify for trade secret protection, then the ability to protect it may depend on such factors as whether: (1) it exists in tangible form; (2) it has been publicly disclosed; (3) its protection can be achieved through possession and control of the physical embodiment of the information; and (4) whether other theories of state law exist under which such information may be characterized as property.

The extent to which information and data that does not qualify for trade secret protection (e.g., mere confidential or proprietary information) is property for purposes of bankruptcy is a question that bankruptcy courts have not carefully considered. However, because trustees are charged with finding as much value in a debtor’s estate as possible, bankruptcy courts may be willing to apply a broader view of property than state courts do when hearing trade secret claims. In this regard, the Bankruptcy

48. Cf. UNIF. TRADE SECRETS ACT §1 (requiring reasonable efforts to maintain secrecy in order for protection).

49. Although intellectual property rights often exist in a tangible form, the ownership of such rights should be thought of and treated separately from their physical embodiment. U.S. Copyright law specifically recognizes this point in section 202 of the Copyright Act which provides “[o]wnership of a copyright … is distinct from ownership of any material object in which the work is embodied.” 17 U.S.C. § 202 (2000). In the case of trade secrets, for instance, the paper on which a customer list is written may be personal property even if the information that is contained on the list does not qualify for trade secret protection. This is why some states recognize a cause of action for conversion of intangibles when they are represented by documents and refuse to recognize such a cause of action when there is no documentary representation. See, e.g., Avery Dennison Corp. v. Allendale Mut. Ins. Co., No. CV 99-09217CM (CWX), 2000 WL 33964136, at *3 (C.D. CA. 2000). But see G.S. Rasmussen & Assoc. v. Kalitta Flying Serv., Inc., 958 F.2d. 896, 906-07 (9th Cir. 1992) (applying three part test to determine if the asserted interest was property subject to conversion under California law). See also Kremin v. Cohen, 314 F.3d 1127, 1133-34 (9th Cir. 2003) (distinguishing between exclusive and non exclusive intangibles for the purpose of determining whether intangibles can be the subject of a conversion action).

50. Significantly, the treatment of non-trade secret information in a bankruptcy proceeding was considered by the U.S. Senate when the definition of intellectual property was added to the Bankruptcy Code in 1988 but the Senate’s broader conception of intellectual property to include confidential and proprietary information was not enacted into law. See S. Rep. No. 100-505 at 7-8 (1988). The Senate Report regarding section 101(35A) of the Bankruptcy Code (then referred to as section 101(52)) provides:

The definition of “intellectual property” is unusual for a federal statute because of its inclusion [sic] of trade secret, normally a concept reserved for development by the states. Because bankruptcy processes can alter rights created by state law, this inclusion is appropriate. Also included as a separate category is confidential research or development information. This was done because some states narrowly define trade secret, but accord protection to the developer of confidential technical information falling outside those definitions.

Id. See also H. Rep. No. 100-506 at 8 (1988) (explaining the limited version of the definition that was enacted into law).

TRADE SECRETS IN BANKRUPTCY

The Bankruptcy Code's broad conception of estate property as "interests" raises the further issue whether such interests can be defined solely by contract. To borrow from Margaret Jane Radin's conception of the issue: Is the meaning of property to be determined by the law of the state, the law of the firm, or both? This issue can arise with respect to trade secrets because parties to a license agreement often agree that information constitutes trade secrets even though it does not meet the statutory definition. However, there is a well-established principle of trade secret law that trade secret rights cannot be created by contract. Thus, if someone agrees to treat information of the debtor that does not qualify for trade secret protection confidentially, is the debtor's interest in that information an asset of the estate?

Due to the bankruptcy courts' reliance on state law definitions of property, it appears clear that bankruptcy courts would not necessarily give respect to an agreement of parties to recognize information as "trade secrets." However, because a
debtor’s contractual rights are “an interest” of the bankruptcy estate, presumably such rights must be identified as a part of the estate. Unfortunately, there is little, if any, discussion in the case law of how non-trade secret information that is the subject of a contract is to be categorized and treated by bankruptcy courts. Clearly, confidential and proprietary business information not meeting the definition of a trade secret is not “intellectual property” as that term is defined in the Bankruptcy Code and need not be defined as such on the debtor’s schedules. However, if such information is an interest of the estate by virtue of it being the subject of contractual rights, then presumably it needs to be identified elsewhere on the debtor’s schedules.

B. Stage Two: Identifying the Property of the Bankruptcy Estate

Pursuant to the Bankruptcy Code, a debtor has the duty to “carefully, completely, and accurately” identify all of its property interests. This must be accomplished with “the utmost good faith” and is carried out by completing and filing a schedule of assets. The official form on which such disclosures are to be made includes a reference to intellectual property as an asset that should be listed, and the

57. Norton, supra note 4, § 61:6, at 61-29 (“Any interest which the debtor acquires under a contract is included in the estate.”).

58. Although intellectual property is not explicitly mentioned in 11 U.S.C. § 541(a), a definition of intellectual property was added to the Bankruptcy Code in 1988 when 11 U.S.C. § 365(n) was added. See 11 U.S.C. § 101(35A) (2000). This definition makes reference to “trade secrets” but does not define what they are. Based upon the law of most states, trade secrets do not include proprietary and confidential information that does not satisfy the three requirements of the UTSA. See note 41 supra.

59. Fed. R. Bankr. P. 1007, 9009 (2001) (detailing the “Lists, Schedules, and Statements” that must be filed by the debtor and proscribes the forms to be used for such purposes). Fed. R. Bankr. P. 1007(b)(1) requires that the debtor “file schedules of assets and liabilities, a schedule of current income and expenditures, a schedule of executory contracts and unexpired leases, and a statement of financial affairs, prepared as prescribed by the appropriate Official Forms.” Official Form 6, Schedule B, available at http://www.access.gpo.gov/uscode/title11a/11a_1_12_6.html, is the form to be used to list personal property, including “[p]atents, copyrights, and other intellectual property” (at line 22) and “[l]icenses, franchises, and other general intangibles” (at line 23). Schedule G of Official Form 6 is the form to be used for the listing executory contracts and unexpired leases. As alluded to in note 49, supra, to the extent such information is embodied in tangible form, the physical embodiment of it may also constitute tangible personal property which should be listed somewhere on Schedule B. Further complicating the question of where and how to list trade secrets and confidential information is the fact that rights in information that are based upon a contract should arguably be listed in Schedule G.


61. In re Breitling, 133 F. 146, 148 (7th Cir. 1911).


63. Official Form 6, Schedule B, Line 21 (on which debtors are instructed to list their
Bankruptcy Code defines intellectual property to include trade secrets. Unfortunately, nowhere in the Bankruptcy Code are trade secrets defined. Thus, as a practical matter, in order for trade secrets to be included on the debtor's schedule of personal property, the debtor must know that trade secrets are a form of intellectual property and be familiar with the applicable definition of trade secrets.

There are a number of ways that trade secrets may become a part of a debtor's estate. First, the debtor may own trade secrets by having purchased them from another. Second, the debtor or the debtor's employees may have developed a secret internally, either pre-petition or post-petition. This might occur, for instance, if the research and development arm of the debtor discovers a cure for cancer. Although this discovery is likely to be a candidate for patent protection, until a patent application is prepared and filed and before it is published in the Patent Office's Official Gazette, information concerning the cure is a trade secret if it meets all of the requirements for trade secret protection. Another way that trade secrets may play a role in the debtor's bankruptcy proceeding is through a license agreement.
debtor is a franchisee of a restaurant chain or the licensee of computer software, the underlying franchise or license agreement is likely to include a reference to trade secrets or confidential and proprietary information.\footnote{71}{178}

While many debtors may own trade secrets, the identification of trade secrets presents a particular challenge for bankruptcy courts because they do not always exist in tangible form and because it is possible for a debtor to own trade secrets without knowing it.\footnote{72}{179} Although debtors may know that they possess and use information that helps them to operate their business, they are often unaware that such information has a specified legal status.\footnote{73}{180} Often, companies discover that they own trade secrets only after a valuable employee leaves their employ to begin work for a competitor or to start a competing business.\footnote{74}{181} If the company consults an attorney to determine if it has legal recourse against the departing employee, the attorney will work with the client to identify potential trade secrets and to ascertain if a viable claim for misappropriation exits. Typically, only large and sophisticated companies take steps to identify and protect trade secrets before the defection of valued employees.

If the debtor's trade secrets are not known to the debtor or are otherwise unscheduled on the debtor's list of personal property, then it is up to the trustee and creditors to identify such assets if they exist.\footnote{75}{182} If the trade secrets are documented in some written form, they should be identifiable during a careful review of the debtor's records.\footnote{76}{183} Clues to the possible existence of trade secrets may be found in

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Because there is a deadline by which executory contracts must be assumed or rejected, debtors who rely upon IP licenses in the conduct and operation of their business should act quickly to identify such assets before the deadline passes. Norton, supra note 4, § 177:29, at 177-45. The deadline under Chapter 7 is "within 60 days after the order for relief." 11 U.S.C. § 365(d)(1). The deadline under Chapter 11 is "anytime before the confirmation of a plan." 11 U.S.C. § 365(d)(2).

\footnote{71}{See Schedule B, supra note 59, at line 22 (calling for the listing of all licenses, franchises, and other general intangibles).}

\footnote{72}{See Norton, supra note 4, § 177:149, at 177-21 (noting the difficulty of articulating trade secrets). Unlike patent rights, trade secrets are not dependent upon a government grant for their existence. Also, unlike trademark and copyrights, there is no federal or state registration process for trade secrets.}

\footnote{73}{Thornton Robison, The Confidence Game: An Approach to the Law about Trade Secrets, 25 Ariz. L. Rev. 347, 382 (1983) (explaining that uncertainty over whether something is or is not a trade secret is a "significant problem" because there is no definitive way to determine what is or is not a trade secret before misappropriation litigation ensues); Kevin R. Casey, Identification of Trade Secrets During Discovery: Timing and Specificity, 24 AIPLA Q.J. 191, 200-02 (1996) (magnifying the concern that a trade secret plaintiff faces an uphill battle to list possible trade secrets appropriated by a defendant because it often does not know which of its trade secrets has been misappropriated of if the material in question is a trade secret).}

\footnote{74}{See, e.g., Metallurgical Indus. v. Fourtek, Inc., 790 F.2d 1195, 1198 (5th Cir. 1989).}

\footnote{75}{Generally, unscheduled property continues to belong to the bankruptcy estate even after the closure of the case. See, e.g., Hutchins v. IRS, 67 F.3d 40, 43 (3d Cir. 1995) ("the bankrupt estate retains unscheduled assets") (citing 11 U.S.C. § 554(d) ("property . . . not abandoned under this section . . . remains property of the estate.")�)

\footnote{76}{In Fundamentals of Bankruptcy Law, the authors argue:}
confidentiality agreements, invention assignment agreements, non-compete agreements, and employee policy manuals, or through the receipt of royalty payments. Pending or threatened trade secret misappropriation claims are also a good source of information about the debtor’s potential trade secrets assets.

