IP Licenses: Restrictions on Assignment and Change of Control

Elaine D. Ziff and John G. Deming, Skadden, Arps, Slate, Meagher & Flom LLP

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This Note discusses US law relating to the transferability of agreements that contain intellectual property (IP) licenses. It includes guidance on evaluating assignability, dealing with non-assignable licenses in M&A transactions and drafting tips for assignment provisions in favor of a licensor or licensee. It also considers issues relating to the transferability of IP licenses in the context of bankruptcy and secured transactions and change-of-control provisions.

The transferability of intellectual property (IP) license agreements requires special consideration because the default rules differ from the treatment of many other agreements. In particular, a licensee's rights are generally not assignable unless the license agreement expressly permits assignment or the licensor otherwise consents.

Understanding whether a particular IP license is transferable is important for two reasons:

- Parties negotiating license agreements must consider clauses that are necessary to prohibit or permit the transfer of the agreement under various future circumstances, for example, a corporate reorganization or a sale of the business.
- Buyers and sellers of companies must consider the effect a proposed transaction may have on existing agreements so that:
  - if the target will lose its license rights, the buyer can either require that the licensor's consent to the transfer of the agreement be a condition precedent to closing or, alternatively, negotiate other adjustments; and
  - the parties can appropriately tailor the purchase or merger agreement and related disclosure schedules to address agreements that require licensor's consents for transfer.

This Note discusses US law relating to the transferability of agreements that contain IP licenses and includes guidance on evaluating assignability, dealing with non-assignable licenses in M&A transactions and drafting assignment provisions. It also considers issues relating to the transferability of IP licenses in the context of bankruptcy and secured transactions, and change-of-control provisions.

TRANSFERABILITY OF CONTRACTS

DEFAULT RULES: CONTRACTS GENERALLY

Under basic contract law, a contract that is silent on assignment is generally freely transferable unless either:

- A statute or public policy provides otherwise.
- There are material adverse consequences to the non-assigning party.

(*Restatement (Second) of Contracts § 317(2) (1981)*; see also *UCC § 2-210 (1)(a) (2003)*.)

A personal services agreement is an example of a contract where public policy weighs against assignment of the service provider's obligations.

DEFAULT RULES: IP LICENSES

Where an IP license is silent on assignability by the licensor, the licensor can generally assign its rights, subject to the same considerations as other types of contracts. Absent special circumstances, the licensed IP, not the licensor's identity, is the main attraction of the license to the licensee. This benefit presumably can be provided by whoever owns the IP. In cases where a license grant was found binding against a subsequent owner of the licensed IP, courts have not addressed whether public policy precludes this result (see *Am. Dirigold Corp. v. Dirigold Metals Corp., 125 F.2d 446, 452 (6th Cir. 1942)* (*Am. Dirigold*), *Sanitec Indus. v. Micro-Waste Corp., No. H-04-3066, 2006 U.S. Dist. LEXIS 86803, at *106 (S.D. Tex. Nov. 28, 2006)* (quoting *Am. Dirigold*); see also *ICEE Distribs., Inc. v. J&J Snack Foods Corp., 325 F.3d 586, 593 (5th Cir. 2003)*).

By contrast, where an IP license is silent on assignability by the licensee, the majority of courts have found that a licensee's rights are presumed not assignable without the licensor's express consent.

Federal Policy Reasons

Authors and inventors enjoy protection under the Constitution. Congress has the power to promote the progress of science and the useful arts by securing to authors and inventors the exclusive rights to their respective works and inventions for a limited time (*U.S. Const. art. I, § 8, cl. 8*). Copyrights and patents give authors and inventors these rights under the federal copyright and patent laws.

Federal policy derived from these constitutional rights favors a copyright proprietor's or patentee's ability to control the identity of its licensees. As a result, courts have treated patent and copyright license agreements similar to personal services contracts (see *Rhone-Poulenc Agro, S.A. v. DeKalb Genetics Corp., 284 F.3d 1323, 1328 (Fed. Cir. 2002)* (patent license), *Harris v. Emus Records Corp., 734 F.2d 1329, 1334 (9th Cir. 1984)* (copyright license) and *In re Buildnet, Inc., No. 01-82293 et al., 2002 Bankr. LEXIS 1851, at *15-17 (Bankr. M.D.N.C. Sept. 20, 2002)* (*Buildnet*) (software license)).

Trademarks have different legal underpinnings. Trademarks are protected under:

- The federal Lanham Trademark Act.
- State laws covering unfair competition and other business torts, state trademark registration statutes, consumer protection statutes and common law.

