

CONSIDERATIONS FOR THE PATENT HOLDER: THE TRANSFER OF PATENT LICENSES IN THE CONTEXT OF A MERGER

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I. INTRODUCTION

As a general premise, patent holders, also known as patentees, want to maintain control of their patents. A patentee will often grant permission to selected parties to utilize his or her invention in exchange for money. However, a patentee would prefer that a license is unable to assign that license to a third party without his or her permission. Such a transfer to a third party would diminish or reduce the value of the patent. Further, a patent holder would be particularly frustrated and disheartened if a competitor was able to obtain control of a license, despite the patentee's efforts, by merely turning to a licensee to whom a license had been granted.

Conversely, a company seeking to acquire another company that possesses a patent license will want the ability to acquire that license without having to ask the patentee for permission. For the acquiring company, acquisition of the licensee may be the only way to gain control over the license. If the patented technology is vital to the company's survival in the marketplace, preserving the ability to acquire licenses through acquisition becomes critically important to the company.

Part II of the article provides background information on patents and addresses the function of a patent for entrepreneurs and society at large. This section discusses the context in which disputes may arise regarding the rights of an acquiring company to assume patent licenses held by a target company.

Part III discusses the legal principles that govern this issue, focusing on whether patents are transferred to the acquiring company by operation of

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law in a merger and whether language in a license may be included to protect the interest of the patent holder. The analysis also discusses the law that governs the transfer of property and the unique policy considerations surrounding patents to determine how courts may respond to efforts by patent holders to restrict the alienation of their licenses. The discussion includes a suggestion that all patent licenses incorporate an anti-assignment clause, specifying that a merger will constitute a transfer. Lastly, part IV concludes and summarizes the discussion of the transfer of patent licenses in the context of mergers.

II. BACKGROUND INFORMATION

A. *Scenario to Consider*

Individuals in today's society give little thought to the revolutionary pioneers who brought us marvels such as the telephone, refrigerator, automobile, and even trivial things such as lined paper, shoelaces, vending machines, and the twisty-tie on bread wrappers bought at the grocery store. Society probably gives even less consideration to the external influences that motivated these inventors not only to create these miraculous discoveries, but also to share their inventions with the world.

Imagine the following scenario. An inventor labors and develops a solar powered automobile that outperforms fossil-fuel-burning cars and trucks. The genius in this new creation is its need for only two solar panels that can also serve as the front and back windshields of the vehicle. An invention such as this would revolutionize the global automobile industry and would also have lateral effects on other markets. What if the inventor chose not to share the invention with the rest of the world?

In the mind of the inventor, he or she may have endured tremendous hardship over decades in order to accomplish this feat. Because the inventor feels entitled to reap the rewards of this new discovery, the inventor waits to reveal the new automobile until the development a mechanism to prevent car manufacturers and others from reverse engineering the new creation. Assuming the inventor succeeds in this endeavor, the inventor begins the process of turning the invention into an exploitable business plan. The inventor must handle logistics such as finance, hiring managers and workers, and developing an infrastructure to mass-produce the new line of vehicles. Instead of contending with these peripheral matters, what if the inventor was able to share his or her idea with someone and allow that other person to develop and execute the business plan?

Leveraging one's resources is probably the most prudent way to conduct business. However, the key to making this business approach work

is the need to reassure the inventor that adequate (more likely lucrative) compensation awaits. This efficiency and incentivizing is what the Patent Act attempts to achieve.¹ The alternative to the patent system is to force the inventor to proceed in a manner that benefits no one. The alternative would encourage inventors to conceal their ideas from the rest of the world until they receive adequate assurances that they will be able to reap the fruits of their efforts. Under this alternative scheme, the end result is that inventors delay the introduction of potentially revolutionary inventions to the world and society is denied technological advancements.

B. The Patent Act

In order to promote the useful arts, the United States Constitution requires Congress to secure an inventor's exclusive right to his or her discovery for a limited period of time.² In accordance with this requirement, Congress designated the Patent and Trademark Office as the administrative body to issue patents.³ Under the Patent Act, a patentee receives the right to exclude others from making, using, selling, or offering to sell his or her invention⁴ for a period of twenty years beginning from the day the patent is application is filed.⁵ Patent owners may use or refuse any rights granted to them.⁶

The reason for securing inventors' exclusive rights in their inventions is to promote the development of new and useful arts.⁷ By giving inventors incentives to invent, the idea is that they will continue to develop new innovations.⁸ Conceptually, an exchange takes place. In exchange for twenty years of exclusivity, the Patent Act requires patentees to describe the invention fully so that others may learn how the invention works.⁹ In

¹ *King Instruments Corp. v. Perego*, 65 F.3d 941, 950, 36 U.S.P.Q.2d 1129, 1132 (Fed. Cir. 1995).

² *See* U.S. Const. art I, § 8, cl. 8.

³ *See* 35 U.S.C. § 1 (1994).

⁴ 35 U.S.C. § 154(a)(1) (1994).

⁵ 35 U.S.C. § 154(a)(2) (1994). For patents in force as of June 8, 1995, the term of the patent is the greater of either 17 years from grant or 20 years from filing. Robert A. Harmon, *Patents and the Federal Circuit* § 1.1(a) (4th ed. 1998).

⁶ *See* 35 U.S.C. § 253 (1994).

⁷ *See Bonito Boats, Inc. v. Thunder Craft Boats, Inc.*, 489 U.S. 141, 150-51, 9 U.S.P.Q.2d 1847, 1852 (1989).

⁸ *See id.*

⁹ 35 U.S.C. § 112 (1994).

addition, patentees must set forth the best mode of carrying out their invention.¹⁰

C. Patent Licenses

A patent holder may grant rights in the patent to others in one of two forms, either as an assignment or as a license.¹¹ An assignment is essentially the transfer of all the rights held by the patentee to the assignee.¹² A license is an agreement that allows the licensee to use the patent without the patentee having to transfer any ownership interest in the patent.¹³ A license may be exclusive or nonexclusive. An exclusive license precludes the licensor from granting other licenses, but otherwise preserves all other rights entitled to a patent holder.¹⁴ A nonexclusive license is merely a grant of permission to the licensee to do a thing that the patentee would otherwise have a right to prevent.¹⁵ In essence, the patentee grants to the licensee the right to infringe the patent without fear of being sued.¹⁶

D. The Acquisition of Patents by a Merger – Transfer by Operation of Law

In some instances, a company will not be able to obtain a license from a patentee. For example, the company may be a competitor of the patentee, or the patentee may simply wish to grant licenses selectively to certain individuals or companies while excluding others. As long as the motivation for refusal is not illegal, the patent holder is free to grant licenses

¹⁰ *Id.*

¹¹ See Sheldon W. Halpern et al, *Fundamentals of United States Intellectual Property Law: Copyright, Patent, and Trademark* 250 (1999).