If the debtor’s trade secrets are not documented in writing and not disclosed on the bankruptcy schedules, the only way to identify them is for the trustee and creditors to become thoroughly familiar with the business operations of the debtor and to examine key employees and executives about the possible existence of trade secrets. Fortunately, the Bankruptcy Code includes a number of tools that are designed to ensure the full and honest reporting of estate assets. For instance, in a chapter 7 case the debtor is required to cooperate with the trustee in preparing a “complete inventory of the property of the debtor.” Bankruptcy Rule 2004(a) allows any party in interest, including the trustee, to petition the court to order the examination of any entity. Creditors may also examine the debtor at the meeting of creditors. In all cases, great care should be taken to ensure that the unknown or unscheduled trade secrets are not lost in the process.

Whether the debtor’s interest in his books, papers, or other recorded information concerning his financial affairs is an interest in property for purpose of section 541(a)(1) is of only academic interest, for ordinarily this financial information must be turned over to the trustee under section 542(e).

FUNDAMENTALS OF BANKRUPTCY LAW, supra note 21, § 4.01(a). This observation, however, is limited to financial information that is recorded in some fashion and does not cover financial information that is not recorded or non-financial information.

77. The articulation of trade secrets will be more or less detailed depending upon whether they stand alone or are attached to a litany of other intellectual property. For instance, it is not uncommon for a franchise agreement to specifically identify a trade secret as “the recipe for making franchisor’s pizzas.” In contrast, software license agreements, confidentiality agreements, and employee manuals tend to be more general, often including a clause that broadly identifies “all patents, copyrights, trade secrets, know-how, and confidential and proprietary information contained therein.” See Smith, supra note 3, at 574-76 (criticizing the court in In re Avalon Software, Inc., 209 B.R. 517 (Bankr. D. Ariz. 1997), for failing to recognize the multiple and distinct intellectual property rights that can exist in computer software).

78. The claim for trade secret misappropriation is an asset in its own right and one which a debtor is required to separately list on its schedule of personal property. See supra note 59. Obviously, if the debtor is the plaintiff in such an action it will have alleged the existence of trade secrets in its complaint.

79. Outside of the bankruptcy context, this process is called an “intellectual property audit” and a number of resources exist to assist in the conduct of such audits. See, e.g., Epstein & Levi, supra note 44, at 898-902.

80. FED. R. BANKR. P. 2015(a), 4002(4).
81. FED. R. BANKR. P. 2004(a).
83. See In re Robert Landau Assoc’s., 50 B.R. 670, 674-75 (Bankr. S.D.N.Y. 1985) (recognizing balance between creditors’ needs for complete disclosure and debtor’s need for...
An interesting issue that may arise with respect to the identification of trade secrets and proprietary information concerns the use of non-compete agreements to mask or diminish the value of assets that are transferred pre-petition.\textsuperscript{84} Typically, a non-compete agreement accompanies the sale of a business and includes a promise by the seller not to compete with the buyer for a limited period of time.\textsuperscript{85} Such agreements relate to trade secret law to the extent they prevent key executives and employees of the seller from using the knowledge, skills, and know-how they learned in the seller’s business.\textsuperscript{86} As several bankruptcy courts have recognized, a company that is planning to file for bankruptcy protection may sell assets at an undervalued price but couple such sale with a non-compete agreement pursuant to which the owners or employees of the debtor receive periodic post-petition payments for their promise not to compete.\textsuperscript{87} To the extent the compensation that is owed under the non-compete agreement is traceable to the property sold, it may belong to the bankruptcy estate.\textsuperscript{88} Thus, the possible existence of oral or written non-compete agreements should be a subject of inquiry by trustees and creditors.

\textsuperscript{84} See, e.g., \textit{In re Andrews}, 80 F.3d 906, 910-911 & n.10 (4th Cir. 1996) (court found that the buyer made the non-compete agreement and the customer lists “a condition of the sale, and made the payments thereunder, to protect and maintain the good will it purchased from [the debtor]”); \textit{In re Bluman} 125 B.R. 359, 360-61 (Bankr. E.D.N.Y 1991) (debtor attempted to sell the business that was part of the estate and then collect monthly payments for the business assets and non-compete agreement); \textit{In re Sloan}, 32 B.R. 607, 611 (Bankr. E.D.N.Y. 1983) (intangible assets of a business such as customer lists and a covenant not to compete sold along with its other assets should be considered part of the bankruptcy estate). \textit{See also infra} Section IV.A for a discussion of how a trustee may avoid preferential or fraudulent transfers.

\textsuperscript{85} \textit{See} \textit{William G. Porter II & Michael C. Griffaton, Using Noncompete Agreements to Protect Legitimate Business Interests, 69 DEF. COUNS. J. 194, 194 (2002).}

\textsuperscript{86} According to the law of many states, non-compete agreements and other restrictive covenants are unenforceable unless they are reasonable in scope and duration. \textit{See, e.g.}, California Business and Professions Code, §§ 16600, 16601. One way to establish the reasonableness of such restrictions is to couple the promise not to compete with a past and future obligation to maintain the confidentiality of trade secrets.

\textsuperscript{87} \textit{In re Andrews}, 80 F.3d at 911 (stating that if the court failed to find the non-compete agreement part of the sale of assets, the debtor “would be able, indeed invited, to circumvent the bankruptcy laws through clever use of agreements not to compete. Specifically, a debtor selling a business, yet anticipating filing bankruptcy, could divert sale proceeds from the bankruptcy estate by shifting these proceeds from pre-petition sales payments to post-petition non-competition payments. There, as here, the post-petition non-competition payments are not part of the debtor's fresh start efforts, but rather payments that are rooted in the debtor's pre-petition conduct.”).

\textsuperscript{88} Several courts have held that compensation due to a debtor pursuant to a pre-petition
C. Stage Three: Protection of Estate Property

Once the bankruptcy estate is created and identified, the trustee (or debtor in possession) is required to take immediate steps to protect the property of the estate. This is often accomplished by taking physical possession of estate property or, in the case of intangible property, by asserting dominion over the documentary evidence or proceeds of such rights. For instance, the debtor and third parties, such as lawyers and accountants, are required to turnover the debtor's "recorded information, including books, documents, records, and papers, relating to the debtor's property or financial affairs." Similarly, "an entity, other than a custodian," is required to turnover all "property that the trustee may use, sell, or lease under section 363 of this title, or that the debtor may exempt under section 522 of this title" unless it is "of inconsequential value or benefit to the estate." Once aware of the existence of the bankruptcy proceeding, a custodian of estate property is required to preserve it and deliver it to the trustee.

The protection of trade secrets presents a number of challenges for trustees. First, the secrets should be put under lock and key if they exist in tangible form. Second, and perhaps more important, steps should be taken to ensure that all persons who are or were in possession of, or who are or were given access to, such secrets are under an ongoing and enforceable duty of confidentiality. This is because trade secret rights can only be enforced to the extent that they are "misappropriated," i.e., either

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agreement not to compete is not attributable to post-petition services and is thus property of the estate. See, e.g., In re Alstad, 265 B.R. 488 (Bankr. M.D. Fla. 2001); In re Sloan, 32 B.R. at 611.


90. 11 U.S.C. § 542 (2000). Courts that have considered whether intangible property is subject to the turnover requirements of sections 542 and 543 have generally held that it is. Typically, however, these cases involved money in a bank account, accounts receivable, tax returns, copyrights, or other types of general intangibles that are evidenced in a documentary form. See, e.g., In re Bristol Convalescent Home, 12 B.R. 448, 449, 451 (Bankr. D. Conn. 1981) (holding that monies owed a Chapter 11 debtor by the State of Connecticut were property of the estate and were subject to turnover); In re Debmar Corp., 21 B.R. 858, 860 (Bankr. S.D. Fla. 1982) (holding that pre-petition levies on an account receivable and a bank account by the I.R.S. were property of the estate).

94. See supra notes 20, 43-46 and accompanying text. See also Electro-Craft Corp. v. Controlled Motion, Inc., 332 N.W.2d. 890, 901 (Minn. 1983) (plaintiff's failure to engage in any efforts to maintain the secrecy of its information was fatal to its trade secret claim).
acquired by improper means or disclosed or used in violation of a duty of confidentiality.

A question that bankruptcy courts have not examined but which may arise with respect to trade secrets is whether the statutory obligations imposed on trustees, custodians, and other entities to preserve the property of the estate create a duty of confidentiality that can serve as the basis for a post-petition claim for trade secret misappropriation. In other words, even if the nature of the relationship that existed between the trade secret owner and the person in possession of the trade secrets would not normally give rise to a duty of confidentiality, does the filing of the bankruptcy petition convert the relationship to one where such a duty is owed? And, if so, may a trustee, custodian, or other entity in possession of estate trade secrets be sued for trade secret misappropriation post-petition if they wrongfully disclose or use such secrets?

Based upon established trade secret law, certain relationships can create a duty of confidentiality even in the absence of an express obligation. For instance, an obligation to maintain the confidentiality of trade secrets is often imposed upon employees because many states treat employees who know or have custody of a trade secret as having a fiduciary duty to the employer. This is important because, in the absence of an express or implied duty of confidentiality, the only way trade secrets can be misappropriated is if they are acquired improperly. If the relationship between a debtor and other participants in a bankruptcy case is fiduciary, an implied duty of confidentiality arguably attaches to estate trade secrets wherever they exist.

