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AUG 25 2017

CLERK U.S. BANKRUPTCY COURT
Central District of California
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**UNITED STATES BANKRUPTCY COURT
CENTRAL DISTRICT OF CALIFORNIA
LOS ANGELES DIVISION**

In re:

East Coast Foods, Inc.

Debtor(s).

Bradley D. Sharp, Chapter 11 Trustee

Plaintiff(s),

v.

Roscoe's Intellectual Properties LLC

Defendant(s).

CHAPTER 11

Case No.: 2:16-bk-13852-BB

Adv No: 2:17-ap-01001-BB

**MEMORANDUM DECISION GRANTING IN
PART AND DENYING IN PART TRUSTEE'S
MOTION FOR SUMMARY JUDGMENT**

Date: July 26, 2017

Time: 11:00 AM

Courtroom: 1539

Bradley D. Sharp ("Trustee"), the chapter 11 trustee for East Coast Foods, Inc. (the "Debtor"), moved for summary judgment avoiding a prepetition transfer of the Debtor's intellectual property to defendant Roscoe's Intellectual Properties LLC ("Defendant") under both actual fraud fraudulent transfer theories [Cal. Civ. Code

1 § 3439.04(a)(1), made applicable by 11 U.S.C. § 544(b), and 11 U.S.C. § 548(a)(1)(A)]
2 (the “First Claim for Relief”) and constructive fraud fraudulent transfer theories [Cal. Civ.
3 Code §§ 3439.04(a)(2) and 3439.05, made applicable by 11 U.S.C. § 544(b), and 11
4 U.S.C. § 548(a)(1)(B)] (the “Second Claim for Relief”). For the reasons set forth below,
5 this Court hereby denies the Trustee’s request for summary judgment on the Second
6 Claim for Relief and grants summary judgment in the Trustee’s favor on the Trustee’s
7 First Claim for Relief.

8 It is axiomatic that a court may not grant summary judgment where there is a
9 genuine issue of material fact. Summary judgment is only appropriate where, based on
10 the undisputed facts, movant is entitled to judgment as a matter of law. Fed. R. Civ.
11 Proc. 7056(a). Summary judgment should be denied where, in order to rule in movant’s
12 favor, the court must weigh conflicting evidence or make credibility determinations.
13 See Zetwick v. County of Yolo, 850 F.3d 436, 441 (9th Cir. 2017); Anderson v. Liberty
14 Lobby, Inc., 477 U.S. 242, 249 (1986).

15 In light of these principles, it is a rare case in which a court may grant summary
16 judgment under an actual fraud fraudulent transfer theory, but this is one such case.
17 The undisputed facts of this case lead inexorably to the conclusion that the transfer of
18 the Debtor’s intellectual property to the Defendant on the eve of the Debtor’s bankruptcy
19 filing was a transfer made with the actual intent to hinder, delay or defraud the Debtor’s
20 creditors. Accordingly, summary judgment for the Trustee on his First Claim for Relief is
21 warranted.

22 However, genuine issues of material fact preclude the Court from granting the
23 Trustee’s motion for summary judgment on his Second Claim for Relief. The Court
24 cannot determine on this record what the Intellectual Property was actually worth at the
25 time of its transfer to the Defendant, whether the Debtor was insolvent at the time of the
26 transfer, whether the Debtor was rendered insolvent by that transfer or whether the
27 Debtor can be said to have failed any of the other tests of financial condition necessary
28 to establish that a constructively fraudulent transfer occurred. Accordingly, the Court

1 must deny the Trustee's motion for summary adjudication of the Second Claim for
2 Relief.

3 **II**

4 **THE UNDISPUTED FACTS**

5 1. The Debtor owns and operates four Roscoe's Chicken 'N Waffles
6 restaurants in the Los Angeles area.

7 2. The Debtor is a California corporation wholly-owned by Herbert Hudson
8 ("Hudson").

9 3. Defendant Roscoe's Intellectual Properties LLC ("Defendant") is a
10 California limited liability company wholly-owned by Hudson.

11 4. Defendant was formed on February 4, 2016.

12 5. The Debtor filed a voluntary chapter 11 case in the United States
13 Bankruptcy Court for the Central District of California on March 25, 2016 (the "Petition
14 Date").

15 6. The Trustee was appointed chapter 11 trustee on or about September 28,
16 2016.

17 7. On March 10, 2016, the Debtor entered into a Trademark and Domain
18 Purchase Agreement with Defendant (the "Original Sale Agreement"), pursuant to which
19 the Debtor agreed to sell and Defendant agreed to buy the trademarks, "Roscoe's
20 House of Chicken 'N Waffles/Rooster & Waffle Logo," as well as "Roscoe's," and certain
21 related domain names (collectively, the "Intellectual Property"), for the price of
22 \$3,500,000, plus up to an additional \$2,500,000 (the "Contingency"), depending on the
23 valuation reflected in an appraisal to be obtained at a later date (the "Subject Transfer").