¹² See generally Harmon, *supra* n. 5, at § 7.2(a); see also *In re AllTech Plastics, Inc.*, 3 U.S.P.Q.2d 1024, 1027 (Bankr. W.D. Tenn. 1987).

¹³ Virginia Henschel, “Backdoor” Access to Patented Technology, 17 Am. Bankr. Inst. J. 40, 40 (Feb. 1998).

¹⁴ See Stephen J. Davidson and Daniel M. Bryant, *Licensing Issues in the New Economy*, 18 No. 9 Computer & Internet L. 1, 6 (Sept. 2001).

¹⁵ See Ramon A. Klitzke, *Patent Licensing: Concerted Action by Licensees*, 13 Del. J. Corp. L. 459, 463 (1988); see also *Western Elec. Co. v. Pacent Reproducer Corp.*, 42 F.2d 116, 118 (2d Cir. 1930) (“a license means only leave to do a thing which the licensor would otherwise have right to prevent”).

¹⁶ See 1 Irving Katon, *Patent Practice* at 28 (Patent Resources Inst., 6th ed. 1995).

or to refuse them.¹⁷ This broad power held by the patentee should concern competitors because their survival in the market could hinge on accessing patented technology.¹⁸

Patent licenses are personal to the licensee and are not assignable without language in the license permitting assignments.¹⁹ This general rule may be attributed to three principle cases: *Troy Iron and Nail Factory v. Corning*,²⁰ *Hapgood v. Hewitt*,²¹ and *Oliver v. Rumford Chemical Works*.²² The general rule relates to situations in which a licensee may assign a license to a third party. Applying the general rule, a company that has been excluded by a patentee cannot seek a license through an assignment or sublicense from an existing licensee.²³ Therefore, an excluded-company's only means of circumventing this barrier may be to merge with a company that already possesses a license.²⁴

A merger occurs when an acquiring company absorbs an existing target corporation.²⁵ The merger consolidates the two corporations into one

¹⁷ See Klitzke, *supra* n. 15, at 463 (citing *Official Airline Guides, Inc. v. FTC.*, 630 F.2d 920, 927-28 (2d Cir. 1980), *cert. denied*, 450 U.S. 917 (1981) for the proposition that a patent holder has the right of private enterprise to decide with whom it will deal so long as there is no illegal activity).

¹⁸ *See id.*

¹⁹ See *Troy Iron & Nail Factory v. Corning*, 55 U.S. 193, 216 (1852) (“A mere license to a party, without having his assigns or equivalent words to them, showing that it was meant to be assignable, is only the grant of a personal power to the licensee, and is not transferable by him to another.”); see also *Oliver v. Rumford Chem. Works*, 109 U.S. 75, 82 (1883) (a license does not carry rights to anyone except the licensee personally, unless there are express words to show an intent to extend the right to an assignee, voluntarily or involuntarily); see also *Hapgood v. Hewitt*, 119 U.S. 226, 234 (1886); see also *Rock-Ola Mfg. Corp. v. Filben Mfg. Co., Inc.*, 168 F.2d 919, 922 (8th Cir. 1948); see also generally Michael Epstein & Frank L Politano, *Intellectual Property Provisions In License Agreements*, 5 No. 6 J. Proprietary Rts. 17, 22 (1993). As a side note, one could interpret these cases as support for the notion that patent licenses are implicitly non-assignable, even absent language to the contrary. However, none of these cases deal with patent licenses and a transfer that occurs by operation of law in a merger.

²⁰ 55 U.S. 193 (1852).

²¹ 119 U.S. 226 (1886).

²² 109 U.S. 75 (1883).

²³ See Epstein & Politano, *supra* n. 19, at 22.

²⁴ See generally Deborah F. Harris, Annotation, *Who Acquires Rights Under Patent License Owned by Constituent Corporation in Case of Corporate Merger or Consolidation*, 49 A.L.R. Fed. 890, 890-91 (1980).

²⁵ See James T. Lidbury, *Drafting Acquisition Agreements*, in *Drafting Corporate Agreements* 1998-1999, 241, 252 (PLI Corp. Law & Prac. Course Handbook Series No. 1089, 1998).

surviving entity.²⁶ By operation of law, the surviving corporation then owns all of the target corporation's assets.²⁷ Each state in the United States has adopted this rule promulgated under the Model Business Corporations Act.²⁸ The effect of the statute is that the merging corporation need not transfer title to individual assets or obtain third party consent for the assignment of contracts that do not otherwise prohibit mergers or changes in control.²⁹ All of the acquired corporation's property transfers by operation of law to the surviving corporation instantaneously upon effectiveness of the merger.³⁰

If a merger and the succession of ownership is characterized as a transfer from the target company to the acquiring company, then the general rule would apply and the patentee/licensor would have a cause of action for any infringing use of the patent by the acquiring company. However, if the merger does not constitute a transfer, then a company that would have otherwise been excluded from the patented technology has a way of accessing that technology without turning to the patent holder. As a result, the central question then becomes whether the transfer of property by operation of law constitutes a transfer for purposes of a patent license.

²⁶ *See id.*

²⁷ *See* Model Bus. Corp. Act. § 11.06(a) (1984); Franklin A. Gevurtz, Corporation Law § 7.2(b) (2000).

²⁸ *See generally* Model Bus. Corp. Act Ann. § 11.07 (Supp. 1998/99) (listing all fifty states as having adopted this rule under the Model Business Corporation Act). Section 11.06 of the 1984 Act states:

When a merger takes effect:

(1) every other corporation party to the merger merges into the surviving corporation and the separate existence of every corporation except the surviving corporation ceases;

(2) the title to all real estate and other property owned by each corporation party to the merger is vested in the surviving corporation without reversion or impairment.

