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Merger may result in improper transfer of intellectual property license agreement

By Jeffrey H. LaBarge

In *Cincom Systems, Inc. v. Novelis Corp.*, 2009 WL 3048436 (6th Cir., September 25, 2009), the Sixth Circuit Court of Appeals affirmed and explained its prior holding that a merger may constitute an impermissible transfer of an intellectual property license, absent text in the license agreement to the contrary.

The synergies and other benefits upon which the decision to enter into a merger is based typically assume that the surviving entity will have the same right to use all of the assets held by the constituent parties to the merger. One such asset may be a license agreement permitting the use of intellectual property that is owned by a third party. However, unless the license agreement specifically permits assignment or transfer, the surviving entity in a merger may not be able to continue to use the intellectual property licensed by the other party to the merger.

In the *Cincom* case, Alcan Rolled Products Division (Alcan Ohio), an Ohio corporation wholly owned by Alcan, Inc., licensed certain software from Cincom Systems, Inc. pursuant to the terms of a license agreement. The agreement provided that the license was “non-exclusive and non[-] transferable” and did not permit Alcan Ohio to “transfer its rights or obligations under [the license agreement] without the prior written approval of Cincom.” The license agreement also required that the software be used only on a specific computer in Alcan Ohio’s Oswego, New York, facility.

As part of an internal corporate restructure, Alcan Ohio underwent a series of mergers with other subsidiaries of Alcan, Inc. As a result, Alcan Ohio was merged out of existence, with the surviving corporation being Novelis Corp. Although the software at issue remained on the specific computer in the Oswego, New York, facility as required by the terms of the license agreement, that facility was now owned by Novelis, not Alcan Ohio. Accordingly, Cincom claimed that the merger resulted in an impermissible transfer of the license from Alcan Ohio to Novelis without Cincom’s consent.

The *Cincom* court began by noting its holding in the case of *PPG Industries, Inc. v. Guardian Industries Corp.* (PPG), 597 F.2d 1090 (6th Cir., 1979) that a patent license is presumed to be non-assignable and non-transferable in the absence of an express provision in the license agreement to the contrary. The court explained that, while state law generally permits free assignability of contracts absent the

parties' agreement to the contrary, and that federal common law generally presumes that an intellectual property license is not assignable unless expressly set forth in the agreement, when interpreting intellectual property licenses, state law may govern only in a manner that is not inconsistent with federal law. The *Cincom* court explained that “[a]llowing state law to permit the free assignability of patent or copyright licenses would ‘undermine the reward that encourages invention’...because any entity desiring to acquire a license could approach either the original inventor or one of the inventor’s licensees.” Accordingly, the court ruled that state law permitting free assignability of contracts must yield to the federal common law rule that an intellectual property license is presumed to be non-assignable and non-transferable in the absence of an express provision in the license to the contrary.

The court then went on to address Novelis’s argument that the *PPG* case is distinguishable because, in that case, the merger resulted in the license rights vesting in a competitor of PPG. Although the primary reason for the federal common law rule is to prevent the transfer of a license without authorization to a competitor of the licensor, the court stated that the fact that Novelis is not a competitor of Cincom was immaterial.

The court next addressed Novelis’s argument that Ohio’s merger statute, which was changed since the ruling in the *PPG* case, distinguishes the outcome of the *PPG* holding from this case. When *PPG* was decided, the Ohio merger statute provided that “all property of a constituent corporation shall be deemed to be transferred to and vested in the surviving or new corporation without further act or deed.” Subsequent to the *PPG* holding, Ohio’s merger statute was revised to read that “[t]he surviving or new entity possesses all assets and property of every description...all of which are vested in the surviving or new entity without further act or deed.” Novelis argued that the deletion of the word “transfer” from the Ohio merger statute prevents a finding that the merger resulted in a transfer of the license agreement. The *Cincom* court, noting that the *PPG* holding “did not hang by so slender a thread,” explained that “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. The deletion of the word [‘]transferred[’] does not change this.” In sum, the *Cincom* court ruled that, “in the context of a patent or copyright license, a transfer occurs any time an entity other than the one to which the license was expressly granted gains possession of the license.”

A few important points also are worth noting about the scope of the *Cincom* decision. *Cincom* expands the *PPG* ruling to cover not only patent licenses, but copyright licenses as well. In doing so, the *Cincom* court noted that “[i]n copyright cases such as this, we refer to case law interpreting patent law ‘because of the historic kinship between patent law and copyright law,’” citing *Sony Corp. of America v. Universal City Studios, Inc.*, 464 U.S. 417, 439, 104 S.Ct. 774 (1984). Furthermore, although the *Cincom* court’s ruling is authoritative only for federal courts within the Sixth Circuit, there are very few judicial opinions on this topic and other courts may find the *Cincom* holding persuasive, especially in light of the explanation provided of its prior holding in the *PPG* case, which addressed and rejected a number of arguments by which the *PPG* case could have been distinguished. Finally, the *Cincom* court did not address whether a transfer occurs when the licensee is the surviving entity in a merger. However, that issue has been addressed by other courts; see, for example, *SQL Solutions, Inc. v. Oracle Corp.*, 1991 WL 626458 (N.D.Cal., December 18, 1991) (holding that a software license held by the surviving entity in a reverse triangle merger was improperly transferred as the licensee went through a fundamental change in its form of ownership).

Many business and legal issues are involved in deciding whether to enter into a merger transaction. It is often easy to overlook the effect the transaction may have on assets such as intellectual property license agreements, as parties tend to believe that a merger does not result in a transfer or assignment of the license that could affect the parties' rights under the license agreement. However, if your company is considering a merger, whether with a third party or for internal reorganization purposes, it is important that intellectual property contracts be carefully reviewed and analyzed to determine if the merger may have an effect on the surviving entity's ability to use the intellectual property at issue. Without a clear understanding of that matter, you may find that you have inadvertently lost some of the benefits the merger was intended to provide.

For more information on this issue, please contact your regular Nixon Peabody attorney or:

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