24 8. Hudson, acting on behalf of the Debtor, retained Pluris Valuation Advisors,
25 LLC ("Pluris") on or about February 21, 2016, to value the Intellectual Property, but the
26 parties did not wait to obtain a valuation of the Intellectual Property from Pluris before
27 entering into the Original Sale Agreement.

1 9. Instead, paragraph 3 of the Original Sale Agreement provides, in pertinent
2 part,

3 In the event the appraisal is not more than the purchase price plus the
4 contingency set forth above, the Purchase Price shall be the appraisal amount
5 determined by Pluris. In the event the appraisal is higher, then Buyer has the
6 option to accept the appraisal amount as the Purchase Price or to terminate this
7 agreement, without any liability to Seller.

8 10. In other words, so long as the appraisal showed that the Intellectual
9 Property was worth \$5,500,000 or less, the Purchase Price was to be the *lesser* of
10 \$5,500,000 and the appraisal amount. If it turned out that the appraisal showed the
11 Intellectual Property to be worth *more than* \$5,500,000, Defendant would not be
12 obligated to pay this higher price unless it elected to do so. If Defendant did not want to
13 pay the higher price, it could simply cancel the agreement without any liability. That is,
14 the Debtor was “locked in” even if the purchase price went down, but Defendant was
15 protected against the prospect of the purchase price’s increasing beyond the amounts
16 specified in the agreement.

17 11. In the Original Sale Agreement, Defendant agreed to pay the purchase
18 price over a period of 15 years (180 months), with interest thereon at the rate of 9
19 percent per annum.

20 12. At the same time, the Debtor entered into a Trademark License
21 Agreement (the “License Agreement”) with Defendant, pursuant to which Defendant
22 licensed the Debtor to use the Intellectual Property for a period of five years,¹ in
23 exchange for 1.5 percent of the Debtor’s quarterly net sales.

24
25
26 ¹ Paragraph 11 of the License Agreement, Exhibit 6 to Defendant’s opposition to the Trustee’s motion (the
27 “Opposition”), reflects that, at the expiration of this initial 5-year term, the agreement will automatically renew for
28 successive five year terms, provided the agreement has not already been terminated. However, under paragraphs
11.2 and 26.1, either party may terminate the contract for any reason or for no reason 60 days before the renewal
date. In other words, even if the Debtor fully performed all of its obligations under the License Agreement, the
Defendant would be free to terminate the license agreement at the end of the initial or any subsequent 5-year
period with or without cause.

1 13. Defendant did not give the Debtor a security interest or collateral of any
2 kind to secure the payment of the purchase price for its Intellectual Property.

3 14. Neither Hudson nor any other person or entity personally guaranteed
4 payment of the purchase price of the Intellectual Property.

5 15. The record does not reflect the existence of any assets of the Defendant
6 other than the Intellectual Property purchased from the Debtor.

7 16. The Subject Transfer was recorded with the U.S. Patent and Trademark
8 Office on March 23, 2016 (two days prior to the Petition Date).

9 17. On May 4, 2016, without obtaining bankruptcy court approval, the Debtor
10 and the Defendant executed an amendment to the Original Sale Agreement (the
11 "Amended Agreement") that increased the purchase price for the Intellectual Property to
12 \$5,500,000, to be paid over 180 months with interest at 9 percent per annum.

13 18. Pursuant to the Amended Agreement, Defendant was supposed to
14 commence making payments of the purchase price on July 10, 2016. The first payment
15 was to be in the amount of \$139,672. Thereafter, payments were to be made at the
16 rate of \$33,285 per month. (According to calculations provided by Hudson, this figure
17 represents a monthly payment from Defendant of \$55,785, less anticipated royalty
18 payments from the Debtor of \$22,500 per month. See paragraph 19 below.)

19 19. Paragraph 5 of the Original Sale Agreement provides that the first
20 payment of the purchase price may be offset by the amount of royalties owed by the
21 Defendant to the Debtor, and the Defendant has the option to offset future payments of
22 the purchase price against its estimate of the amounts that the Debtor will owe to the
23 Defendant for royalties, with reconciliations and balancing payments to be made
24 quarterly within thirty days after the end of each calendar quarter.

25 20. The following are the only payments that Defendant claims have been
26 made under the Original Agreement or the Amended Agreement:

- 27 a. a check from Shoreline Foods (another entity owned by Hudson) in the
28 amount of \$270,000 on October 14, 2016; and

b. checks 2254 through 2258 from Waffle Plaza (another entity owned by Hudson) totaling \$420,000 on September 22, 2016.

These payments total \$690,000, which Defendant claims is actually \$120,243 more than was actually due from Defendant as of August 10, 2017.

21. Defendant did not pay monthly payments currently or conduct quarterly reconciliations of actual royalties due. The only payments that Defendant claims to have made were the lump sum payments from affiliates identified in paragraph 20 above.

22. No payments at all were made under either the Original Sale Agreement or the Amended Agreement before September 22, 2016 – a date that is more than 6 months after the Subject Transfer and one day after the court-appointed examiner, Christopher Barclay, filed a status report [Docket No. 186].