Any Constitutional basis for trademark protection stems from the Commerce Clause (*U.S. Const. art 1, Section 8, cl.3*; see generally *In re Trade-mark Cases, 100 U.S. 82, 93-95 (1879)*). Unlike patents and copyrights, the purpose of trademarks is primarily to prevent customer confusion and to protect the public's expectation as to the source and quality of goods or services, rather than advancing technology or creativity (see *J. Thomas McCarthy, Trademarks and Unfair Competition §§ 6:2-6:3 (West, 2011)* (*McCarthy*) and *Sony Corp. of Am. et al. v. Universal City Studios, Inc., 464 U.S. 417, 439 n. 19 (1984)* (*Sony*)).

The underlying policy distinction between patents and copyrights compared to trademarks could theoretically support different default rules on the assignability of the licensee's rights. However, many courts and commentators considering the issue have held that trademark licenses are to be treated similarly to patent and copyright licenses (see, for example, *In re XMH Corp., 647 F.3d 690, 695 (7th Cir. 2011)* (*XMH*); see also *In re N.C.P. Mktg. Grp. Inc., 337 B.R. 230, 235-236 (D. Nev. 2005)* (*N.C.P.*)).

CONTRACTING AROUND THE DEFAULT RULE

Parties can always contract around these default rules (see *Drafting Considerations*). Contract terms expressly allowing or prohibiting transferability are generally enforceable.

Even if an IP license includes provisions addressing assignment, questions may still arise concerning the transferability of a licensee's rights:

- If the assignment provision is ambiguously drafted.
- If the type of transaction at issue, such as a merger or stock sale, is not expressly contemplated by the applicable provision.
- In the bankruptcy context, where an anti-assignment clause is typically read out of the agreement under Section 365(c) of the Bankruptcy Code (see *Bankruptcy Issues*).

EVALUATING ASSIGNABILITY ISSUES

In addition to the express language of any clause addressing assignment or change of control, several other factors are relevant when analyzing a licensee's ability to transfer its rights without the licensor's consent:

- The application of federal versus state law (see *Federal versus State Law*).
- The nature of the IP involved and the exclusivity of the license (see *Type of IP License Agreement*).
- The type of transaction purporting to effect the transfer (see *What Corporate Transactions Constitute an Assignment?*).
- Other factual considerations (see *Factual Considerations*).

FEDERAL VERSUS STATE LAW

A threshold issue to the determination of assignability is whether federal or state law applies.

FEDERAL LAW GENERALLY GOVERNS ASSIGNABILITY

State law generally governs the assignability of contracts. However, because most IP is established under federal law, the majority of modern courts have held that federal common law governs the assignment of IP licenses (see, for example, *Cincom Sys., Inc. v. Novelis Corp., 581 F.3d 431, 436 (6th Cir. 2009)* (*Cincom*) (patent and copyright licenses), *Gardner v. Nike, Inc., 279 F.3d 774, 780-81 & n.5 (9th Cir. 2002)* (*Gardner*) (copyright license), *N.C.P., at 235-36* (trademark license) and *Everex Sys., Inc. v. Cadtrak Corp. (In re CFLC, Inc.), 89 F.3d 673, 677 (9th Cir. 1996)* (*CFLC*)).

Trade secret licenses are an exception because trade secrets are protected by state law (see *Trade Secret Licenses*). However, agreements licensing trade secrets often include licenses to other types of IP.

A few courts, particularly in California, have held that state law applies to the assignability of IP licenses (see, for example, *Superbrace, Inc. v. Tidwell, 21 Cal.Rptr.3d 404, 407, 409-10 (Cal. Ct. App. 2004)* (*Superbrace*) (patent license); see also *White v. Hitachi, Ltd., No. 3:04-CV-20, 2007 U.S. Dist. LEXIS 68765, at *20 (E.D. Tenn. Sept. 17, 2007)* (*Hitachi*)). If state law applies, then the court may engage in a factual analysis of whether the particular license is analogous to a personal services contract (see, for example, *Superbrace, at 414-416*).

In the context of trademark licenses, the US Court of Appeals for the Seventh Circuit observed, *in dicta*, that the debate over federal versus state law is irrelevant because, whether the law governing the assignability of trademark licenses is state, federal or foreign, the default rule favoring non-assignability is the same (*XMH, at 695*).

STATE LAW GOVERNS WHETHER AN ASSIGNMENT OCCURRED

The question of whether a license in fact has been assigned is controlled by state law (see, for example, *Netbula, LLC v. BindView Dev. Corp., 516 F. Supp. 2d 1137, 1148 (N.D. Cal. 2007)* (*Netbula*) and *Beghin-Say Int'l Inc. v. Ole-Bendt Rasmussen, 733 F.2d 1568, 1571 (Fed. Cir. 1984)*).