95. Uniform Trade Secrets Act § 1, definition of “misappropriation” and “improper.”

Section 1(2) of the UTSA provides that misappropriation may occur when a person breaches a duty of confidentiality. According to applicable case law, such a duty may be either express or implied and implied duties have been found to arise from a number of relationships.

96. See supra notes 89-93.

97. See Sharon K. Sandeen in Trade Secret Practices in California, Chapter 10, §§ 10.16-10.25 (2d ed. 2003) (listing the types of relationships that, based upon case law, have given rise to a duty to maintain the confidentiality of trade secrets).

98. Id. See also Pachmayr Gun Works, Inc., v. Olin Mathieson Chem. Corp., 502 F.2d 802, 807 (9th Cir. 1974) (stating that trade secret law is concerned with “protecting against breach of faith and reprehensible means of learning another’s secret”) (citations omitted).


100. See supra note 95.
and regardless of the relationship that existed pre-petition. This, in turn, would expose the pre-petition possessors of estate trade secrets to an increased risk of liability for trade secret misappropriation once a bankruptcy petition is filed.

What if the pre-petition possessors of estate trade secrets do not know that the information that they possess are trade secrets? In all likelihood, no duty of confidentiality would be implied. This, of course, heightens the need for all parties in interest to quickly identify estate trade secrets so that all persons in possession of such secrets can be made aware of their duties of confidentiality. Once such secrets are identified, rather than relying upon an implied duty of confidentiality that may be imposed by operation of law, the trustee should exact an express promise of confidentiality in which critical trade secrets are identified with sufficient specificity.

D. Stage Four: Administration, Distribution, and Discharge

Once property interests become a part of the bankruptcy estate they must be dealt with in some fashion. How they are dealt with partly depends upon the chapter under which the petition is filed. A debtor reorganizing under Chapter 11 is allowed to remain in possession of estate property subject to a strict fiduciary duty with respect to the handling of estate assets. A similar rule applies to Chapter 13 debtors although confirmation of a plan revests all property of the estate in the debtor. If

101. See, e.g., In re Met-L-Wood Corp., 861 F.2d 1012, 1019 (7th Cir. 1988) (noting that a trustee has fiduciary duties and acts as the creditors' representative); In re REA Holding Corp., 8 B.R. 75, 81 (Bankr. S.D.N.Y. 1980) ("[A] creditors' committee owe[s] a fiduciary duty to all creditors which they fulfill by advising creditors of their rights and of the proper course of action in the bankruptcy proceeding.") (citations omitted)).

102. This would be a risk over and above the penalties that are provided in the Bankruptcy Code for the failure to turnover estate property. See, e.g., 11 U.S.C. § 521 (2000).

103. See, e.g., Dynamics Research Corp. v. Analytic Sciences Corp., 400 N.E.2d 1274, 1283 (Mass. App. Ct. 1980) ("The employer's interest in the secret must be crystal clear to justify the restraint of the employee, for whom it may have become part of his general knowledge and experience.") (citations omitted).

104. If such an agreement cannot be obtained voluntarily, it may be obtained by court order. See discussion of section 107(b) of the Bankruptcy Code infra Part III.A.

105. See FUNDAMENTALS OF BANKRUPTCY, supra note 21, at § 4.04 ("Property that becomes part of the estate ordinarily leaves the estate in one of three ways (not counting the revesting or other transfer of the estate's property that occurs upon or results from confirmation of a plan in a case under one of the rehabilitation chapters): (1) by sale or other disposition under section 363, ... (2) by the debtor's exempting it under section 522(b), ...; and (3) by an abandonment under section 554.


the debtor is proceeding under Chapter 7, then it is up to the trustee to gain control of
the estate assets and liquidate them for as much money as possible.\textsuperscript{108}

Section 363 of the Bankruptcy Code gives the trustee (or a debtor in possession) the
power to use, sell, or lease estate property.\textsuperscript{109} To the extent estate property is the
subject of a secured interest it may be foreclosed upon by the secured creditor once
the automatic stay expires or relief from the stay is obtained.\textsuperscript{110} If the property interest
is in the form of an executory contract (such as a license agreement or franchise
agreement involving trade secrets) then the trustee must decide whether to assume or
reject the contract.\textsuperscript{111} In the case of individual debtors, the property may be exempt
from treatment in bankruptcy.\textsuperscript{112} Lastly, the property may be abandoned.\textsuperscript{113}

The general goal of bankruptcy proceedings is to preserve and maximize the
value of the bankruptcy estate so that creditors can be repaid to the greatest extent
possible and to allow the debtor "a fresh start."\textsuperscript{114} Part of the bankruptcy process
involves the payment or discharge of various claims.\textsuperscript{115} This requires the bankruptcy
court and trustee to take account of the liabilities, as well as the assets, of the debtor.
This is done through a notice and claim process whereby creditors are allowed to file
a claim against the estate.\textsuperscript{116} Once the creditors of the estate are identified, steps are
taken to allow or disallow the claims\textsuperscript{117} and to pay-off or pay-down allowed claims in
a prescribed order.\textsuperscript{118}

Trade secret issues may arise on the liability-side of bankruptcy proceedings in a
number of ways. First, the debtor may be a defendant in a lawsuit for trade secret
misappropriation or a judgment debtor on a trade secret claim.\textsuperscript{119} Second, the debtor
may be the licensor or licensee of trade secret rights, in which case it may owe
various obligations under the terms of the license.\textsuperscript{120} Third, the trade secret assets of
the debtor may be pledged as security for a debt, in which case the secured creditor

\begin{thebibliography}{99}
\item 110. See 11 U.S.C. § 362(c), (d) (2000).
\item 111. 11 U.S.C. §§ 365(a), (m) (2000).
\item 112. 11 U.S.C. § 541(b) (2000).
\item 113. 11 U.S.C. § 554(a) (2000).
\item § 501(a) (2000) (describing the process in a voluntary case).
\item 119. See discussion infra Section VII. See also In re Lionel, L.L.C., No. 04-17324, slip op. at
\item 3 (Bankr. S.D.N.Y. 2007).
\item 120. See discussion infra Section III and VI. See also Menell, supra note 8, at 754
\item (explaining how some executory licenses may be net assets of the bankruptcy estate while others
\item may be net liabilities) (citing Jesse M. Fried, Executory Contracts and Performance Decisions in
\item Bankruptcy, 46 DUKE L.J. 517 (1996)).
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may enjoy the right to use, possess, or sell such assets. Each of these issues is addressed in the subsections that follow from the perspective of the various parties in interest.

E. Stage Five: Post-Closure

When a bankruptcy proceeding is finally resolved, it is the responsibility of the bankruptcy court to formally close the case. Once this is done, it hopes that it will never hear from the debtor or other parties in interest again. However, section 350(b) of the Bankruptcy Code provides that: "[a] case may be reopened to administer assets, to accord relief to the debtor, or for other cause." Often, the reopening of a case involves either unscheduled assets, newly discovered assets, or concealed assets. Given the vagaries associated with identifying trade secrets, particularly those that are not in tangible form, the potential for unscheduled or newly discovered trade secrets is high. The relevant question in such cases is: What happens to trade secrets that are not identified and administered before a bankruptcy case is closed? Can creditors make a successful claim to such property?

It is generally recognized that when property is scheduled but not administered—in other words, when it is not explicitly dealt with as part of the bankruptcy proceeding—it is deemed abandoned and, thereby, returned to the ownership of the debtor. In contrast, where property of the estate is not scheduled, and therefore not administered, the general rule is that it remains an asset of the bankruptcy estate. Given the vagaries associated with identifying trade secrets, particularly those that are not in tangible form, the potential for unscheduled or newly discovered trade secrets is high. The relevant question in such cases is: What happens to trade secrets that are not identified and administered before a bankruptcy case is closed? Can creditors make a successful claim to such property? The so-called "ride-through doctrine" may provide an exception to this rule for unscheduled executory property.

121. See discussion infra Section V.
124. NORTON, supra note 4, at § 40:4.
125. 11 U.S.C. § 554(c) (2000). An obvious exception to this rule applies to chapter 7 liquidation proceeding where there is no debtor remaining to whom the undisclosed assets can be "returned." See also supra note 49.
126. 11 U.S.C. § 347(a) (2000) (unclaimed property "shall be paid into the court"). Any property remaining unclaimed under Chapters 9, 11, or 12 "becomes the property of the debtor or of the entity acquiring the assets of the debtor under the plan." 11 U.S.C. § 347(b); see also In re Alcorn, 252 B.R. 174, 178 (Bankr. D. Colo. 2000) ("The discovery of previously undisclosed and unadministered assets has long been a reason to reopen a case under 11 U.S.C. § 350(b)") (emphasis included) (citing In re Menk, 241 B.R. 896, 911 (9th Cir. BAP 1999) (property that was not scheduled and was not administered retains its status as property of the estate after closing)).
127. 11 U.S.C. § 350(b) (2000). A request to reopen a bankruptcy case should be liberally granted, see In re Dodge, 138 B.R. 602, 605 (Bankr. E.D. Cal. 1992), but not if the costs of reopening a case outweigh the value of the newly discovered property, see In re Mullendore, 741 F.2d 306, 308 (10th Cir. 1984).
In Chapter 7 cases, unassumed executory contracts are deemed rejected. There is no such rule in Chapter 11 or 13 cases, with the result that executory contracts may simply become property of the debtor. This is done in the interest of efficiency and based upon the assumption that if such contracts were particularly valuable, they would have been identified earlier.

It is not clear from the existing case law whether unidentified trade secret rights will be treated like unscheduled executory contracts that ride-through to the debtor or like other unscheduled property of the estate that remains a part of the bankruptcy estate. The efficiency justification for the ride-through of executory contracts would seem to apply equally well to unidentified trade secrets, but no court has addressed this issue. At a minimum, trade secret interests that are a part of the estate by virtue of an executory contract should be treated like any other unidentified executory contracts for purposes of the ride-through doctrine.

