BROOKS PIERCE

# Can an Individual Now Use a Chapter 7 Bankruptcy to Wipe Out an Intellectual Property Judgment?

12.15.2008

In this uncertain economic environment, companies are increasingly concerned about bankruptcy filings. Let's say that a company is owed money from an individual due to a hard-won intellectual property judgment or a painstakingly negotiated settlement. Will the debt be legally owed in full if the person files a Chapter 7 liquidating bankruptcy? Or, will it be "discharged" and treated like any other debt in a bankruptcy, such that the company would be legally entitled to receive only cents on the dollar, if anything? As discussed below, a recent bankruptcy case has cast doubt upon the traditional legal analysis.

The question of Chapter 7 dischargeability is particularly important in intellectual property matters because of the relative ease with which a company owner can be found liable for the infringing acts of his company. In contrast to other types of cases in which liability usually stops at the corporation or limited liability company, a company owner participating in an intellectual property infringement can often be found to be personally liable. Therefore, it can matter greatly whether the owner will be able to escape an intellectual property money judgment or settlement by filing an individual Chapter 7 liquidating bankruptcy and folding his company.

In traditional cases of clear and indefensible infringement, courts have usually found the debt to be "non-dischargeable." That means that the Chapter 7 debtor owes the full amount of the debt even after the bankruptcy. That outcome occurs, however, only so long as certain facts are found, or conceded, during the course of the intellectual property judgment or settlement, and only so long as appropriate action is taken during the bankruptcy to preserve the debt.

A case decided by the Sixth Circuit Court of Appeals in 2004 demonstrates the usual situation. See In re Trantham, 304 B.R. 298 (6th Cir. 2004). The case arose when a defendant farmer used patented seed technology without authorization from the agri-business which owned the technology. The farmer, Mr. Trantham, used technologically superior seed but failed to pay for a license and then tried to conceal what he had done. The patent holder sued, asserting claims for patent infringement.

A jury from the western portion of Tennessee found the farmer liable for patent infringement. The jury further found that the defendant famer had acted willfully. The total judgment was nearly $600,000. The jury's award was comprised of $106,132.50 in compensatory damages, trebled to $318,397.50, plus prejudgment interest of $9,005.27 and attorneys fees of $265,275.12.

After the jury verdict but days before the final judgment was entered, Mr. Trantham filed a Chapter 7 bankruptcy petition. He sought to have his assets distributed to his creditors on a pro rata basis according to the amounts owed and the level of bankruptcy priority given to the debts. The farmer hoped that once his assets were distributed, his debts would be discharged and the discharged creditors would not be able to recover anything else. If all of his debts, including the patent judgment, were discharged, the debtor farmer would have the proverbial "fresh start" coming out of bankruptcy.

The Bankruptcy Act, however, contains certain exceptions in a Chapter 7 case to the general rule of dischargeability. The discharge exceptions are narrowly construed in favor of the debtor. See Meyers v. I.R.S., 196 F.3d 622 (6th Cir. 1999). The party seeking the exception bears the burden of proof of showing by a preponderance of the evidence that the debt should not be discharged. See Grogan v. Garner, 498 U.S. 279, 286 (1991).

The relevant exception provides that an individual debtor is not discharged from any debt "for willful and malicious injury by the debtor to another entity or to the property of another entity." 11 U.S.C. § 523(a)(6). "From the plain language of the statute, the judgment must be for an injury that is both willful and malicious. The absence of one creates a dischargeable debt." See Markowitz v. Campbell, 190 F.3d 455, 463 (6th Cir. 1999).

The Sixth Circuit found that the judgment against Mr. Trantham fell within the Bankruptcy Act's exception for willful and malicious injuries and therefore was nondischargeable. In re Trantham, 304 B.R. at 308. The Court first noted that the jury had found that Mr. Trantham had infringed willfully. This finding satisfied the first requirement of the exception.

