

Tips From a Bankruptcy Trustee on the Treatment of IP Assets in Bankruptcy

By: Jennifer M. McCallum, Ph.D., Esq.

Introduction

Upon the filing of a bankruptcy petition, the trustee is vested with title to all property of a debtor's estate, which includes all legal and/or equitable interests of the bankruptcy estate as of the filing date of the petition. The bankruptcy estate has been held to include the debtor's intellectual property. The bankruptcy trustee may also take title to any patent that ultimately issues on a patent application a debtor failed to list on his or her bankruptcy petition. An invention conceived by the debtor after the filing date of the bankruptcy petition is deemed to be an asset of the debtor and not of his or her bankruptcy estate.

Agreements to assign can also be found binding upon the filing of a bankruptcy petition. A signed agreement to assign to a corporation all ideas, patent applications and/or patents in connection with product development or manufacturing has been held binding even when there was no time limit for such an agreement. (*National Texture Corp. v. Hymes*, 200 U.S.P.Q. (BNA) 59, 1977 WL 22880 (Minn. Dist. Ct. 1977).

Schedule B of a bankruptcy petition requires a written accounting of all personal property belonging to the debtor. Intellectual property is included in question 21 of Schedule B that requires a listing of all patents, copyrights and other Intellectual Property owned by the debtor. Licenses are required to be listed in question 22.

Upon the commencement of a bankruptcy, the contractual relationship between a licensor and one or more licensees may be substantially altered. Additionally, the bankruptcy trustee has significant decision-making authority when determining how to maximize the value of a debtor's estate and then distribute that value equitably among creditors.

The majority of bankruptcy filings are under Chapter 7 of the Bankruptcy Code if the debtor desires liquidation, and under Chapter 11 if the debtor is to be reorganized.

Under 11 U.S.C.A. §362(a), the filing of a bankruptcy petition creates an “automatic stay” barring any actions by creditors such as collection of claims and/or commencement or continuation of judicial proceedings against the debtor. After the filing date of a bankruptcy petition, creditors must first obtain relief from the automatic stay from the bankruptcy court prior to taking any action against a debtor. This relief may be difficult to obtain, particularly in filings under Chapter 11 of the Code.

Perfecting a Security Interest

A creditor can take a security interest in intellectual property as security for a loan. In order for a security interest to be effective against third parties it must attach and also be perfected. The requirements for attachment per UCC § 9-203 include a security agreement, value given by the creditor and rights of the debtor in the collateral itself. A creditor may then perfect its security interest by automatic perfection, taking possession of the collateral, controlling the collateral, or by filing a financing statement.

The UCC defines copyrights, trademarks and patents as general intangibles, which are generally perfected by the filing of a UCC-1 financing statement with the state office. However, UCC §§ 9-104(a) and 9-302(3)(a) and (4) provide that Article 9 doesn't apply to, “a security interest subject to any statute of the United States, to the extent that such statute governs the rights of parties to and third parties affected by transactions in particular types of property...” As copyrights, trademarks and patents all are governed by federal statutes, special care needs to be taken to ensure property perfection of a security interest in each one of them.

1. Patents

The majority of courts hold that a security interest in a patent is perfected if state UCC rules are followed. See *In re Cybernetic Services, Inc.* 239 B.R. 917, 39 U.C.C. Rep. Serv. 2d 1043 (B.A.P. 9th Cir. 1999), *aff'd* 252 F.3d 1039, 44 U.C.C. Rep. Serv. 2d 639 (9th Cir. 2001). The Patent Act does not specifically address the recording of a security interest and courts have fairly consistently found that the Patent Act does not preempt state law in this regard. However, while *Cybernetic* held that security interests do not have to be filed with the USPTO for proper perfection to occur, the court also affirmed the holding of *Waterman v. Mackenzie* that stated that in order to have perfection a security interest must be filed with the USPTO. See 138 U.S. 252, 11 S. Ct. 334, 34 L. Ed. 923 (1891).

In light of the confusion in the area of patents, a creditor should file its security interest both with the USPTO and the relevant state in order to ensure proper perfection of its security interest.

2. Copyrights

Pursuant to 17 U.S.C.A. § 205 of the Federal Copyright Act, “[a]ny transfer of copyright ownership or other document pertaining to a copyright may be recorded in the Copyright Office ...” This is defined in the Copyright Act to include “an assignment, mortgage, exclusive license or any other conveyance, alienation or hypothecation of a copyright or of any of the exclusive rights comprised in a copyright...” A copyright must be registered in order for a recordation under § 205 to be effective against third parties. A secured creditor need only file in the Copyright Office in order to give “all persons constructive notice of the facts stated in the recorded document.” 17 U.S.C. §205(c) Additionally, creditors who wish to have a perfected security interest against a copyrightable work that is not registered may still have to file its security interest with the Copyright Office.

3. Trademarks

A security interest in a trademark is perfected by filing a financing statement with the relevant state office.

