

**UNITED STATES BANKRUPTCY COURT  
FOR THE DISTRICT OF COLORADO**

IN RE:	)	
	)	
United Cannabis Corporation	)	Case No. 20-12692-JGR
Tax ID / EIN: 46-5221947,	)	Chapter 11
	)	
Debtor.	)	

**UNITED STATES TRUSTEE’S OBJECTION TO DEBTOR’S MOTION  
TO REJECT PATENT LICENSE AGREEMENTS WITH  
LASCO MANUFACTURING LIMITED AND FLRISH IP, LLC**

Patrick S. Layng, the United States Trustee for Region 19 (the “UST”), by and through counsel, objects to Debtor United Cannabis Corporation’s Motion to Reject Patent License Agreements with Lasco Manufacturing Limited and FLRish IP, LLC (Docket No. 68, the “Motion”), and in support of the objection, states as follows:

Background

1. UC Colorado Corporation (“UC Colorado”) and United Cannabis Corporation (“UCANN” and together with UC Colorado, the “Debtors”) filed their respective voluntary petitions for relief under chapter 11 of title 11, United States Code, on April 20, 2020 (the “Petition Date”). Pursuant to Sections 1107 and 1108, Debtors continue to manage their affairs as debtors-in-possession.

2. An official committee of unsecured creditors has not yet been appointed in this case.

3. On April 22, 2020, the Court entered its Order to Show Cause, which observed that the Debtors appear to be engaged in the marijuana industry, observed that activities associated with marijuana are illegal under federal law and cannot be condoned by the bankruptcy courts, and directed the Debtors and the UST to show cause why these cases should not be dismissed.

4. On May 11, 2020, the Debtors and the UST filed their responses to the Order to Show Cause. For their part, the Debtors’ Response (Docket No. 53) essentially denies any involvement with illegal marijuana.

5. By contrast, the UST’s Response (Docket No. 55) identified the Debtors’ plain representations concerning marijuana-related assets or activities made in publicly available filings with the U.S. Securities and Exchange Commission (the “SEC”) and on the Debtors’ website. For example, the UST observed that the Debtors’ homepage at that time promoted products containing tetrahydrocannabinol (“THC”), which is an illegal Schedule I substance under the Controlled Substances Act (“CSA”). As another example, and as a matter important to the Motion and this

Objection, the UST observed that the Debtors have been issued US Patent #9730911 (the “911 Patent”) which pertains, in part, to THC.

6. On May 15, 2020, UCANN filed the Motion, by which it seeks this Court’s approval of the rejection under 11 U.S.C. § 365(a) of two license agreements by which it licensed the right to use the 911 Patent.

The 911 Patent:

7. The 911 Patent appears to be one of UCANN’s more significant assets. In its Schedules, UCANN lists over \$28,000,000 in liabilities compared with only about \$107,000 of assets, including an encumbered vehicle and an investment in WeedMD, Inc., plus certain assets<sup>1</sup> with an “unknown” value. *See* Docket No. 39 at p. 23-39.

8. UCANN also disclosed its ownership of the 911 Patent, but assigned a \$0.00 value to it. *See id.* at 29.<sup>2</sup> This is perplexing (and doubtful) as UCANN treats the 911 Patent as highly valuable. UCANN has been an active plaintiff seeking to protect its interest in litigation asserting infringement of the 911 Patent beginning in 2018 and up to the Petition Date.<sup>3</sup> Patent litigation is not inexpensive. UCANN scheduled a claim of \$779,910 in favor of Cooley LLP, which is the law firm that has been prosecuting UCANN’s patent infringement action. *See id.* at 35. Therefore, UCANN’s assertion now that the 911 Patent is worthless is inconsistent with UCANN’s recent and informed decision to incur \$779,910 of unpaid legal fees relating to the patent, plus any other legal fees that may have actually been paid with cash or stock.

9. One can only surmise that UCANN valued the 911 Patent at \$0.00 because it pertains, in part, to THC and because UCANN is a chapter 11 debtor seeking the benefits of federal bankruptcy law. In their Response to the Court’s Order to Show Cause (Docket No. 53), the Debtors acknowledge the 911 Patent, but carefully omit the material fact that the 911 Patent involves THC, stating: “The 911 Patent claims various liquid cannabinoid formulations that contain the non-psychoactive cannabinoid, CBD, *among other cannabinoids.*” Debtor’s Response at ¶ 17 (emphasis added). One of the unidentified “other cannabinoids” is THC.