III. THE INTERESTS OF THE DEBTOR

The interests of a debtor in identifying and preserving trade secrets depends a great deal upon whether the bankruptcy petition is filed under Chapter 7, 11, or 13. If the debtor is pursuing relief from its debts through a liquidation proceeding, then it does not have a great incentive, other than the need to comply with applicable law, to identify and preserve all of its assets. If all of a debtor’s trade secrets are not

128. In re JZ, LLC, 357 B.R. 816, 821 (Bankr. D. Idaho 2006) (“The ride-through doctrine is simply the traditional manner in which courts deal with executory contracts, that for some reason were not assumed or rejected pursuant to § 365 prior to or at confirmation.”); see also Donald F. Parsons, Jr. & John D. Pimot, The Intersection of Patent Law and Bankruptcy: What Every Practitioner Should Know, 18 DEL. LAW. 30, 31 (Winter 2000); Mark R. Campbell & Robert C. Hastie, Executory Contracts: Retention Without Assumption in Chapter 11 – “Ride Through” Revisited, 19 AM. BANKR. INST. J. 33, 33-34 (Mar. 2000).


131. Daniel J. Bussel & Edward A. Friedler, The Limits on Assuming and Assigning Executory Contracts, 74 AM. BANKR. L.J. 321, 330 n.48 (2000) (arguing that the “ride through” doctrine may “avoid or mitigate the risk of forfeiting valuable rights that might be nonassumable or nonassignable under the hypothetical test construction of §§ 365(c) and (f).”).

132. See the discussion of the abandonment of estate property and the possible revocation of such abandonment. See discussion infra Section III.C.

133. See, e.g., In re JZ, 357 B.R. at 821 (pre-petition license agreement between debtor-licensor and a third party rode through to the debtor). See also discussion of the treatment of executory contracts infra Part VI.

134. See supra notes 11-13.

135. It is a crime to intentionally fail to identify estate assets. 18 U.S.C. § 152(1) (2000). Additionally, as the debtor experienced in the case of In re McGee, the failure to truthfully and fully identify estate assets may result in an action by a creditor for an order finding that certain of the debtor’s debts are not dischargeable in bankruptcy. 157 B.R. 966, 976 (Bankr. D. Va. 1993).
identified, valued, and liquidated as part of a chapter 7 proceeding, it is creditors who are primarily harmed. The interest of the debtor in the size and nature of the bankruptcy estate increases substantially if the proceeding is brought under chapters 11 or 13. In such cases, the debtor has a great interest in maximizing the value of the estate and in preserving estate property because it wants to be able to continue its business as debt free as possible. The debtor is also interested in reducing the claims that can be brought against the estate and in avoiding non-dischargeable debts.

Interestingly, the filing of bankruptcy may actually enhance a debtor’s ability to protect its trade secret because it gives the trustee (or the debtor in possession) the power and authority to require others to return estate property. Pursuant to the turnover provisions of the Bankruptcy Code, third parties who are in possession of estate property are generally required to return it on their own initiative once they learn of the filing of the bankruptcy petition. Where the return of trade secrets belonging to the estate does not occur automatically, the trustee can call upon the power of the bankruptcy court to force the return of such information.

In addition to the interest that debtors have in the identification and custody of trade secret assets, there are a number of ancillary issues that arise as a result of the features of trade secret law. First, there is the preservation of trade secrets and confidential information in the bankruptcy proceeding itself. Second, if the debtor has liability for trade secret infringement, the question arises whether such claim is dischargeable in bankruptcy and whether an award of injunctive relief is enforceable against the debtor. Third, there is the issue of the treatment of trade secrets that are “abandoned” back to the debtor, including whether there is any basis for the revocation of abandonment. Fourth, there is the question whether licenses that are granted to the debtor are assignable or assumable. Each of these issues is addressed in the following subsections of this article.

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136. See discussion supra section II.E (discussing how unscheduled trade secrets are handled post petition).
137. Non-dischargeable debts are debts that are exceptions to the general “fresh start” and discharge of the debtor’s obligations. 11 U.S.C. § 523 (2000).
138. See supra notes 89-93 and accompanying text.
139. Id.
140. See supra notes 48, 90 (discussing, as a practical matter, this power is dependent upon whether the trade secrets exist in some tangible or documentary form and, thus, are capable of being physically returned). See also discussion infra Section VI (explaining that it also depends upon the status of the third party). If the third party is the licensee of trade secrets, then the obligation to return such secrets is arguably governed by Section 365 of the Bankruptcy Code which deals with the treatment of executory contracts. Id.
141. See infra Section III.A.
142. See infra Section III.B.
143. See infra Section III.C.
144. See infra Section III.D.
A. The Preservation of Trade Secrets in Bankruptcy Proceedings

Given the secrecy requirement of trade secret law and the usually non-secret nature of court proceedings, anytime trade secrets are a subject of litigation, there is a risk that they will be lost.\textsuperscript{145} For this reason, the UTSA includes a provision that grants courts discretion to fashion protective orders and other orders to protect trade secrets during the pleading, discovery, and trial phases of litigation.\textsuperscript{146} Fortunately for debtors and other parties in interest who desire to preserve trade secrets during bankruptcy, section 107 of the Bankruptcy Code contains a broader provision: "upon request, [the court] may issue an order to protect trade secret, confidential research, development, or commercial information of any entity."\textsuperscript{147}

As noted in the case of \textit{In re Orion Pictures Corp.}, confidential commercial information is entitled to §107(b) protection even though it is not a trade secret.\textsuperscript{148} Additionally, unlike a similar provision contained in Federal Rule of Civil Procedure 26(c)(7), section 107(b) does not require a showing of good cause.\textsuperscript{149} This broad view of protectable information makes sense given the interests that are at stake. It is not just the debtor who is interested in preserving trade secrets, but the trustee and creditors as well. Other parties in interest also have a stake in protecting their own trade secrets to the extent they might be forced to reveal them in the bankruptcy proceeding.

Section 107(b) has been applied to protect a wide variety of information. For instance, in \textit{In re the Frontier Group, LLC}, the court granted the debtor's request to treat its list of creditors as a confidential customer list.\textsuperscript{150} In \textit{In re Global Crossing Ltd.}, the court approved a request to close the hearing on a purchase agreement in

\textsuperscript{145} According to section 107(a) of the Bankruptcy Code and Bankruptcy Rule 5001(b), the general rule is that all documents that are filed in a bankruptcy case and all hearings related to the case are open to the public. 11 U.S.C. § 107(a) (2000); see also FED. R. BANKR. P. 5001(b).

\textsuperscript{146} UTSA § 5 ("In an action under this [ACT], a court shall preserve the secrecy of an alleged trade secret by reasonable means, which may include granting protective orders in connection with discovery proceedings, holding in-camera hearings, sealing records of the action, and ordering any person involved in the litigation not to disclose an alleged trade secret without prior court approval."). See also FED. R. CIV. P. 26 (c)(7).

\textsuperscript{147} 11 U.S.C. § 107(b)(1) (2000). See also FED. R. BANKR. PROC. 9018 (providing that the court may issue any order which justice requires to protect "a trade secret or other confidential research, development, or commercial information").

\textsuperscript{148} \textit{In re Orion Pictures Corp.}, 21 F.3d 24, 27-28 (2d Cir. 1994) (defining "commercial information" as "information which would cause an 'unfair advantage to competitors by providing them information as the commercial operations of the debtor'") (internal citations omitted).

\textsuperscript{149} \textit{Id.} at 27-29; see also \textit{In re Farmland Indus.}, 290 B.R. 364, 368 (Bankr. W.D. Mo. 2003) ("According to the Second Circuit, once it is established that the information sought to be protected fits in any of the categories or definitions in §107(b), 'the court is \textit{required} to protect a requesting interested party and has no discretion to deny the application.'") (internal citations omitted).

order to prevent information about proceedings undertaken to secure regulatory approval from being disclosed to third parties who wished to derail the sales process. In *In re Powell*, the court sealed a bank policy manual even though it was not a trade secret because disclosure of the manual might cause undue harm. Wherever possible, section 107(b) should be used to protect the trade secret and proprietary information of the bankruptcy estate.

B. The Dischargeability of Judgments for Trade Secret Misappropriation

The decision of a debtor to file for bankruptcy protection is often prompted by the commencement of a civil action or the entry of a damage award against it. This is because pre-petition claims are ordinarily dischargeable in bankruptcy. However, there are a number of exceptions to this rule. Of possible relevance to claims for trade secret misappropriation, section 523(a)(4) of the Bankruptcy Code provides that a claim "for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny" is a non-dischargeable debt. Similarly, section 523(a)(6) provides that claims for "willful and malicious injury by the debtor to another entity or to the property of another entity" are non-dischargeable.

As a number of cases establish, it is possible for claims for trade secret misappropriation to be nondischargeable in bankruptcy. However, particularly in light of the public policy that favors dischargeability, such judgments are often found to be dischargeable. The variance in outcome is due to the fact that a bankruptcy court's decision not to discharge a claim is dependent upon a highly fact-specific analysis that, in the case of trade secret misappropriation, requires a careful examination of the intent of the defendant.160

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152. *In re Powell*, 1998 Bankr. LEXIS 1427, *6 (Bankr. D. Ver. 1998); see also *In re One Moore Ford, Inc.* 146 B.R. 800, 806 (Bankr. E.D. Ark. 1992) (Court sealed credit company's policy manual from bank because it was a competitor and records were made in the ordinary course of business under 11 U.S.C. 547(c)(2)(A)).
155. *See id.*
158. *See, e.g., In re Harrison*, 180 Fed. Appx. 485, 486 (5th Cir. 2006); *In re Sarff*, 242 B.R. 620, 622 (6th Cir. BAP 2000); *In re Madsen*, 195 F.3d 988, 989-90 (8th Cir. 1999).
159. *See In re Lopez*, 367 B.R. 99, 106-07 (9th Cir. BAP 2007) (detailing both lines of cases); *see also In re Miller*, 156 F.3d 598, 606 (5th Cir. 1998) (court unwilling to rule that judgment for trade secret misappropriation was nondischargeable without additional findings of fact) and *In re Livingston*, 379 B.R. 711, 718 n.9 (Bankr. W.D. Mich. 2007) (judgment for trade secret misappropriation held dischargeable because it did not serve as the basis of the award of damages).
160. First, the bankruptcy court will consider the preclusive effect of the judgment. *See In re
The intricacy of, conflicts among, and errors in the case law surrounding the dischargeability of trade secret misappropriation claims is beyond the scope of this article. Still, it is worth noting the basic elements involved. When dealing with section 523(a)(4), the focus of the bankruptcy court's analysis is on whether the debtor: (1) owed a fiduciary duty to the judgment-creditor; (2) engaged in embezzlement; or (3) engaged in larceny.\textsuperscript{1}