In *In re Together Development Corp.*, a creditor had filed its security interest with the USPTO but not the relevant state office, and the issue before the court was whether or not the filing with the USPTO was sufficient to perfect the creditor's security interest in the trademark. (227 B.R. 439, 37 U.C.C. Rep. Serv. 2d 227 (Bankr. D. Mass. 1998) In order to make its decision, the court analyzed both UCC § 9-302(3) and also § 1060 of the Lanham Act. The court held that the Lanham Act did not provide filing requirements for a security interest taken in a trademark and, as such, UCC § 9-302(3) controlled.

4. Trade Secrets

As trade secrets are governed by state law, a security interest must be perfected in compliance with state law.

Infringement Post-Petition

The Bankruptcy Code bars the commencement or continuation of a judicial proceeding against the debtor which was or could have been brought before the bankruptcy petition filing date. However, the reverse is not true and a debtor may file an action after commencement of the bankruptcy case, including an action for a declaratory judgment of noninfringement. The automatic stay provisions of 11 U.S.C.A. §362(a)(1) and 362(a)(3) do not apply to an action by a bankrupt. Additionally, a cause of action for patent infringement survives the bankruptcy proceeding and there is no discharge of a debt arising from willful or malicious conduct.

Courts have held that liability for willful copyright infringement and trademark counterfeiting is not dischargeable in bankruptcy. A court has also found a cause of action for patent infringement exists against a Chapter 11 debtor for an act of infringement committed by the debtor pre-filing even when the plaintiff patent-holder had not filed suit prior to the Chapter 11 petition filing date. *Broomall Industries, Inc. v. Data Design Logic Systems, Inc.*, 786 F.2d 401, 14 Bankr. Ct. Dec. (CRR) 433, 14 Collier Bankr. Cas. 2d (MB) 1447, 229 U.S.P.Q. (BNA) 38 (Fed. Cir. 1986).

A U.S. district court has original jurisdiction and the Federal Circuit has appellate jurisdiction over claims for patent infringement or a declaratory judgment of patent invalidity, although issues that may be relevant to the case will be decided under bankruptcy law.

Executory Contracts

Per 11 U.S.C.A. §365 a contract is an executory contract if performance is due to some extent by both parties. An executory contract does not become an asset of the debtor's bankruptcy estate until it is assumed by the bankruptcy trustee per this same statute. An agreement to assign a patent and/or an interest in a patent has been held to be an executory contract with the exception of rights that have been licensed by the debtor. See Intellectual Property Bankruptcy Protection Act of 1988, Pub. L. 100-506. In particular, the Act adds a new provision to §365 that allows a licensee to elect to retain its rights to practice the subject of the license. Patent license agreements providing for a nonexclusive license have also been held to be executory contracts as the licensor is agreeing to refrain from suing the licensee for patent infringement and the licensee is agreeing to do a variety of things, including properly marking all patented embodiments.

If the bankrupt licensor elects to reject a license agreement as an executory contract, the Act provides a provision whereby a licensee can either terminate the agreement or retain the rights to performance by the other party under the agreement. If the licensee chooses to retain its rights, it must continue to make all royalty payments due under the agreement.

The Act applies specifically to agreements pertaining to rights under patents, patent applications, trade secrets, certificates of plant variety protection, copyrights, and semiconductor chip mask works. Courts have also held the Act is applicable to trademarks.

A bankruptcy trustee may also be able to set aside a patent license or assignment allowing him or her to sell the asset to the highest bidder, including a competitor of the original licensee. Where a licensee is a debtor, the bankruptcy trustee lacks the power to transfer the license without first obtaining permission from the licensor.

A bankruptcy trustee is held to the business judgment rule if he or she decides to reject or assume a license agreement, and it is highly unlikely that the bankruptcy court will allow a licensee to prevent this rejection on the grounds that the trustee did not meet the standard.

Ipsa Factor Void Clauses

11 U.S.C.A. §365(e)(1) invalidates “ipso facto” clauses that terminate or modify contractual rights or any right or obligation under such a contract upon the commencement of a bankruptcy case against or by the debtor or the appointment of a bankruptcy trustee. Although these clauses are expressly prohibited under §365(e)(1), they frequently appear in license agreements. Further, §541(c)(1)(B) states that an interest of the debtor in property becomes property of the estate regardless of any “ipso facto” clause in the contract.

Tips

In the license agreement itself, require the bankruptcy trustee to provide intellectual property to the licensee prior to or after rejection of the license agreement. As the bankruptcy trustee is required to provide intellectual property to a licensee to the extent provided in a contract, the licensee should require a clause that carefully characterizes the intellectual property and provides the licensee with access to it in the case of rejection.

Properly perfect security interests in intellectual property as they are important tools when attempting to negotiate with a Trustee to assume the licensee and also make it more difficult for the Trustee to sell the intellectual property itself. The Trustee is less likely to reject the license if there is a security interest as that action would immediately result in a secured claim for damages. Any future purchaser would then take title to the intellectual property subject to the licensee's security interest, which would make it unlikely anyone would want to buy it. The presence of a properly perfected security interest is apt to persuade the Trustee to assume the contract.