Model Bus. Corp. Act. § 11.06(a) (1984).

²⁹ *See* Lidbury, *supra* n. 25, at 255.

³⁰ *See generally* Model Bus. Corp. Act Ann. § 11.07, official cmt. (Supp. 1998/99). Contract rights are presumed transferred in a merger, unless otherwise provided in the contract. *Id.*

III. ANALYSIS

A. *Non-Assignment Clauses v. Operation of Law*

As a general proposition, anti-assignment clauses in a contract are enforceable.³¹ Some courts, however, hold that succession of ownership by operation of law does not constitute a transfer, and therefore no breach of contract occurs when an acquiring company succeeds in the ownership of a target company's assets.³² For example, in *Dodier Realty & Inv. Co. v. St. Louis National Baseball Club, Inc.*, the lessor leased a baseball stadium to the lessee.³³ In the lease, the lessee agreed that it would not assign the lease without written consent from the lessor.³⁴ When the defendant acquired the lessee and assumed the lease, the lessor sued.³⁵ In response to the lessor's claim that the assumption of the lease by the acquiring company violated the anti-assignment clause, the court held that the lease was not breached because a transfer had not occurred.³⁶ The Missouri Supreme Court stated that there was no assignment within the prohibition of the covenant because the defendant corporation succeeded to the rights of the original lease by operation of law.³⁷

Courts are reluctant to enforce anti-assignment clauses when a transfer occurs by operation of law because of the public policy against restraints on alienation.³⁸ Such a clause is subject to the doctrine of strict construction because it creates a restraint on the alienation of property.³⁹ Courts disfavor implied covenants against transfers by operation of law and will hold that a transfer which occurs by operation of law that is not "fairly and substantially" an assignment does not violate such covenants.⁴⁰

³¹ See W.W. Allen, Annotation, *Validity of Anti-Assignment Clause in Contract*, 37 A.L.R.2d 1251, 1253 (1954).

³² E.g. *Dodier Realty & Inv. Co. v. St. Louis Nat'l Baseball Club, Inc.*, 238 S.W.2d 321, 325 (Mo. 1951).

³³ *Id.* at 322.

³⁴ *Id.* at 323 n. 1.

³⁵ *Id.* at 322.

³⁶ *Id.* at 325.

³⁷ See *id.*; see also generally Jay M. Zitter, Annotation, *Merger or Consolidation of Corporate Lessee as Breach of Clause in Lease Prohibiting Conditioning, or Restricting Assignment or Sublease*, 39 A.L.R.4th 879, 887-88 (1985).

³⁸ *Segal v. Greater Valley Terminal Corp.*, 199 A.2d 48, 50-51 (N.J. 1964).

³⁹ See *id.*

⁴⁰ See *id.* at 50-51.

Restraints on alienation receive hostile treatment from courts in other contexts as well. Courts have interpreted anti-assignment clauses with similar disdain when dealing with insurance contracts. For example, the United States Court of Appeals for the Fifth Circuit held that an insurance policy is subject to the rules of succession in a corporate merger and a transfer by operation of law did not violate the anti-assignment provisions of the policy.⁴¹ The compelling consideration that influenced the court's decision was the general policy against forfeiting insurance coverage.⁴² The court acknowledged that parties to an insurance contract may agree that the insured party shall have no rights to assign.⁴³ However, the court construed the anti-assignment provision narrowly in light of this policy.⁴⁴ The court distinguished a transfer that occurs by operation of law from that which occurs through a personal assignment.⁴⁵ In light of the policy and the absence of language that expressly indicated the parties' intent to classify transfers by operation of law as an assignment, the court stated that it would not ritualistically and mechanically apply the restraining provision.⁴⁶

Likewise, operating licenses granted by the City of Seattle ("the City") that were transferred in a merger were found not to violate a city ordinance that prohibited the transfer of these licenses.⁴⁷ In *Diamond Parking, Inc. v. City of Seattle*, the City issued licenses for the operation of parking garages to three corporations owned by the same persons.⁴⁸ Later, the three corporations merged, leaving one surviving corporation.⁴⁹ After the merger, the City demanded payment for new licenses for the operation of the two locations that were merged.⁵⁰ The surviving corporation argued that if the licenses formerly held by the other two corporations constituted rights,

⁴¹ See *Imperial Enters., Inc. v. Fireman's Fund Ins.*, 535 F.2d 287, 293 (5th Cir. 1976). In *Imperial Enterprise*, an insurance company issued a fire insurance policy to insured party. *Id.* at 289. The insured party was later acquired by an acquiring corporation pursuant to the Georgia statutory merger scheme. *Id.* Georgia's statutory merger scheme provided that all property and interest belonging to the acquired corporation shall be taken and deemed to be transferred and vested in the surviving corporation without further act or deed. *Id.* at 291 (citing to Ga. Code Ann. § 22-1007(b)(4) (1970)).

⁴² See *Imperial Enters., Inc.*, 535 F.2d at 290.

⁴³ See *id.*

⁴⁴ See *id.* at 291.

⁴⁵ See *id.*

⁴⁶ See *id.* at 292.

⁴⁷ *Diamond Parking, Inc. v. City of Seattle*, 479 P.2d 47 (Wash. 1971) (en banc).

⁴⁸ *Id.* at 47-48.

⁴⁹ *Id.* at 48.