23. In his report, the examiner alleged, among other things, irregularities in the Debtor's accounting systems, problems with Hudson's management of the Debtor, numerous undisclosed insider transfers and several unauthorized payments to professionals. In other words, notwithstanding the due dates set forth in the Amended Agreement, neither Defendant nor any of its affiliates paid even a single dollar of the purchase price for the Intellectual Property until the day after it seemed likely that a chapter 11 trustee would be appointed shortly.

24. As of the date of the Subject Transfer, the Debtor was a defendant in a the following lawsuits:

(a) Daniel Beasley v. East Coast Foods, Inc., Los Angeles County Superior Court No. BC509995 (the "Beasley Action"). On October 5, 2015, a judgment (the "Beasley Judgment") in the amount of \$3.2 million was entered against the Debtor and in favor of its former employee, Daniel Beasley. The Beasley Judgment is currently on appeal in the California Court of Appeal, Appeal No. B268753.

(b) Dixon, et al. v. Roscoe's House of Chicken and Waffles, et al., Los Angeles County Superior Court No. BC592220, filed August 21, 2015. The Dixon

1 Action is stayed with respect to the Debtor.

2 (c) Duffie v. Herb Hudson Roscoe's House of Chicken 'N Waffles, et
3 al., Los Angeles County Superior Court No. BC606073, filed January 5, 2016.

4 (d) Flores v. East Coast Foods, Inc., Los Angeles County Superior
5 Court No. BC611457, filed on February 24, 2016.

6 (e) Harrington et al v. East Coast Foods, Inc., et al., Los Angeles
7 County Superior Court No. BC508879 (the "Harrington Action"), filed May 13, 2013.
8 The Harrington Action is a class action against the Debtor in which a settlement was
9 reached in January 2016. The settlement has not been consummated.

10 (f) Pamal v. East Coast Foods, Inc., et al., Los Angeles County
11 Superior Court No. BC533263, filed January 15, 2014 (the "Pamal Action"). The Pamal
12 Action is stayed with respect to the Debtor.

13 (g) Pickett v. Hi Point Studios, Inc., et al., Los Angeles County Superior
14 Court No. BC500905, filed February 13, 2013.

15 (h) Thompson v. Herb Hudson Roscoe's House of Chicken 'N Waffles,
16 et al., Los Angeles County Superior Court No. BC606071, filed January 5, 2016.

17
18 22. On April 25, 2016, Ron Maroko of the Office of the United States Trustee
19 conducted the first meeting of creditors under Bankruptcy Code section 341(a) in this
20 chapter 11 case. Hudson appeared and testified *under oath* on behalf of the Debtor. In
21 response to questions from a creditor and the Office of the United States Trustee,
22 Hudson on behalf of the Debtor responded as follows:

23 Ron Maroko ("RM"): Okay, so why don't you tell us a little about why the
24 bankruptcy case was filed.

25 Herbert Hudson ("HH"): Because of a slew of lawsuits. Mainly, lawsuits.

26 RM: Just lawsuits?

27 HH: Yes.

28 RM: Lawsuits that you had filed? Lawsuits that were filed against you?

HH: Yes, against the corporation.

1 RM: Okay, and what about those lawsuits that made you decide that you
2 needed to file the case?

3 HH: Well, one of the lawsuits, I think it was the...I forget the law firm, but
4 they levied my bank accounts, so I had to file a lawsuit to stop them. Otherwise, we
5 would not be in business.

6 RM: Okay, at the time of the bankruptcy filing, how many lawsuits was
7 East Coast Foods involved in as a defendant?

8 HH: About four, but more coming.

9

10 Peter Davidson ("PD"): Peterson Davidson, Ervin, Cohen & Jessup,
11 representing the Harrington plaintiffs and their counsel. Um, I want to go back to the
12 transfer of the intellectual property that took place – that took place in January, is that
13 correct?

14 Herbert Hudson ("HH"): Uh, I believe so.

15 PD: What was the purpose of transferring the intellectual property in
16 Roscoe's at that time?

17 HH: Well, we had a few incidents where entities and people were trying to
18 get a hold of the intellectual property, so we figured it'd be better just to take it out of
19 East Coast's name and put it in an LLC.

20 PD: What do you mean they were trying to get a hold of it?

21 HH: For protection. Through lawsuits, through this and that.

22 PD: They were trying to stop creditors from getting possession...

23 HH: Not creditors, no, I didn't say creditors. Business deals.

24 PD: Can you explain that a little further? Somebody wanted to buy the
25 intellectual property?

26 HH: No, they were trying to get it by fraud, I guess you would say. And
27 certain deals we were making which woke me up to the fact that the intellectual property
28 was in danger by it being where it was at, so...

PD: Why was it safer...

HH: And then we also needed money, so I figured we could...

PD: Why was it safer in the new entity rather than remaining where it
was?

HH: Want to answer that for me?

VK: That was the advice of his counsel, so...

