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Protecting And Enforcing Judgment Creditor Interests In IP

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Law360, New York (June 30, 2017, 11:42 AM EDT) -- Judgment creditors typically satisfy their claims through settlement or, if necessary, by seizing and selling a debtor's real and tangible personal property. In the rare case when a debtor's only asset is intellectual property, a creditor must be more determined and creative in order to satisfy its judgment. Fortunately, there are a number of actions a creditor can take to both protect and secure the satisfaction of its claim.

Discovery of Debtor Assets

As is the case with either tangible or intangible property, a creditor should already have a good idea of the extent and location of a debtor's assets by the time judgment is entered. If the creditor failed to obtain sufficient information during the litigation, there are still various means to obtain discovery in aid of execution after entry of the judgment, such as written discovery demands and depositions directed to the debtor and third parties.

If a creditor suspects that the debtor possesses intellectual property that may be worthwhile to pursue, it should perform a search of the applicable public records body of the state where the debtor resides (the secretary of state in many jurisdictions), as well as the U.S. Patent and Trademark Office and U.S. Copyright Office. Specifically, a creditor should seek out financing statements and other security interests, as well as satisfactory information to ensure that chain of title in the IP is intact. Even a simple internet search can uncover valuable information leading to potential, additional sources from which a judgment can be satisfied.

If Possible, Move Quickly to Perfect a Security Interest

If the debtor granted a security interest in the IP, the creditor should swiftly perfect the interest to prevent its lien from becoming junior to another claim, and to avoid any decrease in value or the fraudulent transfer of the asset. The Uniform Commercial Code largely governs the procedure for

perfecting a security interest in this property, and generally, a creditor must file a financing statement in the state where the debtor is located to ensure perfection. When certain intangible property like copyrights are at issue, however, federal law may require an alternate (or additional) procedure.[1]

When a debtor's copyright is at issue, a creditor must record its interest with the U.S. Copyright Office, as the Copyright Act preempts the UCC.[2] Therefore, the creditor should file the applicable security agreement to secure its interest in a registered copyright and/or a copyright subject to a pending application.[3] An unregistered copyright, however, is not subject to these provisions of the Copyright Act, and therefore, a creditor must follow the traditional method of perfecting its security interest under state law.[4]

On the other hand, perfecting a security interest in trademarks and patents is much more unpredictable and onerous, causing one federal court to go so far as to refer to the practice as a "trap for the unwary."[5] For one, neither the Lanham Act nor the Patent Act specifically sets out a method for perfecting security interests in these forms of IP. Accordingly, federal law does not preempt state law in this regard, so a creditor should again ensure perfection of its security interest in accordance with state law.

That said, the USPTO has itself outlined the method for filing security interests. In fact, the Patent Act requires recordation of a security interest for protection against subsequent purchasers and mortgagees, but oddly enough, the Lanham Act is silent in this regard.[6] For this reason, courts hold that a state filing alone is sufficient protection for trademarks, but an additional filing with the USPTO is required for patents to secure protection.[7] Therefore, a creditor should file their security interest in a patent pursuant to both state law and USPTO procedures, although best practice dictates dual filings for trademarks as a prophylactic measure as well.

Enforcing the Judgment

If the debtor did not grant a security interest in the IP, securing recovery may be a much more difficult and time-intensive endeavor. While assets like trademarks, patents and copyrighted works are available for seizure, the process is usually more complex, expensive, and less reliable. This is primarily because the U.S. Supreme Court held in a series of 19th century opinions that IP is exempt from traditional collection devices like writs of execution and levies.[8] While a judgment creditor can employ these devices to garnish royalties or the physical property associated with the intangible asset itself, such as a patented invention, the underlying IP is deemed to be created by Congress, and therefore, immune from the jurisdiction and enforcement procedures of states.

In this situation, a creditor should consider negotiating for a voluntary assignment of the IP in satisfaction of its judgment, which if achieved, is a win-win situation for both parties. Not only is this an efficient and economical strategy for the creditor, but the debtor's financial and potential sentimental attachment to the IP may end up forcing a monetary settlement. From the debtor's perspective, a voluntary transfer will also achieve finality and avoid the involuntary and intrusive judgment enforcement process.

If the debtor is unwilling, or if a recalcitrant debtor would rather transfer away, destroy, or diminish the value of the IP, judgment satisfaction will be more arduous. The best and most efficient way to seize IP is by obtaining an order compelling the debtor to transfer or assign the property to a receiver for sale. Appointment of a receiver, with or without the need to commence a separate proceeding or creditor's bill, is an enforcement mechanism that is available in many states.[9] In fact, the Supreme Court specifically endorsed this equity remedy after reflecting upon its prior rulings that prohibit the use of traditional enforcement mechanisms to seize IP.[10]

When moving a court to appoint a receiver, a creditor should ensure that the order is specific in its identification of the IP to be acquired and sold in satisfaction of the judgment to avoid any future challenges. At the sale, the judgment creditor can credit-bid all or part of its judgment towards the IP, maintaining the option of obtaining payment in cash or securing the IP itself.

Whether a creditor is enforcing a judgment entered by a state or federal court, it is imperative to remember that state law will govern the proceedings.[11] Accordingly, there may be more (or less) enforcement devices at a creditor's disposal. For example, one federal court broke from the Supreme Court's long-standing precedent by holding that a patent is subject to seizure via a writ of execution, as the common law prohibition of using these mechanisms to obtain IP predates Rule 69 of the Federal Rules of Civil Procedure.[12]

Conclusion

While protecting and securing an interest in intellectual property may be a challenging process, following these steps can significantly increase the chances of ensuring your client's recovery.

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[1] See UCC §§ 9-310 & 9-311.

[2] See In re Peregrine Entm't, Ltd., 116 B.R. 194 (C.D. Cal. 1990).

[3] See 17 U.S.C. § 205.

[4] See In re World Auxiliary Power Co., 303 F.3d 1120 (9th Cir. 2002).

[5] See In re Together Dev. Corp., 227 B.R. 439, 439 (D. Mass. 1998).

[6] 35 U.S.C. § 261.

[7] See In re TR-3 Indus., 41 B.R. 128 (C.D. Cal. 1984); Rhone-Poulenc Agro, S.A. v. DeKalb Genetics Corp., 284 F.3d 1323 (Fed. Cir. 2002).

[8] See Stephens v. Cady, 55 U.S. 528 (1852); Stevens v. Gladding, 58 U.S. 447 (1854).

[9] See, e.g. N.Y. C.P.L.R. § 5228; N.J. Stat. § 2A:17-66; Olive Branch Holdings, LLC v. Smith Tech. Dev., LLC, 909 N.E.2d 671 (Ohio App. 2009).

[10] See Ager v. Murray, 105 U.S. 126 (1881).

[11] See, e.g. Fed.R.Civ.P. 69.

[12] See Skycam, LLC v. Bennett, 62 F.Supp.3d 1261 (N.D. Ok. 2014).