⁵⁰ *Id.*

privileges or franchises, then they were transferred to the surviving corporation by operation of law without violating the City's ordinance.⁵¹ The Supreme Court of Washington agreed with the surviving corporation and held that the City's ordinance would be in conflict with Washington's corporate statute if it were to impose limitations on the transfer of property pursuant to a merger.⁵² When a city ordinance and state statute conflict, the statute will control.⁵³ Therefore, a transfer did not occur for purposes of the ordinance, and the City could not require the surviving corporation to pay additional license fees.⁵⁴

Courts, however, will interpret anti-assignment clauses differently when the parties to the agreement stipulate that transfers by operation of law pursuant to a merger will constitute an assignment in violation of an anti-assignment provision.⁵⁵ In *Pacific First Bank v. New Morgan Park*, a bank leased property from a lessor, where the lease stated that "[t]enant shall not assign, sell, mortgage, pledge, or in any manner transfer the Lease or any interest herein whether voluntary or involuntary or by operation of law . . . without the prior written consent of Landlord."⁵⁶ The Oregon Supreme Court held that a transfer of the lease to the bank's subsidiary following a downstream merger would violate the anti-assignment clause.⁵⁷ The lease specifically included transfers by operation of law as falling within the restrictions imposed by the anti-assignment clause.⁵⁸ Despite public policy favoring free alienation of property, the court concluded that the transfer would violate the anti-assignment clause because of the clear language in the lease.⁵⁹

In short, courts frown upon restraints on alienation and will narrowly construe them.⁶⁰ Despite hostility toward restrictions on alienation, courts will honor a provision that prohibits the transfer of property by operation of

⁵¹ *Id.*

⁵² *Id.* at 51-52.

⁵³ *See id.*

⁵⁴ *See id.*

⁵⁵ *See Pacific First Bank v. New Morgan Park*, 876 P.2d 761, 762 (Or. 1994); *Citizens Bank & Trust Co. of Maryland v. Barlow Corp.*, 456 A.2d 1283, 1288 (Md. 1983).

⁵⁶ *Pacific First Bank*, 876 P.2d at 762-63.

⁵⁷ *See id.* at 765.

⁵⁸ *See id.*

⁵⁹ *See id.* at 766.

⁶⁰ *See* Roger A. Cunningham et al., *The Law of Property* § 6.71 (1993).

law when the restraining clause specifies that an assignment includes a transfer that occurs by operation of law in a merger.⁶¹

B. The Governing Law – Patents

By analogizing to cases that deal with restraints on real property leases, one could conclude that courts would honor language in a patent license that identifies transfers by operation of law as an assignment. Courts appear to be more hostile towards anti-assignment clauses in real property leases than patent licenses.⁶² If this premise is correct, drafters of patent licenses may rely on the fact that courts will enforce an anti-assignment clause in a lease by finding mergers to constitute a transfer when the lease specifically so provides. If courts are willing to enforce anti-assignment clauses in this context, despite the public policy against such enforcement, then courts should be willing to do the same when presented with patent licenses.

1. Federal Law v. State Law

There remains some uncertainty as to whether patent licenses are exclusively governed by federal or state law.⁶³ As mentioned earlier, Congress derives its authority to grant patents from the Constitution of the United States.⁶⁴ The Constitutional grant and the unique policy pursuits under the Patent Act generally induce courts to hold that federal law governs the assignability of patent licenses.⁶⁵ Some commentators have argued that state

⁶¹ See e.g. *Pacific First Bank*, 876 P.2d at 765; *Citizens Bank & Trust Co. of Maryland*, 456 A.2d at 1289.

⁶² See *PPG Indus., Inc. v. Guardian Indus. Corp.*, 597 F.2d 1090, 1095, 202 U.S.P.Q. 95, 99 (6th Cir. 1979) (explaining that restrictions on the assignment of real property are subject to the deep-rooted policy against restraints on alienation; however, “no similar policy . . . is offended by the decision of a patent owner to make a license under his patent personal to the licensee, and non-assignable and non-transferable.”).

⁶³ See *Unarco Indus., Inc. v. Kelley Co., Inc.*, 465 F.2d 1303, 1306, 175 U.S.P.Q. 199 (7th Cir. 1972) (assignability of patent licenses is a federal issue and federal law applies); *but cf. Synergy Methods, Inc. v. Kelly Energy Sys., Inc.*, 695 F. Supp. 1362, 1366 (D. R.I. 1988) (the general rule under federal law, that patent licenses are not assignable, does not apply when assignment results from a transformation in form).

⁶⁴ See U.S. Const. art I, § 8, cl. 8.

⁶⁵ See *Unarco Indus., Inc.*, 465 F.2d at 1306, 175 U.S.P.Q. at 201; see also *PPG Indus., Inc.*, 597 F.2d at 1093, 202 U.S.P.Q. at 96-97; see also *In re CFLC, Inc.*, 89 F.3d 673, 677, 39 U.S.P.Q.2d 1518, 1522 (9th Cir. 1996).

law should control, contending that freely assignable patent licenses would be a preferable policy objective.⁶⁶ This argument, however, ignores the adverse impact of inconsistent state court decisions on the rights of the patentee, namely the right to exclude others from the patented invention.

In *Farmland Irrigation Co. Inc. v. Dopplmaier*,⁶⁷ the Supreme Court of California held that federal law does not exclusively govern patents and state contract law would control.⁶⁸ The holding in *Farmland Irrigation*, therefore, contradicts the notion of federal common law controlling the interpretation of patent licenses.⁶⁹ In *Farmland Irrigation*, the patent holder granted a license to Stout Irrigation Corp. that later dissolved.⁷⁰ The shareholders of Stout sold the company's assets, including the patent license, to Farmland Irrigation Co., the plaintiff.⁷¹ The patentee later assigned his interest in the patent to Dopplmaier, the defendant, in plaintiff's declaratory judgment action.⁷²

The court held that the patent license was assignable.⁷³ The court reasoned that rights under patent licenses arise from contracts and so long as state law does not destroy the advantages of a patent monopoly which is "to promote the progress in science and useful arts by stimulating invention and encouraging disclosure."⁷⁴ The court opined that there is no reason why the state law should not govern.⁷⁵ The court, however, reached the decision without fully analyzing some important considerations, or offering a persuasive discussion to suggest that the court's position was correct. In addition, the *Farmland Irrigation* court disregarded a string of U.S. Supreme Court cases standing for the proposition that rights under a patent license are

⁶⁶ See generally Carole A. Quinn and R. Scott Weide, *Violation of the Erie Doctrine: Application of a Rule of Federal Common Law to Issues of Patent License Transferability*, 32 Creighton L. Rev. 1121 (1999); Daniel A. Wilson, Note, *Patent License Assignment: Preemption, Gap Filling, and Default Rules*, 77 B.U. L. Rev. 895 (1997); Peter T. Moore, *The Passage of Rights Upon Merger: PPG Industries, Inc. v. Guardian Industries, Corp. – The Sixth Circuit Equates Assignment with Transfer by Operation of Law*, 58 Dev. L. J. 181 (1980).