1 PD: And who was his counsel that gave that advice?

2 VK: Rostam Law.

3 25. In his declaration in opposition to the Trustee's motion for summary
4 judgment (the "Hudson Declaration") [Docket No. 40], Hudson offers the following
5 testimony concerning the reasons for the Subject Transfer:²

6 a. Prior to the time of the Debtor's bankruptcy filing, he had been
7 negotiating with companies such as Sony, Home Shopping Network,
8 and a frozen food company to expand Roscoe's brand through various
9 licensing arrangements. During the negotiations with all three
10 companies, it was suggested and agreed that the trademarks and
11 tradenames should be set aside and placed in a different entity.
12 [Hudson Declaration, at par. 12.]

13 b. He had long been giving thought to significant expansion of the
14 Roscoe's name and brand. He formed a separate entity in 2013 called
15 Hudson-Munoz LLC for the purpose of licensing the Roscoe's brand.
16 He also consulted with an intellectual property lawyer named Frank
17 Frisenda in or around the fall of 2015 and discussed with him a wide
18 range of issues on how best to create a business platform to
19 implement an expansion plan. Mr. Frisenda was the one who
20 recommended the creation of a single-asset limited liability company
21 for the purpose of licensing the Roscoe's intellectual property to
22 various third parties. That was the reason that Defendant was formed.
23 [Hudson Declaration, at par. 17.]

24 c. He learned that creating a separate entity for the purpose of owning
25 the Intellectual property was the quickest, easiest and least expensive
26

27
28 ² The Court sustained hearsay objections this testimony to the extent that Hudson was attempting to testify as to the truth of statements made to him by advisors or lawyers as to a desirable structure for the Subject Transaction. However, this testimony is admissible to the extent that it is being offered as evidence of Hudson's state of mind at the time he entered into the Subject Transaction.

1 way to protect the goodwill associated with the business, that
2 establishing an IP holding company would be the best way to do it from
3 a structuring perspective and that this type of corporate structuring is
4 relatively common in the restaurant industry. [Hudson Declaration, at
5 par. 18.]

6 d. He learned that placing assets in a separate holding company may
7 make it easier to determine the value of the IP assets separate from
8 the operations and goodwill generated by the restaurant chain.
9 [Hudson Declaration, at par. 19.]

10 e. Another primary motivation for him to enter into the Subject
11 Transaction was to create a more effective means of administration.
12 Given that there were seven locations (four operated by the Debtor
13 and three others operated by other Hudson-owned entities), there
14 needed to be a more effective level of centralized management of the
15 intellectual property associated with Roscoe's name and brand.
16 [Hudson Declaration, at par. 21.]

17 f. Hudson admits that there was also an element of asset protection in
18 his motivation to enter into the Subject Transaction, "but certainly not in
19 the manner asserted by the Trustee's MSJ. I was told that by
20 separating out the Roscoe's IP into a separate entity, it would provide
21 a level of future protection from people or companies that might be
22 inclined to exploit or infringe it without my consent." [Hudson
23 Declaration, at par. 22.]

24 26. In paragraph 29 of the Hudson Declaration, at page 8, Hudson explains,
25 "Had I fully understood the scope and breadth of the questions being asked of
26 me at the 341(a) examination, I would have answered the question posed
27 ['Why did you transfer the intellectual property assets of East Coast Foods to
28 Roscoe's Intellectual Property, LLC?'] on an expanded basis. Without

1 preparation or the opportunity to rehabilitate my response (i.e., I was never
2 given a transcript to review, correct or provide any level of supplemental
3 response), it is understandable to see how the brief answer that I gave could
4 be misconstrued to be an admission that the transfer was being made in
5 order to defeat the claims of existing creditors and to remove a valuable asset
6 from the reach of those creditors. However, this was not the case at all as
7 reflected by my desire to obtain an independent valuation, RIPL's agreement
8 to pay a 9% interest rate on the unpaid sums, and the fact that RIPL has
9 already paid \$690,000 towards the purchase price and is current on all such
10 payments."

11 27. In paragraph 14 of the Hudson Declaration, at page 4, Hudson explains,
12 "This was a single question, to which I was expected to answer immediately
13 and I did; however, I did not have the benefit of any level of preparation for
14 this hearing and admittedly, was not very articulate in my response. The
15 complete list of reasons for the transfer of assets are for more compelling and
16 while I knew exactly why this transfer was made, without any form of
17 preparation or further questioning from my own lawyer on this point, it is easy
18 to see how my response could be viewed as an effort to take the asset value
19 of the intellectual property away from the claims of creditors. This was not the
20 case at all as evidenced by, among other things, the fact that Debtor
21 contracted with an independent valuation company, Pluris Valuation Advisors
22 LLC ("Pluris"), to obtain an independent, fair market valuation of the
23 intellectual property in order to make sure that RIPL was paying fair market
24 value for those assets."

25 26 III

27 THE RECORD IS REplete WITH BADGES OF FRAUD

28 Rarely do the parties to an allegedly fraudulent transfer openly admit that it was

1 their intention to hinder, delay or defraud creditors by entering into the transaction.

2 Therefore, in the majority of cases, actual intent to hinder, delay or defraud must be
3 inferred from the circumstances surrounding the transfer.