10. The Debtors were not nearly as reluctant to acknowledge the 911 Patent’s connection to THC in their SEC Form 10-Q report for the third quarter of 2019 (the “Form 10-Q”), which is the most recently filed quarterly report.<sup>4</sup> In that recent public filing:

- a. the Debtors disclose that they “own distinct intellectual property relating to the *legalized* growth, production, manufacture, marketing, management, utilization

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<sup>1</sup> Assets assigned an “unknown” value include interests in certain subsidiaries, including Debtor UC Colorado, and in joint ventures, causes of action, and UCANN’s websites. *See* Docket No. 39 at pp. 25-30.

<sup>2</sup> UCANN also disclosed that it owns US Patent #10,555,928. *See id.* According to the Debtors’ testimony at the Meeting of Creditors held on May 28, 2020, this second patent is related to the 911 Patent.

<sup>3</sup> The patent infringement action is styled *United Cannabis Corporation v. Pure Hemp Collective, Inc.*, 1:18-cv-01922-WJM-NYM, pending in the United States District Court for the District of Colorado. *See id.* at p. 2.

<sup>4</sup> Per the SEC’s EDGAR System, the Form 10-Q was filed November 14, 2019. The UST attached a copy of the Form 10-Q to his Response to the Court Order to Show Cause at Docket No. 55.

and distribution of *medical and recreational marijuana and marijuana infused products;*”

- b. the Debtors disclose that they “license [their] intellectual property to businesses in the cannabis industry;” and
- c. the Debtors disclose that the 911 Patent was issued on August 15, 2017, and that it pertains to “proprietary formulations based on compounds extracted from cannabis plant materials” including cannabinoids, with one of the cannabinoids being “tetrahydrocannabinol (THC).”

Form 10-Q at p. 27 (emphasis added).

11. A copy of the 911 Patent is attached hereto as Exhibit “A.”<sup>5</sup> As set forth in a summary, the 911 Patent includes formulations of cannabinoids, including THC:

#### SUMMARY OF THE INVENTION

The invention provides an extract comprising a mixture of at least 95% total cannabinoids, and at least one terpene/flavonoid. The extract contains at least 4, 5, 6, 7 or more cannabinoids. The cannabinoids are selected from tetrahydrocannabinolic acid (THCa), cannabidiolic acid (CBDa), cannabinolic acid (CBNa) cannabichromenic acid (CBCa), tetrahydrocannabinol (THC), cannabinol (CBN), cannabidiol (CBD) or cannabichromene (CBC). In some aspect the cannabinoids are THCa and CBDa and at least two cannabinoids selected from CBNa, CBCa, THC, CBN and CBC. In a preferred embodiment the cannabinoids are THC, CBN, CBC and CBD. In another preferred embodiment the cannabinoids are THCa, CBDa, CBNa and CBCa. In yet another preferred embodiment the cannabinoids are THCa, CBDa, THC, CBN, and CBC.

See Exhibit “A” at page (column) 1.

12. The 911 Patent then describes various formulations and processes, many of which involve THC. As just a few examples:

- UCANN explains that THC is the “principal psychoactive constituent” and that “[n]on drug plants produce relatively low levels of THC and high levels of CBD, while drug plants produce high levels of THC and low levels of CBD.” *See id.* at p. 4.
- “In some aspects the *cannabis* plant material is derived from a *cannabis* strain having a minimum of 15% THC and less than 1% CBD.” *See id.* at pp. 2, 9 (italics in original).

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<sup>5</sup> UCANN attached the 911 Patent to its First Amended Complaint in the aforementioned patent infringement litigation.

- “In other aspects the *cannabis* plant material is derived from *cannabis* strains having a minimum of 10% CBD and less than 10% THC.” *See id.* at p. 9 (italics in original).
- In one formulation, THC is less than or equal to 9% and CBD is greater than or equal to 40%. *See id.* at p. 8.
- UCANN claims numerous formulations involving THC, including for example, “[a] liquid cannabinoid formulation, wherein at least 95% of the total cannabinoids is tetrahydrocannabinol (THC).” *See id.* at p. 18 (Claim No. 5); *see also* Claims No. 6, 7, and 9, in which at least 95% of the cannabinoids are THC.