⁶⁷ 308 P.2d 732, 113 U.S.P.Q. 88, 90 (Cal. 1957).

⁶⁸ See *id.* at 739-40, 113 U.S.P.Q. at 93.

⁶⁹ See *id.* at 739, 113 U.S.P.Q. at 93.

⁷⁰ See *id.* at 735, 113 U.S.P.Q. at 90.

⁷¹ See *id.*

⁷² See *id.*

⁷³ See *id.* at 741, 113 U.S.P.Q. at 95.

⁷⁴ See *id.* at 739, 113 U.S.P.Q. at 93.

⁷⁵ See *id.*

not assignable.⁷⁶ The court considered the authoritative weight of these cases to be less than binding in light of the United States Supreme Court's holding in *Erie Railroad Co. v. Tompkins*.⁷⁷ In the *Farmland Irrigation* court's zealous application of the *Erie* doctrine, the court failed to examine the possible exceptions to the doctrine – one in particular that requires courts to apply federal law in cases where a unique federal policy is implicated.⁷⁸

The *Erie* doctrine reminds courts that federal common law does not exist and instructs courts to apply state law, unless commanded otherwise by the Constitution or by acts of Congress.⁷⁹ In *Texas Industries, Inc. v. Radcliff Materials*,⁸⁰ the Supreme Court provided additional guidance as to when federal courts may diverge from state law.⁸¹ Federal courts may apply federal law when the matter falls into essentially one of two categories: (1) “those in which a federal rule of decision is necessary to protect uniquely federal interest,” and (2) when “Congress has given the courts the power to develop substantive law.”⁸² With respect to the second category, Congress has not provided federal courts with authority under the Patent Act to create substantive law. Therefore, any authority that federal courts may have regarding this issue must stem from their power to protect unique federal interests.

Absent a Congressional authorization, federal common law exists in very narrow areas.⁸³ However, federal courts may judicially create a federal rule if the application of state law significantly conflicts with a federal policy under a federal statute.⁸⁴ The *Farmland Irrigation* court's rationale for disregarding pre-*Erie* Supreme Court decisions was misguided because the Supreme Court of California failed to consider fully the way in which a policy favoring free assignability would compromise rights granted under the Patent Act.

⁷⁶ See *id.* at 737, 113 U.S.P.Q. at 91.

⁷⁷ 304 U.S. 64, 78 (1938) (holding that there is no federal common law and that state law should apply, except in matters involving the Federal Constitution or by acts of Congress).

⁷⁸ *Texas Indus., Inc. v. Radcliff Materials*, 451 U.S. 630, 640 (1981).

⁷⁹ See *Erie R.R. Co.*, 304 U.S. at 78.

⁸⁰ See *Texas Indus., Inc.* 451 U.S. at 640-41.

⁸¹ *Id.* at 640.

⁸² *Id.*

⁸³ See *id.*

⁸⁴ *O'Melveny & Myers v. Federal Deposit Ins. Corp.*, 512 U.S. 79, 87 (1994).

In the *Farmland Irrigation* court's analysis, a state rule favoring assignability would not significantly affect the value of the patent.⁸⁵ A state rule would not hamper the patentee's right to profit from his or her patent because "the patentee must in any event look to state law to determine most of its rights under the license."⁸⁶ The court added that the state statute manifests a policy in favor of the free transferability of all types of property, including rights under contract.⁸⁷

Herein lies the inconsistency with federal policy. The *Farmland Irrigation* court did not properly identify the rights granted under the Patent Act. Unlike the Copyright Act,⁸⁸ which gives specific rights to the Copyright holder,⁸⁹ the Patent Act does not grant enumerated rights to the patentee.⁹⁰ The Patent Act does not award a patent holder the right to profit.⁹¹ Instead, the Patent Act only grants the right to exclude others from using, making, selling, or offering to sell the patentee's invention.⁹² In addition, the Patent Act is a creature of a Constitutional authority.⁹³ Rights from a patent license are so intertwined with the sweep of Constitutional and congressional mandate, federal law governs any question with respect to the transfer of patent licenses.⁹⁴ A state policy that promotes free assignment⁹⁵ of patents runs in direct conflict with this unique federal interest.

Commentators who favor the application of state law also mischaracterize the policy pursuits under the Patent Act. These commentators have argued federal law does not deal with the transferability or nontransferability of licenses; thus, courts, bound by the *Erie* doctrine and in absence of federal

⁸⁵ See *Farmland Irrigation Co.*, 308 P.2d at 739, 113 U.S.P.Q. at 93.

⁸⁶ *Id.*

⁸⁷ See *id.* at 740, 113 U.S.P.Q. at 94.

⁸⁸ 17 U.S.C. § 101 (1994, Supp. II 1996 & Supp. IV 1998).

⁸⁹ See *id.* at § 106.

⁹⁰ See 35 U.S.C. § 271 (1994, Supp. II 1996 & Supp. IV 1998).

⁹¹ See *Farmland Irrigation*, 308 P.2d at 739, 113 U.S.P.Q. at 93 (stating that a rule favoring assignability would not significantly affect the patentee's right to profit).

⁹² See 35 U.S.C. § 271(a).

⁹³ See U.S. Const. art I, § 8, cl. 8.

⁹⁴ See *Unarco Indus., Inc.*, 465 F.2d at 1306, 175 U.S.P.Q. at 200.

⁹⁵ See *Farmland Irrigation*, 308 P.2d at 740, 113 U.S.P.Q. at 94; see also Moore, *supra* n. 66, at 193 ("given the lack of a clear federal policy favoring the nontransferability of patents in the merger context, and given a strong statutory presumption of the free passage of rights, it is doubtful that the holding *PPG Industries* may be properly taken as support for the proposition that generally nonassignable rights do not pass to the surviving corporation in a merger").

law, should apply the law of the forum state.⁹⁶ However, these commentators improperly frame the issue as whether patent licenses should be transferable or not transferable. They fail to appreciate that the Patent Act grants to the patentee the right to exclude and prevent others from using the patented invention.⁹⁷ When examined from this perspective, the policy objective of the Patent Act would be compromised by cases such as *Farmland Irrigation* that promote freely alienable patent licenses.