If counsel for a client learns that his or her client has filed for bankruptcy protection, immediately contact the bankruptcy trustee and request to be employed. If approval is received, file the appropriate Application To Employ with the court and properly notice all creditors. Also request detailed instructions from the bankruptcy trustee regarding how he or she would like the intellectual property to be maintained and how authorization is to be received for work that is to be performed as court approval may need to be requested in numerous instances.

If properly employed by the bankruptcy court as counsel for the bankruptcy trustee, periodic Fee Applications may be filed with the bankruptcy court. As intellectual property is expensive to maintain, be prepared to go to hearing to discuss the charges. In anticipation of a possible hearing, maintain detailed records of all transactions done on behalf of the bankruptcy estate. Also properly document authorization from the bankruptcy trustee and/or court for each expenditure included in the Application. If a hearing is held, bring documentation for average fees and costs for all expenditures included in the Application. The author of this paper has utilized the AIPLA Survey successfully as a tool to support fees and costs for patents, trademarks, trade secrets, hourly rates and other unique costs associated with intellectual property.

As counsel for a bankruptcy trustee, it is helpful to go to the 341 Meeting of Creditors and question the debtor and/or key individuals that worked for the creditor to properly identify all intellectual property. It is often not all listed on a bankruptcy petition in Question 21 or 22 and in-person questioning can be very helpful in identifying additional pieces not listed by bankruptcy counsel for the debtor. Prepare well for this meeting and question the relevant parties about anything else of value that may not be included on a bankruptcy petition, including regulatory approvals, prototypes, research and development agreements, clinical data, grant funds, and the like. Bankruptcy counsel for the debtor may not understand intellectual property or technical companies, in general, and often valuable assets are left off of bankruptcy petitions. If after questioning the debtor there are additional issues to research prior to further questioning the debtor, request the bankruptcy trustee continue the 341 Meeting of Creditors to a later date to allow time for research. This Meeting is critical as it allows for a lot of information to be obtained without the need for a subpoena or deposition.

When counsel for a bankruptcy trustee and software is involved, immediately query the debtor as to the existence of a software escrow agreement and notify them that they must safe-guard the asset. Often the escrow company immediately releases the software upon the commencement of a bankruptcy case and this action results in the loss of an asset that could have been sold.

When conducting due-diligence for a prospective purchase of intellectual property belonging to a bankruptcy estate, thoroughly investigate that all annuities have been paid, responses to all outstanding office actions have been filed, notice of allowance fees have been paid and the like. Intellectual property in bankruptcy estates is often not well-maintained and prospective purchasers must use caution when purchasing it and conduct detailed due-diligence prior to making an offer to purchase it.

Be prepared to be patient with all parties involved with a bankruptcy case, including the bankruptcy trustee, bankruptcy judge assigned to the case, creditors and the United States Trustee's Office. Specifically, be prepared to explain the very basics of intellectual property

to many parties repetitively via telephone and to the court in any type of pleading filed in the case and/or in a hearing. Document files in detail to be prepared for a status request at any time as the bankruptcy judge assigned to the case may request a hearing simply to ask about the intellectual property.

Tips Provided By: Jennifer M. McCallum, Ph.D., Esq.

Background:

Jennifer is a biotechnology patent attorney with a Ph.D. in Biotechnology from Colorado State University and a J.D. from the University of Colorado. After working at two different law firms and also in-house, she founded her own biotechnology patent law firm in Erie, Colorado. She has received numerous awards and accolades in her field, including the 2008 Congressional Medal of Distinction, and an appointment by Governor Owens to the Biotechnology Council for the State of Colorado. The *Denver Business Journal* voted Jennifer one of the 40 top business leaders under the age of 40, and named her Outstanding Woman in Business in the professional services category in 2004. Jennifer has received four appointments as the Vice-Chair of the American Bar Association's Committee on Bioethics, and she was one of seven attorneys sponsored in 2006 by the American Bar Association for an in-person *en banc* lifetime admission to the US Supreme Court. The McCallum Law Firm, P.C. was recently voted one of the 25 top woman-owned businesses in Colorado.

Jennifer is actively involved in complex biotechnology legal issues. She was instrumental in arguing a case to help make private storage of stem cells available to all expectant parents, and played an integral part in the issuance of the first permit for the production of pharmaceuticals in plants in Colorado. Jennifer is a frequent guest speaker and has been the keynote legal speaker at the International Stem Cell Conference in London, and also at the Stem Cell Research and Human Cloning Symposium in Boston. She also works overseas on client projects including the roll-out of stem cell facilities, and is involved in a variety of new reproductive technologies such as the female microbial condom project that

was recently featured in *The Economist* and *Discover Magazine*. Jennifer is currently assisting with the development of nanotechnologies, in particular, development of the next generation sequencing devices for DNA, RNA, and a protein that has been featured in Genetic Engineering News. Jennifer's Firm represents biotechnology, pharmaceutical, and medical device companies; several renewable energy companies; financial entities of many types, such as venture capital groups and investment banks; universities; and bankruptcy trustees.