Although the relationships that can lead to a duty to maintain the confidentiality of trade secrets are frequently labeled as fiduciary, they are often not the type of fiduciary duty the breach of which can result in a non-dischargeable claim. The fiduciary duties to which section 523(a)(4) refers are narrow:\textsuperscript{162} "[u]nder § 523(a)(4), 'fiduciary' is limited to instances involving express or technical trusts. The purported trustee's duties must . . . arise independent of any contractual obligation . . . [and] must have been imposed prior to, rather than by virtue of, any claimed misappropriation or wrong."\textsuperscript{163} For a debtor to have a fiduciary duty within the meaning of federal bankruptcy law there must be identifiable property and "trust-like" duties.\textsuperscript{164} To the extent that trade secrets qualify as property, they may serve as the required res, but whether the required trust-like duties are present depends upon the precise nature of the relationship between the debtor and the claimant. Although the required trust may be established by contract or by statute,\textsuperscript{165} a contractual duty to maintain the confidentiality of trade secrets will not necessarily create the requisite trust-like duties.\textsuperscript{166}

Balta, 151 B.R. 506, 508 (Bankr. E.D. Mo. 1993) ("The Supreme Court has held that bankruptcy courts deciding dischargeability may, in appropriate circumstances, give collateral estoppel effect to state court decisions.") (citing Grogan v. Garner, 498 U.S. 279 (1991)). Next, it must identify the elements of the underlying claim for relief and examine the record to determine the precise findings of fact that led to the judgment. \textit{Id.} ("For collateral estoppel to apply, this court must find that: (1) the issue sought to be precluded is identical to the one litigated in a prior action; (2) the issue was actually litigated in the prior action; (3) the prior determination resulted in a valid and final judgment; and (4) the factual determination for which preclusion is sought was necessary to the prior outcome.").

161. 11 U.S.C. § 523(a)(4). \textit{In re Miller}, 156 F.3d at 602 (noting that the focus of the inquiry under section 523(a)(6) is on whether the debtor engaged in a criminal act).


163. \textit{In re Tran}, 151 F.3d 339, 342 (5th Cir. 1998) (holding that Texas law did not impose a fiduciary duty on those who were licensed to sell Texas lottery tickets) (internal citation omitted); \textit{In re Livingston}, 379 B.R. 711, 717 n.8. \textit{But see In re Daniel}, 225 B.R. 249, 251-52 (Bankr. N.D. Ga. 1998) (holding that Georgia law did impose a fiduciary duty on those who were licensed to sell Georgia lottery tickets). \textit{See also Davis v. Aetna Acceptance Co.}, 293 U.S. 328, 333 (1934) (holding that the trust upon which the fiduciary relationship relies must be an express or technical trust); \textit{In re Blaszak}, 397 F.3d 386, 390 (6th Cir. 2005); \textit{In re Garver}, 116 F.3d 176, 178-79 (6th Cir. 1997).

164. \textit{In re Tran}, 151 F.3d at 343-44.


166. \textit{In re Fox}, 370 B.R. 104 (6th Cir. BAP 2007) (noting that not all agreements, even if labeled "trusts," establish the requisite trust-like duties). Such an agreement may, however, provide a basis for a finding of nondischargeability under 11 U.S.C. § 523(a)(6). \textit{See infra} note 182 and
The absence of a trust-like fiduciary duty does not end the inquiry under section 523(a)(4) because the provision also makes nondischargeable claims for embezzlement or larceny. The Fifth Circuit has defined embezzlement to mean: "fraudulent appropriation of property by a person to whom such property has been entrusted, or into whose hands it has lawfully come." This might be broad enough to include a misappropriation of trade secrets even if the trade secrets were rightfully acquired. However, the requirement of "fraudulent appropriation" will not always be something the claimant can demonstrate. It requires "proof of the debtor's fraudulent intent in taking the property." Thus, as with the willful and malicious exception discussed infra, application of the embezzlement exception in trade secret cases requires a finding that the debtor acted with a specific intent to defraud, an intent that is not an essential element of a claim under the UTSA.

As another court recently explained, "larceny" under section 523(a)(4) means "felonious taking of another's personal property with intent to convert it or deprive the owner of same." Thus, it too requires proof of the debtor's intent. More
significantly, the Fifth Circuit ruled that larceny cannot occur if an individual or company is in lawful possession of the trade secrets of another. Thus, trade secret misappropriation claims that are brought against those who are in rightful possession of such secrets, such as employees and vendors, apparently cannot constitute larceny. However, nondischargeable debts for larceny may encompass that portion of the UTSA which prohibits the misappropriation of trade secrets by improper means.

Under section 523(a)(6), the critical question is whether the actions of the debtor resulted in injury and were both "willful and malicious" as those terms are understood and applied under the Bankruptcy Code. On the issue of willfulness, the U.S. Supreme Court ruled that section 523(a)(6) requires a "deliberate or intentional injury, not merely a deliberate or intentional act that leads to injury." Subsequent lower court decisions have emphasized the need for "an objective substantial certainty of harm or a subjective motive to cause harm." On the issue of maliciousness, there is a split of authority. Some circuit courts require proof of "special malice," while others will accept proof of "implied malice." In either case, application of the willful and malicious exception requires evidence that the judgment debtor had a specific intent that is different and more exacting than the mens rea requirement of section 1 of the UTSA.


174. *But see In re McCoy*, 189 B.R. 129 (Bankr. N.D. Ohio 1995) (claim against former employee for misappropriation of trade secrets was nondischargeable under § 523(a)(4) as larceny and under § 523(a)(6) as causing a willful and malicious injury).


177. *Miller v. J.D. Abrams, Inc. (In re Miller)*, 156 F.3d 598, 606 (5th Cir. 1998); Williams v. IBEW Local 520 (*In re Williams*), 337 F.3d 504, 509 (2003); *In re Salisbury*, 331 B.R. 682, 687 (N.D. Miss. 2005). In practice, this standard requires courts to examine "clear and specific findings into [the debtor's] state of mind." *See Raspani v. Keaty (In re Keaty)*, 397 F.3d 264, 274 (5th Cir. 2005).


180. *Compare supra* notes 175-179, *with UTSA § 1(2) (requiring that the defendant have at least a "reason to know" that a trade secret was acquired improperly, or that the defendant disclosed*
however, be found under section 3(b) of the UTSA which sanctions the award of exemplary damages in the case of "willful and malicious misappropriation." In some circumstances, the intentional breach of a contractual duty of confidentiality will be treated as a nondischargeable claim.

Based upon the foregoing, it is clear that pre-petition claims for trade secret misappropriation will be dischargeable in certain circumstances. However, some misappropriation claims will be nondischargeable, and these almost certainly include claims resulting from the violation of a pre-petition injunction.

C. The Revocation of Abandoned Trade Secrets

As noted above, abandonment occurs when property is disclosed on the debtor’s schedule of assets but is not explicitly dealt with during the administration of the estate. The legal effect of abandonment is to retroactively vest the debtor with the property interest as of the date of the petition. But what if the property interest is not scheduled in a manner that allows the trustee to determine the value of such interest? Or, what if a trade secret interest is not scheduled as "intellectual property" on Schedule B of Official Form 6 but, instead, is listed on Schedule G as an executory or used a trade secret with knowledge). See also supra notes 168, 170.

See In re Kellerman, 980 F.2d. 737, 737, 738 (9th Cir. 1992) (citing In re Levy, 951 F. 2d. 196, 198 (9th Cir. 1991)).

See In re Williams, 337 F.3d. 504, 510 (5th Cir. 2003).

Buffalo Gyn Womenservices, Inc. v. Behn (In re Behn), 242 B.R. 229, 238 (Bankr. W.D.N.Y. 1999) ("An intentional violation of the order is necessarily without 'just cause or excuse' and cannot be viewed as not having the intention to cause the very harm to the protected persons that order was designed to prevent."). As explained in In re Behn:

[When a court of the United States ... issues an injunction or other protective order telling a specific individual what actions will cross the line into injury to others, then damages resulting from an intentional violation of that order as is proven either in the Bankruptcy Court or, so long as there was a full and fair opportunity to litigate the questions of volition and violation, in the issuing court are ipso facto the result of a "willful and malicious injury."]

242 B.R. at 238. See also In re Udell, 18 F.3d 403, 410 (7th Cir. 1994); In re Nyren, 187 B.R. 424, 426 (Bankr. D. Conn. 1995).

Section 554(a) of the Bankruptcy Code provides that: "After notice and hearing, the trustee may abandon any property of the estate that is burdensome to the estate or that is of inconsequential value and benefit to the estate." 11 U.S.C. § 554(a) (2000). Abandonment may also be ordered upon the request of a party in interest after a noticed hearing, 11 U.S.C. § 554(b). Subsection (c) of section 554 provides that abandonment will occur automatically with respect to property “scheduled under section 521(1)” that is not “administered at the time of the closing of a case.” 11 U.S.C. § 554(c).

FUNDAMENTALS OF BANKRUPTCY, supra note 21, at § 4.04, p. 189. But see United States v. Grant, 971 F.2d 799, 806 (1st Cir. 1992) (holding that the revesting should be deemed to occur as of the time of the abandonment).
Similarly, what if the debtor is not aware that information it owns enjoys trade secret status and, therefore, lists it under some other label such as "proprietary and confidential information?" Does the failure of the debtor to clearly identify its trade secrets provide a basis for revoking the abandonment of such property to the debtor?