The United States Court of Appeals for the Ninth Circuit recently rendered a decision that offers some clarification regarding the question of whether federal or state law controls.⁹⁸ The court held that federal law governs the assignability of nonexclusive patent licenses.⁹⁹ In response to the argument that courts should apply state law under the rules set forth under the *Erie* doctrine and *Farmland Irrigation*, the court stated that free assignability of “nonexclusive patent licenses would undermine the reward that encourages invention because a party seeking to use the patented invention could either seek a license from the patent holder or seek an assignment of an existing patent license from a licensee.”¹⁰⁰ The court foresaw a possible scenario where licensees would become competitors of the patentee.¹⁰¹ Although a patentee could control the number of licenses issued, the patentee would have no control over the identity of subsequent licensees.¹⁰² In effect, free assignability would ultimately impair the patent system by discouraging patent holders from granting licenses.¹⁰³

In short, the standard again for determining whether application of federal law is appropriate is whether “a significant conflict between some federal policy or interest the use of state law.”¹⁰⁴ Courts appear to recognize that a policy favoring free alienation clashes with the policy pursuits under the Patent Act.¹⁰⁵ Because the right to exclude is the centerpiece of the Patent Act, state law must give way to the paramount policy objective of the Patent

⁹⁶ See Quinn & Weide, *supra* n. 66, at 1133.

⁹⁷ See 35 U.S.C. § 271(a) (1994 & Supp. V 1999).

⁹⁸ See *In re CFLC, Inc.*, 89 F.2d at 679, 39 U.S.P.Q.2d at 1523.

⁹⁹ See *id.* at 679-80, 39 U.S.P.Q.2d at 1523.

¹⁰⁰ *Id.* at 680, 39 U.S.P.Q.2d at 1523.

¹⁰¹ See *id.* at 679, 39 U.S.P.Q.2d at 1523.

¹⁰² See *id.*

¹⁰³ See *id.*

¹⁰⁴ See *O'Melveny & Meyers*, 512 U.S. at 87 (quoting *Wallis v. Pan Am. Petroleum Corp.*, 384 U.S. 63, 68 (1966)).

¹⁰⁵ See *In re CFLC, Inc.*, 89 F.2d 673, 679, 39 U.S.P.Q. 1518, 1523 (9th Cir. 1996); see also *Unarco Indus., Inc.*, 467 F.2d at 1306, 175 U.S.P.Q. at 200.

Act when the two conflict.¹⁰⁶ Therefore, federal law appropriately governs the assignability of patent licenses.

2. Federal Case Law

a) The Authoritative Cases

*Unarco Indus., Inc. v. Kelley Co., Inc.*¹⁰⁷ and *PPG Indus., Inc. v. Guardian Indus. Corp.*¹⁰⁸ are the only authoritative cases that answer the question: does a transfer of patent that occurs by operation of law in a merger constitute an assignment.

In *Unarco Industries*, the defendant company attempted to acquire the licensee after efforts to merge with the patent holder failed.¹⁰⁹ The acquiring company and the licensee sued the patent holder seeking a declaratory judgment regarding the assignability of the patent license.¹¹⁰ The issue presented before the court was whether the licensee had the right to assign the license.¹¹¹ The court confirmed that federal law would apply to issues involving the assignability of patent licenses.¹¹² In addition, the court restated that “[licenses] are personal to the licensee and not assignable unless expressly made so in the agreement” expressly following federal patent law.¹¹³ However, the court failed to provide a holding on point. The court never discussed the possibility that a patent license could be transferred from the licensee to the surviving company by operation of law – that is, without a formal assignment. This issue, however, was eventually addressed in *PPG Industries*.

In *PPG Industries*, the plaintiff and the licensee were companies that exchanged patent licenses.¹¹⁴ The parties agreed that the licensee would have

¹⁰⁶ See Harmon, *supra* n. 5, at § 1.4(c) (citing *Interpart Corp. v. Italia*, 777 F.2d 678, 228 U.S.P.Q.2d 124 (Fed. Cir. 1985) for the proposition that state law must fail if it clashes with the objectives of the federal patent laws).

¹⁰⁷ 465 F.2d 1303, 175 U.S.P.Q. 199 (7th Cir. 1972).

¹⁰⁸ 597 F.2d 1090, 202 U.S.P.Q. 95 (6th Cir. 1979).

¹⁰⁹ See *Unarco Indus., Inc.*, 465 F.2d at 1304-05, 175 U.S.P.Q. at 200.

¹¹⁰ See *id.* at 1305, 175 U.S.P.Q. at 200.

¹¹¹ See *id.* at 1304, 175 U.S.P.Q. at 199.

¹¹² See *id.* at 1306, 175 U.S.P.Q. at 200.

¹¹³ See *id.*

¹¹⁴ See *PPG Indus., Inc.*, 597 F.2d at 1091-93, 202 U.S.P.Q. at 95-96.

no rights to assign the license without the consent of the plaintiff.¹¹⁵ When the licensee merged with the defendant and continued to use the plaintiff's license, the plaintiff sued for infringement.¹¹⁶ The Court of Appeals for the Sixth Circuit held that the surviving corporation/defendant did not acquire license rights from the acquired corporation/licensee.¹¹⁷

The *PPG Industries* court adopted the *Unarco Industries* court's rules and held that (1) federal law controls issues with respect to the assignability of a patent license and (2) that patent licenses are personal, and therefore not assignable unless expressly made so.¹¹⁸ The court's most significant comment was in response to the defendant's assertion that a transfer did not occur because the defendant and licensee had merged pursuant to Ohio statute.¹¹⁹ The court stated, "[a] transfer is no less a transfer because it takes place by operation of law rather than by a particular act of the parties. The merger was effected by the parties and the transfer was a result of their act of merging."¹²⁰ Thus, the *PPG Industries* court articulated the default rule: transfers of a patent license that occur by operation of law in a merger will violate an anti-assignment clause in the license, even where the license does not define assignment to include transfers by operation of law.¹²¹

b) District Court Decisions

Acceptance of the *PPG Industries* court's rule remains unsettled because district court decisions both support and reject the *PPG Industries* court's reasoning. Two district court cases, *Lightner v. Boston & A.R. Co.*¹²² and *Hartford-Empire Co. v. Demuth Glass Works, Inc.*,¹²³ have been cited as support for the notion that patent rights transfer by operation of law.¹²⁴ Both

¹¹⁵ *See id.* at 1092, 202 U.S.P.Q. at 96. Conversely, the license issued by the licensee to the plaintiff stated that the license would be assignable by the plaintiff to any successor of the plaintiff's business. *See id.*

¹¹⁶ *See id.* at 1093, 202 U.S.P.Q. at 97.