4 Among the more common circumstantial indicia of fraudulent intent at the time of
5 the transfer are: (1) actual or threatened litigation against the debtor; (2) a purported
6 transfer of all or substantially all of the debtor's property; (3) insolvency or other
7 unmanageable indebtedness on the part of the debtor; (4) a special or close relationship
8 between the debtor and the transferee; (5) retention by the debtor of the property
9 involved in the putative transfer. See Acequia, Inc. v. Clinton (In re Acequia, Inc.), 34
10 F.3d 800, 805-06 (9th Cir. 1994) and cases cited therein. But other factors have been
11 identified as well.

12 California Civil Code § 3439.04(b) provides the following list of nonexclusive
13 factors or "badges of fraud" for a court to consider for the purpose of divining fraudulent
14 intent:

- 15 1. Whether the transfer or obligation was to an insider.
- 16 2. Whether the debtor retained possession or control of the property after the
17 transfer.
- 18 3. Whether the transfer or obligation was disclosed or concealed.
- 19 4. Whether the debtor was sued or threatened with suit before the transfer was
20 made or obligation incurred.
- 21 5. Whether the transfer was of substantially all of the debtor's assets.
- 22 6. Whether the debtor absconded.
- 23 7. Whether the debtor removed or concealed assets.
- 24 8. Whether the value of the consideration received by the debtor was reasonably
25 equivalent to the value of the asset transferred or obligation incurred.
- 26 9. Whether the debtor was insolvent or became insolvent shortly after the
27 transfer was made or obligation incurred.
- 28 10. Whether the transfer occurred shortly before or shortly after a substantial

1 debt was incurred; and

2 11. Whether the debtor transferred essential assets of the business to a
3 lienholder who then transferred the assets to an insider of the debtor.

4 Cal. Civ. Code § 3439.04(b).

5 These factors are intended "to provide guidance to the trial court, not compel a
6 finding one way or another." Filip v. Bucurenciu, 129 Cal.App.4th 825, 834, 28 Cal. Rptr.
7 3d 884 (2005). There is no mathematical formula for applying these factors. No
8 minimum number of factors is required to establish actual intent, and a court may find
9 actual intent based on the evidence in the case even if no badges of fraud are present.
10 Conversely, specific evidence may negate an inference of fraud notwithstanding the
11 presence of a number of badges of fraud. Wolkowitz v. Beverly (In re Beverly), 374
12 B.R. 221, 236 (Bankr. 9th Cir. 2007). "The presence of a single badge of fraud may spur
13 mere suspicion; the confluence of several can constitute conclusive evidence of an
14 actual intent to defraud, absent 'significantly clear' evidence of a legitimate supervening
15 purpose." Id. (quoting Max Sugarman Funeral Home, Inc. v. A.D.B. Inv'rs, 926 F.2d
16 1248, 1254-55 (1st Cir. 1991)).

17 A careful review of the undisputed facts of this case reveals the following badges
18 of fraud:

- 19 • The transfer was to an insider – an entity wholly-owned by the same person who
20 owns 100 percent of the Debtor;
- 21 • Hudson, the Debtor's principal, negotiated the Subject Transfer on behalf of both
22 the transferor and the transferee; the Subject Transfer cannot in any sense of the
23 word be characterized as an "arms-length" transaction;
- 24 • The Debtor retained possession and control of the Intellectual Property after the
25 Subject Transfer in the sense that it was permitted to continue to use the
26 Intellectual Property as if nothing had changed; however, after the Subject
27 Transfer, the Debtor was required to pay the Defendant 1.5 percent of its gross
28 revenues for this privilege and the Debtor's right to use the Intellectual Property

1 could be terminated without cause at the expiration of any 5-year term;

- 2 • The Debtor filed chapter 11 fifteen days after entering into the Original Sale
3 Agreement at a time when it was beset by “a slew of lawsuits”;
- 4 • There is no evidence that the Subject Transfer was concealed. Defendant
5 recorded the Subject Transfer with the U.S. Patent and Trademark Office on
6 March 23, 2016 (two days before the Petition Date). But for this recordation, the
7 Subject Transfer might have been avoided as not properly perfected;
- 8 • The Intellectual Property is absolutely critical to the operation of the Debtor’s
9 business; without the use of this property, the Debtor has no business. The
10 Intellectual Property constitutes the essential assets of the Debtor’s business;
- 11 • The parties retained an independent valuation firm, but did not wait to obtain a
12 valuation from Prius before entering into the Subject Transfer. Instead, they
13 structured the transaction in such a way as to ensure that, although the purchase
14 price could go down based on the results of the valuation to any amount (i.e.,
15 there was no “floor”), it could not exceed the cap placed on it in the agreement
16 without the Defendant’s consent;
- 17 • Although it was on appeal, a judgment in the Beasley Action for \$3.2 million had
18 been entered against the Debtor within a few months prior to the Subject
19 Transfer;
- 20 • Hudson testified at the first meeting of creditors that the purpose of the Subject
21 Transfer was “for protection” to get the Intellectual Property out of the Debtor’s
22 name to keep parties that were trying to get possession of it “through lawsuits”
23 from doing so. Hudson denies that these people were creditors and asserts that
24 they were trying to get the Intellectual Property “by fraud.” (The Court takes
25 judicial notice of the claims alleged in these lawsuits. None of them has anything
26 to do with the Intellectual Property. They are all lawsuits by employees or former
27 employees asserting employment-related claims.)