Although there do not appear to be any reported cases involving undisclosed trade secrets or proprietary information that are on point, the effect of listing an IP right under an unclear label was the topic of the Ninth Circuit's decision in the case of Cusano v. Klien. In that case, a former member of the rock group KISS brought suit against other members of the band for royalties he claimed were owing by virtue of his ownership of the copyright in various songs. Because the plaintiff had previously filed for Chapter 11 bankruptcy, the issue arose whether he continued to own his copyrights or whether they had otherwise been administered by the bankruptcy court. Because the debtor had listed his "songrights" on his schedule of assets and they were not specifically dealt with in the reorganization plan, such rights reverted to him upon the closure of the case. However, because of alleged defects in how the debtor described and valued such rights, the defendants argued that the abandonment should be revoked.

After first noting that errors in the valuation of estate property do not provide a basis for a trustee to seek the return of abandoned property, the court in Cusano focused its attention on the alleged failure to adequately describe the subject property interest. The court noted that, although abandonment is generally irrevocable, "[r]evocation of abandonment is appropriate . . . where 'the trustee is given incomplete or false information of the asset by the debtor, thereby foregoing a proper investigation of the asset.'" The critical question in Cusano was whether the

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186. See supra note 59.
189. Cusano, 264 F. 3d at 945.
190. Id. at 946.
191. Id. (citing In re Ozer, 208 B.R. 630, 633 (Bankr. E.D.N.Y. 1997); In re Adair, 253 B.R. 85, 89 (B.A.P. 9th Cir. 2000). In re DeVore, 223 B.R. 193, 198 (B.A.P. 9th Cir. 1998). As summarized in a recent case, there are actually three exceptions to the general rule of irrevocability:
1) where the trustee is given false or incomplete information about the asset by the debtor,
2) where the debtor fails to list the asset altogether, and (3) where the trustee's abandonment was the result of a mistake or inadvertence, and no undue prejudice will result from revocation of the abandonment.
In re Johnson, 361 B.R. 903, 907 (Bankr. D. Mont. 2007) (quoting In re Gonzalez, 302 B.R. 687, 691 (2003)). With respect to item two on this list, there is actually an exception to the exception which is known as the "ride-through doctrine." For a discussion of the ride-through doctrine, see supra Section II.E.
debtor's schedule of assets put the other parties to the proceeding on inquiry notice of the existence of estate property.\textsuperscript{192} The court held that the debtor's use of the term "songrights" was not so defective as to forestall a proper investigation and could be reasonably interpreted to mean copyrights and rights to royalty payments.\textsuperscript{193} Thus, pursuant to the confirmed plan of reorganization, the debtor retained ownership in them.\textsuperscript{194}

Based upon \textit{Cusano}, it appears that if a description of trade secrets is reasonably sufficient to prompt the trustee or the creditors committee to investigate further, then it should operate to preclude creditors' subsequent efforts to revoke the abandonment of such property to the debtor.

D. The Assumability and Assignability of Trade Secret Licenses

In the discussion that follows in section VI, this article explores the important and oft-examined issue of how bankruptcy deals with the rights of those who license IP from the debtor.\textsuperscript{195} Here, the focus is on an equally important issue: whether a debtor's pre-petition rights as a licensee of IP are assumable and assignable.\textsuperscript{196} While the general rule is that all executory contacts can be assumed, assigned, or rejected,\textsuperscript{197} due to the perceived personal nature of IP licenses, licensors of IP rights have successfully objected to the assumption of such agreements.\textsuperscript{198}

\begin{itemize}
\item \textsuperscript{192} \textit{Cusano}, 264 F.3d at 946 (stating: Is the description of property on the schedules "so defective that it would forestall a proper investigation of the asset?").
\item \textsuperscript{193} \textit{Id.} at 946-47.
\item \textsuperscript{194} In contrast, the debtor's right to unpaid pre-petition royalties and other damages which accrued pre-petition, which the debtor had not listed, did not revert to the debtor and remained in the estate. \textit{Id.} at 947-48.
\item \textsuperscript{195} As a threshold matter, whether an IP license can be assumed or rejected depends upon whether it is an executory contract. 11 U.S.C. § 365 (2000). \textit{See also} Vern Countryman, \textit{Executory Contracts in Bankruptcy}, 57 MINN. L. REV. 439, 439 (1973); Jay Lawrence Westbrook, \textit{Functional Analysis of Executory Contracts}, 74 MINN. L. REV. 227 (1989); Michael T. Andrew, \textit{Executory Contracts Revisited: A Reply to Professor Westbrook}, 62 U. COLO. L. REV. 1 (1991); Madlyn Gleich Primoff & Erica G Weinberger, \textit{E-Commerce and Dot-Com Bankruptcies: Assumption, Assignment and Rejection of Executory Contracts, Including Intellectual Property Agreements, and Related Issues Under Sections 365(C), 365(E) and 365(N) of the Bankruptcy Code}, 8 AM. BANKR. INST. L. REV. 307, 310 (2000) ("While the term 'executory contract' is not defined in the Bankruptcy Code, the legislative history of and case law under section 365 rely on the \textit{Countryman} definition—i.e., 'contracts on which performance remains due to some extent on both sides.'").
\item \textsuperscript{197} 11 U.S.C. § 365(a) (2000).
\item \textsuperscript{198} Generally, there are two competing tests for dealing with the assumption of IP licenses.
With respect to all executory contracts, the critical question under applicable bankruptcy law is whether they are the type of contract that is not assumable under nonbankruptcy law. Specifically with respect to trade secret licenses, the issue is whether they are in the nature of a personal services contract. If so, then absent the approval of the licensor, the estate cannot benefit from the continued use of the licensed IP. Obviously, the rejection of IP licenses can have a significant effect on the bankruptcy proceeding, particularly in a Chapter 11 case, if the major asset of the debtor is the income it derives from ongoing operations.

Whether a contract is one for personal services is a factual question to be resolved under state law after considering all facts and circumstances. The mere

The first is the so-called “hypothetical test” of Catapult and its progeny. See In re Catapult Entm’t, Inc., 165 F.3d 747 (9th Cir. 1999); In re Sunterra Corp., 361 F.3d 257 (4th Cir. 2004) (copyright license); In re O’Connor, 258 F.3d 392 (5th Cir. 2001) (partnership agreement). See also Roger A. Clement, Jr., Going for Broke with Intellectual Property, 17 Me. B.J. 178, 184 (2002). Under this test, assumption is almost never possible. The second test is the so-called “actual test.” Courts that apply this test examine whether there is a material change in the identity of the person who is rendering the services, and if not, the license may be assumed. See Institut Pasteur v. Cambridge Biotech Corp., 104 F.3d 489, 493 (1st Cir. 1997).

For a discussion of section 365(c)(1) as it applies to IP licenses, see generally Madlyn G. Primoff et al., supra note 195. See also Daniel J. Busse et al., supra note 131, at 338-39.

199. Section 365(c) provides, in pertinent part:

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

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

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

11 U.S.C. § 365(c). As explained in In re CFLC, Inc., 174 B.R. 119, 121 (N.D. Cal. 1994), “[t]his language is interpreted as prohibiting the trustee from assigning over objection a contract of the sort that applicable law makes non assignable when the contract itself is silent about the assignment.” In this regard, each of the four principal IP disciplines, including trade secret law, have different histories and rules concerning the assignability of licenses involving such rights and each area of law should be separately researched and considered to determine the circumstances under which assignment is allowed, if at all.

200. As noted in the case of In re Lil’ Things, Inc., 220 B.R. 583, 586 (Bankr. N. D. Tex. 1998), there is a split of authority on the question of whether section 365(c)(1) applies only to personal services contracts. For the broader view, see In re Pioneer Ford Sales, Inc., 729 F.2d 27, 28-29 (1st Cir. 1984) (noting that the language of § 365(c)(1)(A) is not limited to personal service contracts).

201. This fact may explain the reluctance of some bankruptcy courts to find that franchise agreements are non-assumable. See, e.g., In re James Cable Partners, LP, 27 F.3d. 534 (11th Cir. 1994) (involving a municipal cable franchise); In re Sunrise Restaurants, Inc. 135 B.R. 149 (Bankr. M.D. Fla. 1991) (involving a Burger King franchise).

fact that an individual is performing a service is not enough, "there must be a special relationship between the parties, or the party to perform must possess special knowledge or a unique skill, such that no performance save that of the contracting party could . . . meet the obligations of the contract." Generally, "the test is whether the contract involves a personal relation of confidence between the parties or relies on the character and personal ability of a party."

No bankruptcy case could be found that addresses whether an executory trade secret license is a personal services contract and, therefore, is unassumable under section 365(c)(1). On the surface, given the need of trade secrets owners to exercise reasonable efforts to maintain the secrecy of their trade secrets and the importance of relationships to a trade secret claim, an argument can be made that a debtor-licensee's duty is personal in nature. Because trade secrets are lost once they become generally available, trade secret licensors have a critical interest in knowing and approving the identity of the individuals and companies that will be given access to their secrets and in ensuring that they have the personal integrity and skills to protect such secrets. However, whether a given trade secret license is personal in nature ultimately depends upon the actual relationship between the debtor and the licensor, the terms of the license agreement itself, and whether the debtor is an individual or a business. If the debtor is a business, arguably the licensor was not relying upon the debtor's personal character and skill in deciding whether to share its trade secrets.

The assumability of executory license and franchise agreements presents a special case when those agreements are coupled with a covenant not to compete.

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203. Id. (citing In re Rooster, Inc., 100 B.R. 228, 233 (Bankr. E.D. Pa 1989)).

204. Id. (citing Coykendall v. Jackson, 17 Cal.App.2d 729, 731, 62 P.2d 746 (1936)).

205. Pursuant to applicable patent and copyright law, it is well-established that non-exclusive patent and copyright licenses are not assignable without the consent of the licensor. See In re CFLC, 89 F.3d 673, 679 (9th Cir. 1996); In re Patient Educ. Media, Inc., 210 B.R. 237, 243 (Bankr. S.D.N.Y. 1997). In the recent case of In re Wellington Vision, Inc., a nonexclusive trademark license was held to be non-assignable as well. 364 B.R. 129 (S.D. Fla. 2007).

206. See supra note 96 and accompanying text.

207. Perthou v. Steward, 243 F. Supp. 655, 659 (D.C. Or. 1965) ("The fact that a person may have confidence in the character or personality of one employer does not mean that the employee would be willing to suffer a restraint on his freedom for the benefit of a stranger to the original undertaking.").