¹¹⁷ *See id.* at 1095, 202 U.S.P.Q. at 99.

¹¹⁸ *See id.* at 1093, 202 U.S.P.Q. at 97.

¹¹⁹ *See id.* at 1096, 202 U.S.P.Q. at 99.

¹²⁰ *Id.*

¹²¹ *See id.*

¹²² 15 F. Cas. 514 (D. Mass. 1869).

¹²³ 19 F. Supp. 626 (E.D.N.Y. 1937).

¹²⁴ *See Harris, supra* n. 24, at 891.

these cases are distinguishable from *PPG Industries* and should not be interpreted as support for a view that opposes the rule articulated by the *PPG Industries* court. Two other district courts, however, have ruled on precisely the same issue – one opposing the approach adopted by the *PPG Industries* court, while the other adhering to it.

The earliest federal case that deals with the transferability of a patent license is *Lightner*.¹²⁵ Although the transaction in *Lightner* involved the transfer of a patent license pursuant to a merger, the case does not offer any insight because the court's ruling is not based on Massachusetts' merger statute.¹²⁶ Instead, the court analyzed the terms of the license and whether the licensee permitted transfers.¹²⁷ The court examined whether the license was personal and whether the patentee would sustain injuries if the transfer were permitted.¹²⁸ The *Lightner* decision offers no support for the position that federal law permits the transfer of patent licenses when two corporations merge because the court did not rely on the merger statute, nor did it discuss the implication of that statute to the transaction.¹²⁹

In *Hartford-Empire*, the court noted that the rights under a patent license transfer by operation of law in a merger.¹³⁰ However, the facts differ from the *PPG Industries* case. In *Hartford-Empire*, the party asserting the assignability of the patent license was an original licensee that received an assignable, exclusive license.¹³¹ Distinguishable from *PPG Industries*, the original licensee had the right to assign the license,¹³² whereas the licensee in *PPG Industries* did not.¹³³ In *Hartford-Empire*, the license agreement spoke directly to “an exclusive, assignable, and divisible license to make and sell

¹²⁵ In *Lightner*, the patentee issued two separate licenses to two railroad companies. The two railroad companies merged and the new corporation continued to use the license. The patentee sued the newly formed corporation for infringement. See Harris, *supra* n. 24, at 891.

¹²⁶ See *Lightner*, F. Cas. at 514-15 (trial court analyzed the terms of the license agreement to reach its decision).

¹²⁷ See *id.* at 515. The license granted unlimited use and did not discuss the possibility of a merger. See *id.*

¹²⁸ See *id.*

¹²⁹ See *id.*

¹³⁰ 19 F. Supp. 626, 627 (E.D. N.Y. 1937).

¹³¹ See *id.* The court stated “[the] merger conveyed to the new corporation all the assets of the old company, including equitable rights, such as licenses under the patents, owned by the old corporation.” *Id.*

¹³² See *id.*

¹³³ See *PPG Indus., Inc.*, 597 F.2d at 1092, 202 U.S.P.Q. at 96.

apparatus and to use or license others.”¹³⁴ In contrast, the transfer in *PPG Industries* had a restriction “on transferability and assignability preventing the patent licenses becoming the property of third parties.”¹³⁵ Therefore, *Hartford-Empire* does not support a view that conflicts with the *PPG Industries* court’s rule.

District courts in New Jersey and Rhode Island, however, have ruled on the same issue. The District Court of Rhode Island opposes the approach adopted by the *PPG Industries* court and the District Court of New Jersey adheres to the *PPG Industries* decision. The District Court of New Jersey in *Westinghouse Electric & Mfg. Co. v. Radio-Craft Co., Inc.*¹³⁶ applied a rule similar to the rule adopted by the *PPG Industries* court. The case involved a defendant company that acquired the stock of a company that had a limited license to use the patentee’s invention.¹³⁷ The license prohibited transfers and assignments.¹³⁸ The court found that the defendant intended to acquire the licensee for the purpose of obtaining the license, which the licensee held.¹³⁹ The court determined that there is no difference between a corporation gaining control of a company for purposes of obtaining a patent license and having the license transferred voluntarily to the acquiring company.¹⁴⁰

The only district court decision that rejects *PPG Industries* outright is *Syenergy Methods, Inc. v. Kelly Energy Sys., Inc.*¹⁴¹ The *Syenergy Methods* case arises out of an earlier case that was settled by an agreement that included a covenant not to sue.¹⁴² The issue addressed in *Syenergy Methods* is whether the earlier covenant not to sue prevents a claim of infringement by the patentee when a new corporation is formed acquiring the covenant not to sue.¹⁴³ The court stated the *PPG Industries* court’s rule is not absolute.¹⁴⁴ The court commented that the general rule, licenses are personal to the licensee, does not apply in cases where the assignment results from a transformation

¹³⁴ *Hartford-Empire*, 19 F. Supp. at 627.

¹³⁵ *See PPG Indus., Inc.*, 597 F.2d at 1096, 202 U.S.P.Q. at 99.

¹³⁶ 291 F. 169 (D.N.J. 1923).

¹³⁷ *See id.* at 170-71.

¹³⁸ *See id.* at 170.

¹³⁹ *See id.* at 174.

¹⁴⁰ *See id.*

¹⁴¹ 695 F. Supp. 1362 (D.R.I. 1988).

¹⁴² *See id.* Although the agreement was not a license, the court analyzed the transfer as though the covenant not to sue was a patent license. *See id.* at 1366.

¹⁴³ *See id.* at 1363-64.

