

**UNITED STATES BANKRUPTCY COURT
FOR THE WESTERN DISTRICT OF VIRGINIA
Roanoke Division**

IN RE:

GENERAL CREATIONS, LLC,

Case No. 03-03058-7

Debtor

**MARRA DESIGN ASSOCIATES, INC.
LUND AND COMPANY INVENTIONS, LLC,**

Plaintiffs

v.

**Adversary Proceeding
No. 06-07095**

**WILLIAM E. CALLAHAN, JR., TRUSTEE for
GENERAL CREATIONS, LLC,**

Defendant

DECISION AND ORDER

At Roanoke in said District this 2nd day of May, 2008:

On January 3, 2008, this court entered a decision and order in the above captioned adversary proceeding granting the Plaintiffs, Marra Design Associates, Inc. (herein Marra) and Lund and Company Inventions, LLC (herein Lund), constructive trusts in portions of settlement proceeds held by William E. Callahan, Jr., Trustee (herein Trustee) from Toys R. Us, Inc. (herein Toys). As a part of the decision and order, the court ordered an evidentiary hearing to determine the value of the imposed constructive trusts. The chapter 7 Trustee subsequently filed a motion to amend findings pursuant to Federal Rule of Civil Procedure 52 and to alter or amend judgment pursuant to Federal Rule of Civil Procedure 59(e) with a prayer that the court overturn

its previous ruling and find in favor of the Trustee. The court has considered the memoranda of authority and argument submitted by the Trustee and Marra, and for the reasons stated herein, the Trustee's motion is DENIED.

Discussion:

The Trustee argues in his memorandum in support of motion to alter or amend findings and/or judgment that by setting an evidentiary hearing for the purpose of determining the amount of each constructive trust in the settlement proceeds, the court confirms the Plaintiffs' failure to satisfy the burden of identifying and tracing the trust res. Virginia law requires that the party claiming a constructive trust identify the res and then trace the res if it has been commingled with other funds or property. See Haley, Chisholm & Morris, Inc. v. Parrish, 127 B.R. 366, 372 (W.D. Va. 1991) ("the claimant must identify the trust fund or property and, where the trust fund has been commingled with general property of the bankrupt, sufficiently trace the property or funds."). By setting an evidentiary hearing to determine the value of the constructive trusts, the Trustee argues the court is permitting the Plaintiffs to remedy their "failure to bear the burden of sufficiently identifying the res."

In its decision and order of January 3, 2008, the court made clear that the res had been identified as the "royalties Marra and Lund would have been entitled to under their respective licensing agreements together with the profit margin that the Debtor would have realized on the gross price per unit after adjustment for the defective product credit allowed Toys." The fact that an evidentiary hearing must be held to place a dollar value on the res does not mean that the res has not be identified or traced.

The value of the royalties that the Plaintiffs would have been entitled to can be determined from their respective license agreements with the Debtor.¹ (See Joint Stipulation Ex. 11, 16.) The Trustee, though, has the burden under Virginia law of accounting for the Debtor's profits at the evidentiary hearing. In the Supreme Court of Virginia case of Horne v. Holley, 167 Va. 234, 188 S.E. 169 (1936), the court confirmed the lower court's finding that the defendant had violated his fiduciary relationship with the plaintiff and confirmed the imposition of a constructive trust with respect to the property purchased adverse to the interest of the plaintiff and profits derived therefrom. Id. at 167, 188 S.E. at 174. The Supreme Court of Virginia then affirmed the lower court's holding that the defendant was under "the duty and obligation to account for the profits derived therefrom." Id. In coming to its decision, the court explained that

It is well settled that where one person sustains a fiduciary relation to another he can not acquire an interest in the subject matter of the relationship adverse to such other party. If he does so equity will regard him as a constructive trustee and compel him to convey to his associate a proper interest in the property or to account to him for the profits derived therefrom.

Id. at 240, 188 S.E. at 172.

Although Marra's and Lund's constructive trusts do not arise from the same circumstances from which the constructive trust in Horne arose, in both cases a constructive trust was imposed. In Horne, the constructive trustee was then required to account for the profits. See id. at 167, 188 S.E. at 174. Because the chapter 7 Trustee in this case has been found to be

¹ Marra identified the value of the royalties that would have been owed to them under its breached license agreement with the Debtor in its response to the Trustee's motion to reconsider.

the constructive trustee of royalties and profits owed to the Plaintiffs, it follows from the Supreme Court of Virginia's decision in Horne that the chapter 7 Trustee now has the burden of accounting to the Plaintiffs for profits derived from the unauthorized use of their protected toy designs.

As was determined in the court's January 3, 2008 decision and order, the constructive trust in favor of Marra and Lund arose "prepetition when the Debtor delivered the Items to Toys." See Capital Investors Co. v. Morrison, 800 F.2d 424, 427 n.5 (4th Cir. 1986). Therefore, the value of the constructive trust is to be determined according to the unsettled value of the res.

Conclusion:

In the January 3, 2008 decision and order, the court made clear that the res of the imposed constructive trust had been identified as the royalties owed under the Plaintiffs' respective license agreements plus any profits made by the Debtor from the sale of toys manufactured with the Plaintiffs' designs. The Plaintiffs were able to clearly trace these funds to an account receivable owed to the Debtor by Toys. Therefore, the Plaintiffs have satisfied their burden of identifying and tracing the res of the constructive trust. The chapter 7 Trustee now has the burden of accounting for profits made by the Debtor from the unlicensed manufacturing of toys from the Plaintiffs' designs. Accordingly, it is:

ORDERED:

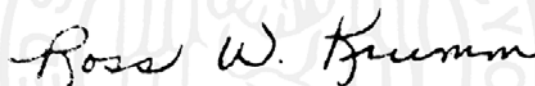
That the Trustee's motion to amend findings pursuant to Federal Rule of Civil Procedure 52 and to alter or amend judgment pursuant to Federal Rule of Civil Procedure 59(e) is

DENIED. It is:

FURTHER ORDERED:

That the chapter 7 Trustee has the duty and obligation to account for the Debtor's profits derived from the sale of the Plaintiffs' respective toys.

Copies of this order are directed to be sent to Trustee, William E. Callahan, Jr., Esquire; to Joseph B. Lyle, Esquire, counsel for Marra Design Associates, Inc.; and to David J. Hutton, Esquire, counsel for Lund and Company Inventions, LLC.



Ross W. Krumm

Ross W. Krumm
U. S. Bankruptcy Judge