208. As was succinctly stated in the case of In re Headquarters Dodge, Inc: "determining whether a contract is personal in nature depends 'upon the nature of the subject of the contract, the circumstances of the case and the intent of the parties to the contract.'" In re Headquarters Dodge, Inc., No. 90-25863, 1992 WL 437432, at *7 (D.N.J. 1992) (citing 2 COLLIER ON BANKRUPTCY § 365.05 (Lawrence P. King, ed., 15th ed., 1992)).

209. But see In re Rooster, Inc., 100 B.R. at 233, n. 12 (noting that it is possible for a corporation to enter into an agreement that is dependent on personal service).

210. See Erin Brisbay McMahon, Covenants Not to Compete: Bankruptcy Issues, 4 J.
On one hand, an individual's promise not to compete appears to be so personal in nature that the agreement cannot be assumed. On the other hand, debtors who enter into covenants not to compete should not be allowed to avoid their obligations by declaring bankruptcy and thereafter rejecting the agreement to which such obligations attach. Accordingly, most courts find a way to impose a continuing obligation on debtors to abide by pre-petition noncompete agreements, provided that such agreements are otherwise enforceable under applicable state law.211

IV. THE INTERESTS OF THE TRUSTEE

Generally, it is the job of the trustee to identify all of the assets of the bankruptcy estate, to obtain maximum value from such assets, and to ensure that only legitimate claims are made against the estate.212 While the debtor is required to identify all of its assets and liabilities, given the vagaries of the identification process, the trustee has a great interest in obtaining sufficient information so that she can test the veracity of the debtor's schedules.213 The trustee also must acquire sufficient information to determine whether to allow or disallow creditors' claims.214

Assuming that there are trade secrets and proprietary information in the bankruptcy estate, the trustee has an interest in taking steps to secure such assets.215 If the debtor is a licensee or licensor of trade secrets under an executory contract, the trustee must decide whether to assume or reject the contract.216 The trustee also has an interest in avoiding pre-petition transfers that serve to diminish the worth of the bankruptcy estate. In the event that estate trade secrets are infringed during the pendency of the bankruptcy proceeding, the trustee (or debtor-in-possession) also has an interest in pursuing a trade secret misappropriation claim. The first two of these issues were addressed in previous sections of this article. The final two are addressed in the subsections that follow.

211. See Kennedy v. Medicap Pharmacies, Inc., 267 F.3d 493 (6th Cir. 2001); In re Udell, 18 F.3d 403 (7th Cir. 1994) (both declining to treat the right to an injunction to enforce a covenant not to compete as a claim, with the result that it could not be discharged in bankruptcy). But cf. In re Schneeweiss, 233 B.R. 28, 31-32 (Bankr. N.D.N.Y 1998) (holding that a non-compete agreement does not call for the performance of a service and, in any event, is not an executory contract).


213. See supra section II.B.

214. See supra section II.B.

215. See supra Section II.B.

216. See supra Section II.D.
A. Avoiding Pre-petition Transfers of Trade Secrets

In addition to being obligated and authorized to gain control of estate property, trustees have standing, in certain circumstances, to demand the return of property that was transferred pre-petition. The general purpose of this power is to prevent debtors from distributing plum assets of their business before declaring bankruptcy and from favoring some creditors over others. Section 548(a)(1) of the Bankruptcy Code provides one of the principal sources of authority for a trustee to obtain an order avoiding the fraudulent transfer of property. It covers two different types of fraudulent transfers: (1) those made with actual intent to hinder, delay, or defraud any entity to which the debtor was indebted at the time; and (2) those for which the debtor did not receive reasonably equivalent value in return. Both types reach transfers made within two years of the date of the bankruptcy petition.

Theoretically, trade secrets should be treated like any other asset of the pre-petition estate for purposes of section 548(a). If there is evidence that ownership of trade secrets was fraudulently transferred pre-petition, the bankruptcy court has the power to avoid the transfer and order that the trade secrets be turned-over to the estate. In practice, however, the non-rivalrous and intangible nature of trade secrets is likely to render such an order ineffectual. Obviously, trade secrets that are not documented in writing cannot easily be “returned” to the estate. If they exist only in the mind or expertise of a former owner or employee of the debtor, the only way they can be physically returned is through a process of documentation which, depending upon the nature of the secrets, may be difficult to fully capture in writing. Additionally, the very act of documenting the trade secrets can increase the risk that they will be publicly disclosed and lost forever. Even if they can be captured in a manner that allows for their physical return, they cannot be magically excised from the minds of those who were privy to the secrets. Thus, to fully protect the trade secrets of the estate, the trustee should consider initiating litigation against anyone.

218. Another source of such authority is section 544(b), which authorizes the trustee to use whatever avoidance powers may exist under non-bankruptcy law, such as the Uniform Fraudulent Transfer Act. See 11 U.S.C. § 544(b)(1) (2000).
221. For an overview of the difficulties of identifying and securing intangible property, see In re Allentown Ambassadors, 361 B.R. 422, 437 n.33.
222. MILGRIM, supra note 17, at § 2.06[1], p. 2-43 (“But a trade secret can by its nature be “delivered” to the purchaser and yet still be “retained” by the seller.”).
223. To borrow a line from the Sound of Music that illustrates this point: “How do you solve a problem like Maria?”
who has or threatens to misappropriate such secrets with the goal of obtaining an injunction prohibiting the disclosure and use of estate trade secrets.

B. Pursuing Trade Secret Infringement Claims During the Pendency of the Bankruptcy Proceeding

The trustee (or debtor in possession) is obligated to act expeditiously to identify and preserve estate assets. Due to the unique nature of trade secrets — specifically, the fact that they may be lost if not protected — this may require that a lawsuit be brought for trade secret misappropriation. Due to the limited jurisdiction of the Bankruptcy Courts, consideration must be given to whether the bankruptcy court has jurisdiction to hear such a case or whether it must instead be filed in a federal district or state court. The answer to this question depends upon whether the trade secret misappropriation claim is a “core” or “non-core” proceeding.

Section 157 of Title 28 of the United States Code sets forth a non-exclusive list of court proceedings that are considered “core proceedings” that can be heard by a bankruptcy court. While this list does not explicitly mention trade secret claims, there are a number of proceedings which, depending upon the purpose and facts of a particular action, may involve trade secret assets. For instance, section 157(b)(2)(A) defines “matters concerning administration of the estate” as a core proceeding. Section 157(b)(2)(E) lists “orders to turn over property of the estate.” Pursuant to sections 157(b)(2)(H) and (I), respectively, “proceedings to determine, avoid, or recover fraudulent conveyances” and “determinations as to the dischargeability of particular debts” are core proceedings.

Because the list in section 157 is non-exclusive, the analysis of what constitutes a core proceeding ultimately depends on the general question whether the proceeding “arises under Title 11” or “arises in a case under Title 11.” This must be determined on a case-by-case basis and depends upon the precise nature of the case and whether the alleged wrongdoing occurred before or after the petition. For instance, in In re Pixius Communications, the court held that the debtor’s trade secret misappropriation

224. See supra section II.C.
claims were a core proceeding under 28 U.S.C. §157(b)(2)(A) because they pertained to the administration of the estate. A critical fact supporting the decision was the finding that the debtor's claims were based upon alleged post-petition wrongdoing (i.e., wrongdoing against the estate). Similarly, in *In re Nutri/Systems, Inc.*, the court cited the post-petition behavior of the defendant/franchisee as establishing the core nature of the proceeding.

Ultimately, the decision to pursue a trade secret misappropriation claim should depend upon whether the claim is worth pursuing. As with all potential litigation, this requires a cost/benefit analysis to determine whether the likely return on the claim is more than the expense of litigation. If the alleged trade secrets are a principal asset of the estate, this decision may be easy. But it will depend upon the current value and useful life of the trade secret. If the trustee (or debtor in possession) fails to act quickly to protect such trade secrets during the early stages of the bankruptcy proceeding, there will be nothing to fight over.

V. The Interests of Creditors

The principal interest of creditors is to make certain that their claims are repaid to the greatest extent possible. Thus, like the bankruptcy court and trustee, they have a great interest in ensuring that all of the assets of the debtor are properly identified and valued. The interests of creditors diverge, however, depending upon whether they are secured or unsecured creditors.

A. The Interests of Secured Creditors

The smart lender will not give a loan unless the borrower pledges sufficient collateral to cover the loan in the case of a default by the borrower. Like other property interests, trade secret rights can serve as security for a loan. Given the intangible nature of trade secrets, however, care must be taken by the lender to ensure that it has perfected its security interest. Generally, there are four steps in this process: (1) the property that will serve as collateral is identified; (2) the borrower's ownership of that property is confirmed; (3) a written security agreement is executed between the lender and the borrower; and (4) the security interest is perfected, typically by filing a financing statement in the appropriate governmental office. Three

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230. *In re Pixius Commc'n, LLC*, 2005 WL 2850297 (Bankr. D. Kan. 2005), at 2-3 (finding that a trade secret claim based upon post-petition activities was a core proceeding). *But see Lauer*, 288 B.R. at 277 (finding that a claim for trade secret misappropriation was not a core proceeding).

231. *In re Pixius Commc'n, 2005 WL 2850297*, at 3.