- 1 • The Subject Transfer was made on the eve of bankruptcy to a newly-formed
2 entity that had no assets other than the assets it acquired in the Subject Transfer;
- 3 • Under the Original Sale Agreement and the Amended Agreement, the Debtor
4 would not receive a large cash payment in exchange for the transfer of its
5 essential assets. Instead, the Debtor was to receive a small down payment (that
6 was not paid in a timely manner) and monthly payments thereafter over a period
7 of 15 years;
- 8 • The Defendant was permitted to setoff against the amount of its monthly
9 payments a stream of royalty payments to be paid to it by the Debtor in exchange
10 for the use of the Intellectual Property;
- 11 • The Defendant did not provide the Debtor with any collateral for its payment
12 obligations, and no one guarantied these obligations. The Defendant did not
13 have the financial wherewithal to make the required payments under the
14 agreements at the time it entered into the Subject Transfer;
- 15 • The initial down payment required under the Amended Agreement was not paid
16 in a timely manner. None of the monthly payments were made in a timely
17 manner. The only payments that Defendant claims to have made were
18 payments from other entities owned by Hudson – payments totaling \$420,000
19 from Waffle Plaza on September 22, 2016 (one day after the examiner filed his
20 status report) and a payment of \$270,000 from Shoreline Foods on October 14,
21 2016;
- 22 • None of the testimony offered by Hudson discusses why the Subject Transfer
23 was structured in such a way as to leave the Debtor without the ability to ensure
24 that it would be able use the Intellectual Property that it needed to run its
25 business after a period of 5 years; and
26
27
28

- None of the testimony offered by Hudson explains why the Subject Transfer was structured in such a way as to make someone other than the Debtor the owner of the newly-established special purpose entity into which the Intellectual Property was transferred.

In short, the undisputed facts of this case reveal that Hudson caused the Debtor and the Defendant to enter into a transaction that provided tremendous value and benefits to Defendant and no assurance whatsoever for the Debtor that it would be able to collect the purchase price for the Intellectual Property or to retain the ability to continue to operate its business at the end of 5 years. No business would ever enter into such a transaction unless it was controlled by the person that was receiving the benefits of this transaction. And when did this transaction occur? On the eve of the Debtor's bankruptcy filing at a time when the Debtor was the subject of a "slew of lawsuits."

The end result of the transaction was to make it impossible for a representative of the Debtor's creditors to be able to sell the Debtor's business to anyone other than Hudson or another entity that he controlled for anything remotely resembling the value that the Debtor's business had immediately prior to the Subject Transaction. Who in their right mind would purchase the Debtor's assets without knowing what they would have to pay to Defendant at the end of the initial 5-year period for the privilege of continuing to use the Intellectual Property? Any prospective purchaser would have no alternative but to enter into negotiations with Hudson for an extended licensing agreement for, or a separate purchase of, the Intellectual Property. And this is, of course, the precise predicament in which the Trustee currently finds himself as he attempts to formulate an exit strategy for this chapter 11 case.

All of the facts and circumstances surrounding the Subject Transfer scream actual intent to hinder, delay or defraud. And, before Hudson had had an opportunity to be coached by counsel, he himself admitted that putting the value of the Intellectual

1 Property beyond the reach of people who were trying to get at it through lawsuits was
2 the purpose of the transaction. It would be hard to imagine a clearer example of an
3 actual fraud fraudulent transfer.

4
5 **IV**

6 **THE ONLY EVIDENCE OFFERED IN OPPOSITION TO THE MOTION**
7 **IS INSUFFICIENT TO CREATE A GENUINE ISSUE OF MATERIAL FACT**
8 **AS TO THE INTENT WITH WHICH THE SUBJECT TRANSFER WAS MADE**

9 In an effort to raise a triable issue of material fact, Defendant offers the Hudson
10 Declaration. In that declaration, Hudson testifies that (1) Hudson did not have the
11 opportunity to confer with counsel or properly prepare before admitting in response to a
12 direct question that the purpose of the Subject Transfer was to keep the Intellectual
13 Property away from parties who were suing the Debtor and (2) it could not have been
14 his intent to deprive the Debtor of the value of the Intellectual Property because he hired
15 an independent valuation firm to perform a valuation of the Intellectual Property and
16 agreed to pay 9 percent interest on the purchase price.