13. In the Form 10-Q, the Debtors assert that, on a consolidated basis, they derive revenue from hemp processing *and* from licensing their intellectual property: “All of the Company’s revenues are derived from the sale of *legal* CBD products that were extracted from industrial hemp plants *or from licensing fees for the use of our patented product formulations.*” Form 10-Q at p. 7 (emphasis added).<sup>6</sup>

14. The Debtors also advise that future enforcement of the Controlled Substances Act “may cause significant financial damage to us.” *See id.*

15. The Debtors further advise that “[t]he factors that will most significantly affect future operating results will be:

- State by state regulatory changes with respect to marijuana in the United States; and
- Rescheduling of marijuana by the federal government.”

*See id.* at p. 32.

#### The License Agreements:

16. Through the Motion, UCANN requests that the Court apply federal law under 11 U.S.C. § 365(a) to allow UCANN to reject (i) a Supply, Distribution, and Licensing Agreement between UCANN and Lasco Manufacturing Limited and (ii) a Licensing Agreement between Debtor and FLRish IP, LLC (together, the “License Agreements”). UCANN Attached both License Agreements as exhibits to its Motion.

17. In both License Agreements, UCANN granted the counterparty a license to use the 911 Patent.

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<sup>6</sup> The 911 Patent and the apparently related Patent #10,555,928 are the only patents disclosed by the Debtors in their Schedules. *See* Docket No. 39 at p. 29; *see also* Docket No. 37 in Case No. 20-12689-JGR at p. 49.

### Objection

18. As discussed in detail in the UST's Response to Order to Show Cause (Docket No. 55), under the CSA, it is unlawful for any person knowingly or intentionally "to manufacture, distribute, or dispense, or possess with intent to manufacture, distribute, or dispense, a controlled substance." *See* 21 U.S.C. § 841(a)(1). The term "controlled substance" means "a drug or other substance, or immediate precursor, included in schedule I, II, III, IV, or V of part B of [the CSA]." 21 U.S.C. § 802(6).

19. Congress has designated both marijuana and THC as Schedule I substances. *See* 21 U.S.C. § 812, Schedule I (c)(10) & (17).

20. It is a violation of the CSA to conspire with another to violate any part of the CSA. *See* 21 U.S.C. 846. Anyone who "aids, abets, counsels, commands, induces or procures" a violation of federal law, including the CSA, "is punishable as a principal." *See* 18 U.S.C. § 2(a).

21. The Motion pertains to the rejection of License Agreements relating to the use of the 911 Patent, and the 911 Patent relates in part to illegal THC. The UST objects to the Motion for the following reasons:

22. First, the License Agreements submitted with the Motion are unclear as to whether the licensees are authorized to use the 911 Patent to manufacture, sell, or distribute products containing THC. However, it is clear that the licensees are authorized to use the 911 Patent, and the 911 Patent pertains in part to THC.

23. UCANN should explain whether either of the License Agreements contemplate or allow the use of the 911 Patent to manufacture, sell, or distribute products containing THC. If so, the Court should not provide a federal benefit to one party to a contract the purpose of which was the violation of federal criminal law. *See, e.g., In re Rent-Rite Super Kegs West, Ltd.*, 484 B.R. 799 (Bankr. D. Colo. 2012) (as an aspect of its business, chapter 11 debtor was a lessor to a marijuana grower, which was cause for dismissal under § 1112(b)); *In re Medpoint Management LLC*, 528 B.R. 178 (Bankr. D. Ariz. 2015), *vacated in part on other grounds*, 2016 WL 3251581 (B.A.P. 9th Cir. June 3, 2016) (bankruptcy court would not grant federal bankruptcy relief to petitioning creditors who financed a medical marijuana business in violation of the CSA).

24. By seeking court approval of rejection, UCANN is asking this Court to entangle itself in readjusting the debts of those who seem to have conspired to violate the CSA. This is not the type of issue that belongs in federal bankruptcy court. As Judge Tallman emphasized in the *Rent-Rite* decision, the "Court's power to adjust the debtor-creditor relationship . . . goes to the essence of the Court's equitable jurisdiction and requires the Court to look to equitable factors to determine the propriety of the Debtor's filing." *Rent-Rite*, 484 B.R. at 806. Again, proceedings in equity to adjust obligations incurred to further criminal conduct cannot be a valid purpose of a bankruptcy.

25. Second, according to case law cited by UCANN, its request for authority to reject the License Agreements requires a showing that rejection will benefit the estate. *See* Motion at ¶ 7. However, UCANN does not adequately explain whether rejection of the License Agreements would actually result in a benefit to the estate. To the extent that the License Agreements are

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