233. Security interests in personal property are perfected either by taking physical control of the property or entering into a security agreement. Since trade secrets do not always exist in tangible form, the latter option is the best way to perfect a security interest in trade secrets.
prerequisites must be met in order to create a security interest which "attaches" and is enforceable against the debtor or a third party: (1) the collateral must be in the possession of the secured party or the debtor must sign a security agreement that describes the collateral; (2) value must be given; and (3) the debtor must have rights in the collateral.\footnote{234} Lenders who succeed in perfecting their security interests are secured creditors under the Bankruptcy Code and, "as a general rule, [their security interests] pass through the bankruptcy unaffected."\footnote{235}

The failure of a security agreement to properly identify property that is the subject of the lender's security interest means that such property is available for general administration by the bankruptcy court.\footnote{236} Section 9-108(a) of the Uniform Commercial Code (U.C.C.) provides that a description of personal property in a security agreement is sufficient "whether or not it is specific, if it reasonably identifies what is described." Thus, in order to adequately identify trade secrets as the subject of a security agreement, it might suffice to list "trade secrets" in the litany of property to which the security interest attaches.\footnote{237} On the other hand, more particularity may be required, in which case care must be taken to adequately describe the trade secrets in a manner that does result in their disclosure.\footnote{238} Because all IP, including trade secrets, are classified as "general intangibles" under Article 9,\footnote{239} and the Code makes it clear that describing the collateral by its U.C.C. classification is sufficient,\footnote{240} a security agreement that includes general intangibles in its collateral description should be sufficient to encumber all of the debtor's trade secrets.\footnote{241} However, because the term

\footnote{234} See U.C.C. § 9-203(b)(1)-(3). The Article 9 requirement that the debtor have "property rights" in the pledged collateral highlights the importance of both identifying information and data that the debtor claims to own and being able to characterize such information and data as "property." Because not all information and data will qualify for trade secret protection, as discussed infra, for Article 9 purposes a different theory of state law must exist that would support the characterization of non-trade secret information as property that can be the subject of a security interest.

\footnote{235} Norton, supra note 4, at §177:20.

\footnote{236} Smith, supra note 3, at 556 ("if the asset is not included in the description of goods covered by the security interest, the lender does not have a priority interest in the asset.")

\footnote{237} Cf. id. at 563 ("[n]o case law discusses what is minimally required for an adequate description of trade secrets.").

\footnote{238} Id. at 562.

\footnote{239} U.C.C. § 9-102(a)(42).

\footnote{240} U.C.C. § 9-108(b)(3).

\footnote{241} See id. at 556. See also Cynthia Grant, Description of the Collateral Under Revised Article 9, 4 DePaul Bus. & Comm. L.J. 235, 269 (Winter 2006).

Courts generally find a \textit{listed} general intangible "property" and thus subject to a bankruptcy trust. See, e.g., \textit{In re} Mid-West Motors, Inc., 82 B.R. 439, 442 (Bankr. N.D. Tex. 1988) ("FDIC's lien on general intangibles includes the payments made by the buyer with respect to the covenant not to compete"); \textit{In re} Griffith, 194 B.R. 262, 267 (Bankr. E.D. Okla. 1996) (creditor perfected a security interest in a noncompete covenant with debtor-farmer); \textit{In re} Prince, 85 F.3d 314, 321-22 (7th Cir. 1996) (noncompete agreement considered integral to a sale of assets). See also Xuan-Thao Nguyen, \textit{Collateralizing Intellectual Property}, 42 Ga. L. Rev. 1, 32 (2007) (criticizing the failure of the U.C.C.
"general intangibles" does not include accounts or commercial tort claims, a collateral description limited to general intangibles would not normally be sufficient to cover royalty payments due or to become due to the debtor under a license of its trade secrets, or claims for trade secret misappropriation, or other business torts which often accompany trade secret claims. Use of the broad term "general intangible" would also seem to exclude the tangible embodiment of trade secrets that are treated as "goods." Thus, if a lender wants to be sure to have a security interest in the debtor's trade secrets and related property, the lender should separately list and carefully categorize those property interests instead of relying solely on the use of the term "general intangibles." This, of course, would require the creditor to actually identify the subject trade secret assets and may serve the added benefit of enabling the creditor to more accurately value the debtor assets.

Even if a lender's security interest in the debtor's trade secrets has attached, the lender must take steps to perfect its security interest or risk losing (1) priority to another secured party, or (2) the entire security interest to a good faith purchaser, or bankruptcy trustee. Perfection can be accomplished by completing a financing statement (known as a U.C.C.-1) and filing it with the proper government authorities. Because there is no federal registration or recordation schema for trade secrets, an issue that has surrounded the perfection of security interests in patents, copyrights, and trademarks - whether notice of the lender's interest must be filed at

to require specific reference to IP in security agreements).

See U.C.C. § 9-102(a)(42).

243. A right to payment arising from property licensed is an "account." See U.C.C. § 9-102(a)(2)(i).

244. See U.C.C. § 9-102(a)(13) (defining "commercial tort claim"). However, because a security interest automatically extends to identifiable proceeds of the original collateral, see U.C.C. § 9-315(a)(2), the royalties from a license of trade secrets and a claim for misappropriation of trade secrets would be covered by a security interest in general intangibles if the security interest attached before the right to royalties or the misappropriation claim arose.

245. Article 9 defines "good" as "all things that are movable when a security interest attaches," including a computer program embedded in goods. U.C.C. § 9-102(a)(44). But cf United States v. Antenna Sys., Inc., 251 F. Supp. 1013, 1015-16 (D.N.H. 1966) (ruling that confidential blue prints and technical data were "general intangibles," not "goods").


248. See U.C.C. § 9-317(d).

249. See 11 U.S.C. § 544(a)(1) (2000) (giving the trustee the status of a someone with a judicial lien on all property of the debtor in which a creditor can obtain a judicial lien). If state law does not provide for judicial liens on intangible assets such as trade secrets, the lender's failure to perfect may not lead to avoidance of the security interest by the trustee.

the state level, the federal level, or both – does not affect trade secrets. 251 Perfection of security interests in trade secrets is governed solely by state law, and thus filing a U.C.C. financing statement in the appropriate state office should suffice. 252 However, where the trade secret asset also consists of overlapping copyright, patent or trademark protection, care should be exercised to determine if the security agreement must also be filed with federal authorities in order to be a perfect security interest in such assets. 253

B. The Interests of Unsecured Creditors

The principal interest of unsecured creditors is to make sure that something remains of the bankruptcy estate after all of the secured debts are paid. Then, they want to be first in line to receive what is left. To the extent the estate includes interests in trade secrets, the unsecured creditor, like the secured creditor, wants those assets to be identified and highly valued. But unlike the secured creditor, the unsecured creditor does not want those assets to be subject to a perfected security interest. Generally, the more unencumbered property the bankruptcy estate contains, the better the chances are for the unsecured creditor to receive payment.

VI. THE INTERESTS OF TRADE SECRET LICENSEES

If a debtor owns trade secrets and has licensed those secrets to others, the licensees have a great interest in being able to continue to use those secrets after the bankruptcy petition is filed. This is particularly true with respect to IP assets that are an integral part of a licensee’s ongoing business operations. Thus, licensees of the debtor’s trade secrets are very interested in efforts by the debtor, the trustee, and the court to maintain the trade secret status of licensed information. 254 They also have an interest in ensuring that their license to use the trade secrets survives the bankruptcy proceeding.

Given the vagaries of trade secret law, particularly the ability of others to discover them through reverse engineering or independent discovery, the licensor of trade secret assets cannot guarantee that its trade secrets will remain secret for all time. However, it can, and usually does, represent and warrant in the license agreement that it will engage in reasonable efforts to maintain the confidentiality of

251. Smith, supra note 3, at 564-65 (detailing the process for perfecting a security interest in trade secrets).
252. Id.
253. Id. at 574-578.
254. Although the estate’s loss of trade secret rights would allow a trade secret licensee to use the former trade secrets without any obligation to the estate, often the existence of trade secrets and the ability to use such secrets under a license gives the licensee an advantage that is not enjoyed by its competitors.
such secrets. When the licensor of trade secrets declares bankruptcy, the trustee (or
the debtor in possession) may well wish to assume responsibility for securing and
protecting such assets both for the benefit of the estate and for licensees. In other
words, failure to protect the trade secrets might both jeopardize the revenue due from
the licensee and increase the claims on the estate by giving the licensee an action for
breach. Nevertheless, pursuant to section 365 of the Bankruptcy Code, the trustee has
the option to either assume or reject all executory contracts, including license
agreements in which the debtor is the licensor. In some cases, it may make sense
to reject existing licenses if new, more lucrative licenses can be obtained.

Because companies often build their businesses around IP that is licensed to
them by others, those businesses could be jeopardized by rejection of the technology
license agreement under section 365(n)(1) of the Bankruptcy Code. Section 365(n)(1)
provides that if the trustee (or debtor in possession) rejects an executory contract
under which the debtor was a licensor of intellectual property, the licensee may elect:

- to retain its rights (including a right to enforce any exclusivity provision of such
  contract, but excluding any other right under applicable nonbankruptcy law to
  specific performance of such contract) under such contract and under any
  agreement supplementary to such contract, to such intellectual property
  (including any embodiment of such intellectual property to the extent protected
  by applicable nonbankruptcy law), as such rights existed immediately before the
case commenced.

Executory license agreements that involve trade secrets clearly fall within the
defined scope of section 365(n) because “trade secrets” are included in the definition
of intellectual property that was added to the Bankruptcy Code at the time of the
adoption of section 365(n). Thus, under this rule, the licensee has the power to
retain the licensed trade secrets despite rejection of the license agreement. That said,
an interesting issue that has gone unaddressed by the bankruptcy courts is whether the
information that was licensed actually qualifies as a trade secret as that term is
defined under the UTSA. To the extent a rejected executory license agreement allows
the licensee to use “confidential and proprietary information” not rising to the level of
a trade secret or other non-IP assets, the section 365(n) exception may not apply.
Thus, the need to determine whether licensed information is, in fact, a trade secret is
critical to a licensees’ right under section 365(n) and should not be glossed over by
bankruptcy courts.

255. See supra notes 195-204 and accompanying text.
VII. Conclusion

As the foregoing examination of trade secrets in bankruptcy reveals, there are numerous issues that may arise when trade secrets are part of a bankruptcy estate. Unfortunately, because IP assets are often thought of and treated as one amorphous asset, a rich body of law concerning the treatment of trade secrets in bankruptcy has yet to develop. While this article identifies and analyzes many of the issues that bankruptcy trustees, attorneys, and judges may encounter when dealing with trade secret related assets, there are undoubtedly more issues that may arise in the complex and convoluted world of bankruptcy law. At a minimum, the fleeting and ethereal nature of trade secrets demands that special efforts be undertaken to ensure that trade secrets that do exist in a bankruptcy estate are not lost through ignorance and inadvertence. This requires not only an understanding of the broad theoretical scope of trade secret protection, but an appreciation of the business activities of the debtor and the limits of trade secret protection.
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