The Court then stated that the "maliciousness" requirement would be satisfied if the debtor had acted with a conscious disregard of his duty or if he had acted without just cause or excuse. The Court noted that the district court found that Mr. Trantham "deliberately" infringed the patent for the sole purpose of avoiding payment of the license fee and then attempted to conceal his actions. Those actions, the Court concluded, were tantamount to a finding that Mr. Trantham acted in conscious disregard of his known duty with respect to the patent. Id. The entire judgment for willful patent infringement in the amount of $592,677.89 was therefore nondischargeable. Id. at 309.

Similar outcomes of non-dischargeability have been reached in a variety of other types of intellectual property cases. For example, non-dischargeability has been found in cases involving judgments of cybersquatting, In re Wright, 355 B.R. 192 (Bankr. C.D. Cal. 2006), trademark infringement, In re Klayminc, 37 B.R. 728 (Bankr. S.D. Fla. 1984) (violation of a consent judgment), misappropriation of customer lists, In re Springer, 85 B.R. 634 (Bankr. S.D. Fla. 1988), violation of a state trade secrets law, In re Allison, 176 B.R. 60 (Bankr. S.D. Fla. 1994), and other patent

infringement cases, In re Magnavox Co., 627 F.2d 803, 806 (7th Cir. 1980); Monsanto Co. v. Thomason, Ch. 11 Case No. 00-31755, Adv. No. 01-3012, slip op. (Bankr. W.D. La. Apr. 4, 2003); Goldsmith v. Overseas Scientific Corp., 188 F. Supp. 530 (S.D.N.Y. 1960). The requisite finding of intent to injure was not found in a trademark counterfeiting case because of its particular facts. In re Meece, 261 B.R. 403 (Bankr. N.D. Tex. 2001).

The legal analysis stated in Mr. Trantham's case may, however, be evolving. Earlier this year, a Bankruptcy Court for the District Court of New Jersey faced a situation that it found distinguishable from the "garden-variety" infringement of In re Trantham, 304 B.R. 298 (6th Cir. 2004), and In re Wood, 309 B.R. 745 (Bankr. W.D. Tenn. 2004). See In re Benun, 386 B.R. 59, 78 (Bankr. D.N.J. 2008). In Benun, the underlying patent case addressed whether Mr. Benun had infringed Fuji Photo Film's rights when, through his business, he refurbished Fuji-patented disposable camera shells. Mr. Benun and his company were found liable for willful patent infringement and owed a judgment of roughly $23 million. The New Jersey Bankruptcy Judge, however, "split the baby" and decided that a portion of a patent infringement judgment was discharged by Mr. Benun's bankruptcy and a portion would still be owed after bankruptcy. In a long and complicated decision, the Bankruptcy Court in New Jersey reasoned that that the Bankruptcy Act's requirement of willfulness required intentional consequences, not merely intentional acts. Id. It determined that such a finding had not been automatically made when the jury in the patent case found willful patent infringement. The Court indicated that the jury could have found willfulness under the Patent Act based merely upon recklessness (with unintended consequences) rather than deliberately intended consequences, as required by the Bankruptcy Act. The Court therefore decided that willfulness proven under the Patent Act was not necessarily the same as willfulness under the Bankruptcy Act.

Thusly freed from jury's underlying determination of willful patent infringement, the Bankruptcy Judge re-assessed the particular facts of infringement that the jury had already evaluated. The Judge determined that a portion of the infringing activity was willful and malicious and that other infringing activity was not. Id. at 106-07.

The Bankruptcy Judge's decision was very recently affirmed in relevant part by the District Court. See In re Benun, Case No. 08-1927 (D.N.J. December 1, 2008) (stating that the parties challenged certain findings but not the appropriateness of the test applied by the Bankruptcy Court).

The lessons from these cases? First and foremost, the question of dischargeability in a Chapter 7 bankruptcy often matters because it asks whether a judgment or settlement for money should be wiped out for the infringer or the infringing company's owner and primary decision-maker. Second, the particular facts proven about the infringement, or agreed to in a settlement, will decide the question. Third, a bankruptcy judge may revisit a jury's decision (or the parties' settlement) if the

decision (or settlement) is not sufficiently clear. Fourth, now that bankruptcy activity has increased in recent months, these legal issues are again likely to surface.

## PEOPLE

David W. Sar