17 However, Prius, the independent valuation firm retained by the Debtor, never
18 actually provided the parties with a valuation report. The parties were in too much of a
19 hurry to complete the Subject Transfer before the bankruptcy filing to wait for the results
20 of the valuation. (In the interim, the parties structured the Original Sale Agreement to
21 impose the risk of a lower valuation on the Debtor and to give the Defendant an out if
22 the valuation came in higher than expected.) And Defendant never actually paid a dime
23 toward the purchase price until months after the initial payment was due and it
24 appeared imminent that a chapter 11 trustee would be appointed. And it is worthy of
25 note that the manner in which the Defendant agreed to pay the purchase price – *in*
26 *monthly installments over a period of 15 years without any collateral or even a third*
27 *party guaranty* – would make the promissory note that the Debtor received worth

1 substantially less than the face amount of the purchase price even if the face amount of
2 the purchase price itself was fair. Moreover – and this is critical – a transfer can be
3 made with actual intent to hinder, delay or defraud creditors – and can negatively impact
4 the ability of creditors to collect on their debts -- even if the transferee agrees to pay
5 reasonably equivalent value in exchange for the transfer.

6 Hudson's testimony about the benefits of putting the Intellectual Property into a
7 separate LLC and the fact that he has been thinking about doing this for years does not
8 raise a genuine issue of material fact as to the intent with which he entered into this
9 particular transaction on behalf of both the Debtor and the Defendant. The question is
10 not whether it would have been an actual fraud fraudulent transfer for Hudson to set up
11 a special purpose entity and sell the Intellectual Property to that entity for reasonably
12 equivalent value, the question is whether the Subject Transfer itself – and the particular
13 manner in which it was structured -- was an actual fraud fraudulent transfer. It would
14 certainly have been possible for Hudson to structure a transaction of the Intellectual
15 Property that would not have been a fraudulent transfer, but that transaction would have
16 borne little resemblance to the transaction that actually occurred.

17 Hudson could have achieved all of the objectives outlined in the Hudson
18 Declaration without diverting all the value of the Intellectual Property to himself. Hudson
19 could have transferred the Intellectual Property to a special purpose entity owned by the
20 Debtor. He could have actually obtained an independent valuation of the Intellectual
21 Property and actually paid the purchase price in cash. He could have provided for a
22 significantly shorter payout period and given the Debtor collateral or at least a personal
23 guaranty for the amount of the purchase price. *And, most importantly, he could have*
24 *ensured that the Debtor would have the right to use the intellectual property that it*
25 *needed to run its business in perpetuity and not merely for a period of 5 years.* He did
26 none of these things. Instead, he structured the Subject Transfer in a way that would
27 never in the farthest reaches of anyone's imagination have been approved by anyone
28 who was acting in the interests of the Debtor and/or its creditors.

1 Under the circumstances, the testimony offered by Hudson as to the reason for
2 transferring the Intellectual Property to a special purpose entity is not even relevant to,
3 let alone probative of, the real issue here. The issue is why did Hudson cause the
4 Debtor to enter into *the Subject Transfer*, not why might there have been good reasons
5 for the Debtor to have entered into some other transaction that placed its Intellectual
6 Property into a special purpose entity. He offers no explanation for the manner in which
7 the Subject Transfer was structured, except for the explanation that he provided under
8 oath when he was first asked the question – there were people who were trying to get a
9 hold of the Intellectual Property through “lawsuits,” so he figured that it would be better
10 to take it out of the Debtor’s name and put it into a separate LLC “for protection.”

11 And what were these lawsuits about? The court has taken judicial notice of the
12 claims alleged in these actions. These lawsuits have nothing to do with the Intellectual
13 Property itself. They do not represent attempts to obtain an interest in the Intellectual
14 Property by fraud or otherwise. They are claims by employees or former employees
15 based on alleged harassment, discrimination, retaliation and/or other employment-
16 related misconduct. The plaintiffs in these lawsuits seek monetary damages. In other
17 words, if and when these plaintiffs obtained judgment in their favor in these actions, they
18 would be creditors of the Debtor. Hudson may dispute that the plaintiffs had meritorious
19 claims, but there is no genuine dispute that, by transferring away assets of the Debtor to
20 protect them from these plaintiffs, Hudson intended to hinder, delay or defraud parties
21 who might turn out to be the Debtor’s creditors.

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23 **V**

24 **THE COURT CANNOT GRANT SUMMARY JUDGMENT**

25 **ON THE CLAIM THAT THE SUBJECT TRANSFER**

26 **WAS A CONSTRUCTIVE FRAUD FRAUDULENT TRANSFER**

27 In order to establish that the Subject Transfer was a constructive fraud fraudulent
28 transfer, whether he proceeds under nonbankruptcy law or under section 548 of the

1 Bankruptcy Code, the Trustee must establish that the Debtor received less than
2 reasonably equivalent value in exchange for the Intellectual Property and that the
3 Debtor's financial condition failed one of the standards set forth in the relevant statutes.
4 Although serious questions exist as to the Debtor's financial condition both before and
5 after the Subject Transfer and the extent to which the Debtor received reasonably
6 equivalent value in exchange for the Intellectual Property, neither issue is suitable for
7 summary adjudication.