¹⁴⁴ *See id.* at 1366.

of the legal form of the licensee/assignee.¹⁴⁵ The court added, “where there has been a continuation, the argument that the patent license is not assignable is inapplicable.”¹⁴⁶

Although at least one district court has rejected *PPG Industries*, the federal rule remains unchanged.¹⁴⁷ Among the federal circuits, only the Sixth Circuit has rendered a decision that offers a basis for a federal rule.¹⁴⁸ The *Unarco Industries* court’s decision suggests that the Seventh Circuit is committed to supporting the Patent Act, the underlying policies, and would be willing to adopt the *PPG Industries* court’s rule.¹⁴⁹ The other circuits have not provided any guidance. Without a conflicting view from any of the other circuits or the Supreme Court, the *PPG Industries* decision provides the only basis for a federal rule regarding the transfer of patent licenses in the context of mergers. As a policy matter, the *PPG Industries* court’s rule is the most sensible approach to harmonizing the various interests intertwined when a company acquires the assets, which includes a patent license, of a target company. The *PPG Industries* rule recognizes the unique federal interests promoted through the Patent Act and realizes that those policy objectives would be comprised by a conflicting rule that favors free alienation of patent licenses.

However, the *PPG Industries* court’s rule is the default rule. Parties to a patent license may agree otherwise.¹⁵⁰ For example, the parties may add explicit language in the license to permit assignments, including transfers by operation of law.¹⁵¹ Alternatively, permission may be implied through the conduct of the patentee.¹⁵²

¹⁴⁵ See *id.*

¹⁴⁶ See *id.*

¹⁴⁷ District courts do not create federal law – this authority rests with the United States Supreme Court and the Federal Courts of Appeals. See *e.g.*, *U.S. v. Glasser*, 14 F.3d 1213 (7th Cir. 1994) (a district court within the Seventh Circuit is bound by the decisions of the Seventh Circuit Court of Appeals); see generally *Hart v. Massanari*, 266 F.3d 1155, 1163 (9th Cir. 2001) (trial court decisions are not binding).

¹⁴⁸ See *PPG Indus., Inc.*, 597 F.2d 1090, 202 U.S.P.Q. 95 (6th Cir. 1979).

¹⁴⁹ See *Unarco Indus., Inc.*, 465 F.2d at 1303, 175 U.S.P.Q. at 199.

¹⁵⁰ See generally *PPG Indus., Inc.*, 597 F.2d at 1095, 202 U.S.P.Q. at 99.

¹⁵¹ See *e.g.* *Hawkinson v. Carnell*, 112 F.2d 396, 398, 45 U.S.P.Q. 536 (3rd Cir. 1940) (a patent license transferred by operation of law is permitted where the license states that “it is mutually agreed that the Licensee shall have the right to assign this contract . . .”).

¹⁵² See *e.g.* *Lane & Bodley Co. v. Locke*, 150 U.S. 193, 200 (1893). Although the Court stated that the patentee acquiesced to the successor corporation’s use of the license, which resulted in an implied license to the successor corporation, the Court’s reasoning indicates that the theory upon which the patentee’s claim was dismissed was actually implied waiver. See *id.* at 200-01; but *cf.* *King v. Anthony Pools, Inc.*, 202 F. Supp. 426,

C. Three Approaches

A patentee who wishes to preserve his or her exclusive rights to a patented invention should consider the rules that govern assignment of patent licenses. In the context of a merger and a transfer that occurs by operation of law, there are three controlling principles that may help to prevent an unwanted transfer of a patent license to an unknown or undesirable third party. First, the patentee may issue a license without any restrictions on assignment or transfer. Under this approach, the patentee could assert the rule from *Troy Iron & Nail factory v. Corning*¹⁵³ – a patent license is personal and not transferable, unless the license contains words to the contrary – to contest any attempts to transfer the license.¹⁵⁴ However, this would not be the prudent approach to drafting a patent license in light of the uncertainty that lingers as to whether all courts will follow *Unarco Industries* and *PPG Industries*. Under the second approach, the patent license will include a general anti-assignment clause. Under the rule from *PPG Industries*, a transfer by operation of law that occurs in a merger constitutes an assignment and will violate an anti-assignment restraining provision.¹⁵⁵ However, not all district courts have accepted this rule; thus, a patent holder, especially one that is not governed by the Court of Appeals for the Sixth Circuit's rules, should think twice before relying solely on a general anti-assignment clause.

Under the final and most prudent approach, the patentee will include an anti-assignment clause in the patent license and a provision that explicitly states that a transfer that occurs by operation of law shall be an assignment. No case has addressed the enforceability of such a provision in a patent license. However, courts have enforced these provisions in other contexts, such as real estate leases.¹⁵⁶ Although *PPG Industries* is the only standing decision on the issue, the prudent patent holder will include explicit language in the license, rather than relying on common law default rules, which have not been universally embraced by all courts.

430, 133 U.S.P.Q. 300, 302 (S.D. Cal. 1962) (although the plaintiff/patentee permitted his employer, the acquired company, to use his patented device, there was no license; assuming a license existed, the acquiring company did not acquire rights to use the patented device by acquiring the employer).

¹⁵³ 55 U.S. 193 (1852).

¹⁵⁴ See *id.* at 216.

¹⁵⁵ See *PPG Indus., Inc.*, 597 F.2d at 1096, 202 U.S.P.Q. at 99.

¹⁵⁶ See *e.g. Pacific First Bank*, 876 P.2d at 765; see also *e.g. Citizens Bank & Trust Co. of Maryland*, 456 A.2d 1283, 1289 (Md. 1983).

IV. CONCLUSION

In order for the patent system to accomplish its intended objective, inventors must be assured the benefits of their labor. This assurance encourages inventors to share their discoveries with others without fear of having their idea misappropriated. Patent licenses play an important role in the promotion of processes and federal courts have acted appropriately to protect the policies that underlie the Patent Act. Rules that promote free alienation of licenses would only undermine the rights granted to an inventor under the Patent Act. The federal rules recognize and perpetuate the importance of protecting the exclusive rights of the patentee. However, states continually interpret patent licenses under contract law or merger statutes availing the patentee to unwanted third party licenses. Thus, a license should include an anti-assignment clause with additional language explaining the meaning of the assignment.