8 The record does not contain any admissible evidence as to the value of the
9 Intellectual Property. The documents prepared by Prius are difficult to read or
10 understand and were authenticated only by the Hudson Declaration. The Court
11 sustained the Trustee's objections to the admission of these documents on hearsay
12 grounds. And, without admissible evidence as to the value of the Intellectual Property,
13 the Court cannot assess whether the consideration received in exchange was
14 reasonably equivalent.

15 Further, although it might be possible to determine from the undisputed facts the
16 approximate amount of the Debtor's known liabilities as of the date of the Subject
17 Transfer, without knowing the value of the Intellectual Property, the Court cannot assess
18 whether the Debtor these liabilities rendered the Debtor insolvent at the time of the
19 transfer. Therefore, the Trustee's request for summary judgment on his constructive
20 fraud fraudulent transfer claims must be denied.

21 22 VI

23 THE DEFENDANT'S REQUEST THAT AVOIDANCE OF 24 THE TRANSFER BE CONDITIONED ON THE TRUSTEE'S 25 REPAYMENT OF \$690,000 MUST BE DENIED

26 As the Court has determined that the Subject Transfer constitutes an actual fraud
27 fraudulent transfer under Bankruptcy Code §§ 544(b) and 548(a)(1)(A), Bankruptcy
28 Code § 550(a) permits the Trustee to recover for the benefit of the estate the property

1 transferred or, “if the court so orders, the value of such property” Defendant
2 requested that it be ordered to pay the balance of the purchase price in lieu of having to
3 return the Intellectual Property. The court denies that request. The Trustee prefers to
4 recover the Intellectual Property itself, and there are no facts or circumstances that
5 would make requiring the Defendant to return the Intellectual Property inequitable,
6 inappropriate or impractical. Accordingly, pursuant to section 550(a), concurrently
7 herewith, the Court will grant the Trustee’s motion for summary judgment on his seventh
8 claim for relief and direct the Defendant to turnover the Intellectual Property to the
9 Trustee.

10 Defendant also requested a refund of the \$690,000 paid by Shoreline Foods and
11 Waffle Plaza in September and October of 2016 (the “Affiliate Payments”), yet provides
12 no authority to support this request. When a court avoids a transfer as fraudulent, the
13 transferee is not necessarily entitled to a refund of any of the consideration that it paid.
14 Certain limited protections are available to good faith transferees, see 11 U.S.C. §
15 548(c) (“a transferee that takes for value and in good faith has a lien on or may retain
16 any interest transferred or may enforce any obligation incurred, as the case may be, to
17 the extent that such transferee or obligee gave value to the debtor in exchange for such
18 transfer or obligation”) and 11 U.S.C. § 550(e) (a good faith transferee may assert a lien
19 on property recovered to secure the lesser of the cost of improvements it made or the
20 increase in value attributable to these improvements), but even these limited protections
21 are unavailable to a party who received a transfer with the actual intent to hinder, delay
22 or defraud creditors. Such a party would not qualify as a good faith transferee.

23 Pursuant to Federal Rule of Bankruptcy Procedure 3002(c)(3), which applies in
24 chapter 7, 12 and 13 cases, an unsecured claim that arises or becomes allowable as a
25 result of a judgment avoiding a claimant’s interest in property may be filed within 30
26 days after the judgment becomes final. Federal Rule of Bankruptcy Procedure 3003(c)
27 provides that, in chapter 11 cases, the court shall fix the time within which proofs of
28 claim may be filed, and that, “Notwithstanding the expiration of that time, a proof of

1 claim may be filed to the extent and under the conditions stated in Rule 3002(c)(2),
2 (c)(3), (c)(4) and (c)(6).”

3 Therefore, the appropriate procedure for the assertion of a claim arising from the
4 avoidance of a claimant’s interest in property in a chapter 11 case is for that claimant to
5 file a proof of claim, or, in an appropriate case, a request for payment of an expense of
6 administration by such deadline as may be established by the Court for this purpose.
7 This Court will decide in the resulting contested matter whether and to what extent the
8 Defendant is entitled to recover any portion of the Affiliate Payments.³ Concurrently
9 herewith, the Court will enter an order setting a deadline for the Defendant to file any
10 such claims and requests.

11 12 13 VI

14 CONCLUSION

15 As a general rule, a court cannot grant summary judgment when the key issue is
16 the intent with which a party engaged in a particular act, but this case is the exception
17 that proves the rule. The facts and circumstances surrounding the Subject Transfer,
18 combined with Hudson’s sworn admission as to the purpose of the transaction and the
19 complete absence of any evidence or testimony providing an alternate explanation for
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³ The pendency of this separate contested matter does not prevent the judgment that the Court will be entering concurrently herewith from being a final judgment, fully resolving this adversary proceeding.

1 the structure of the transaction compel the conclusion that the Trustee is entitled to
2 summary judgment on his First Claim for Relief. Accordingly, the Court will enter an
3 order and judgment to this effect concurrently herewith.

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25 Date: August 25, 2017

A handwritten signature in black ink, appearing to read 'Sheri Bluebond', written over a horizontal line.

26 Sheri Bluebond
27 United States Bankruptcy Judge
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