For example, in a merger, the applicable state merger statute or statutes may determine whether the merger causes an assignment of an IP license held by the constituent entities (see *Mergers*).

TYPE OF IP LICENSE AGREEMENT

The type of licensed IP and the exclusivity of the license grant are both factors in evaluating the assignability of an IP license.

EXCLUSIVITY GENERALLY

Regardless of the type of IP, non-exclusive licenses have almost unanimously been found non-assignable by a licensee without the licensor's consent. This is supported by the federal policy protecting IP owners (see *Federal Policy Reasons*). There is also an argument that a non-exclusive license is similar to a mere covenant-not-to-sue the licensee for infringement. Courts typically consider covenants-not-to-sue inherently personal to the recipient (see, for example, *CFLC, at 679* and *Murray v. Franke-Misal Techs. Grp., LLC (In re Supernatural Foods, LLC), 268 B.R. 759, 798-802 (Bankr. M.D. La. 2001)* (*Supernatural Foods*)).

Fewer cases have addressed the assignability of the licensee's rights under exclusive licenses.

It can be argued that an exclusive license represents the grant of a property interest to the licensee rather than a mere contractual right to use the licensed IP. Nevertheless, the licensor has a similar interest in controlling the identity of its licensees, whether the license is exclusive or non-exclusive. For this reason, an increasing number of recent decisions appear to ignore the distinction between exclusive and non-exclusive licenses or find it irrelevant to the default rule, with the exception of copyright licenses.

PATENT LICENSES

Non-exclusive Patent Licenses

On the basis of federal policy protecting the patent owner, non-exclusive patent licenses have been found to be presumptively non-assignable by the licensee (see, for example, *CFLC, at 679-80*, *PPG Indus., Inc. v. Guardian Indus. Corp., 597 F.2d 1090, 1093-94 (6th Cir. 1979)* (*PPG*) and *Board of Regents v. BASF Corp., 2007 U.S. Dist LEXIS 82492, at *36-37 (D. Neb. Nov. 5, 2007)* (*Board of Regents*)).

Exclusive Patent Licenses

The trend is moving toward treating exclusive patent licenses the same way as non-exclusive licenses concerning non-assignability of the licensee's rights (see, for example, *ProteoTech, Inc. v. Unicity Int'l, Inc., 542 F. Supp. 2d 1216, 1219 & n.2 (W.D. Wash. 2008)* and *In re Hernandez, 285 B.R. 435, 440-42 (Bankr. D. Ariz. 2002)* (*Hernandez*)).

Nevertheless, in *Superbrace*, a California appellate court, relying on California Supreme Court precedent from 1957, found that a particular patent license (which happened to be exclusive) was assignable under state contract law principles, noting that there is no reason to exempt patent licenses from general rules (see also *Hitachi, at *20*).

COPYRIGHT LICENSES

Courts recognize the similar constitutional origins of copyright and patent law (see *Sony, at 439*) and have treated copyright and patent licenses similarly in many contexts. However, the analysis of exclusive copyright licenses raises distinct issues under the Copyright Act (see *Exclusive Copyright Licenses*).

Non-exclusive Copyright Licenses

Like patent licenses, non-exclusive copyright licenses have virtually unanimously been found non-assignable without the licensor's consent (see *In re Patient Educ. Media, Inc., 210 B.R. 237, 240, 242-43 (Bankr. S.D.N.Y. 1997)* (*Patient Educ.*), *In re Golden Books Family Entm't, Inc., 269 B.R. 311, 314, 316-17 (Bankr. D. Del. 2001)* (*Golden Books*) and *Buildnet, at *14-15*).

Exclusive Copyright Licenses

The law concerning exclusive copyright licenses is less developed. From a statutory perspective, exclusive copyright licenses are distinguishable from non-exclusive copyright licenses.

The Copyright Act defines an exclusive copyright license as a "transfer of copyright ownership" (*17 U.S.C. § 101*). The owner of any exclusive right in a copyright is entitled to all protections and remedies of a copyright owner (*17 U.S.C. § 201(d)(2)*). Because a copyright owner's rights include the right to transfer ownership, several cases and a leading copyright commentator support the position that an exclusive copyright license should be freely assignable by the licensee, absent contrary provisions in the agreement (see *Traicoff v. Digital Media, Inc., 439 F. Supp. 2d 872, 877 (S.D. Ind. 2006)*, *Golden Books, at 318* and *3 Melville B. Nimmer & David Nimmer, Nimmer on Copyright § 10.02 (2010)*).

However, the US Court of Appeals for the Ninth Circuit took the opposite position in *Gardner*, which involved the grant of an exclusive sublicense. Based on legislative history, policy considerations and statutory construction, the court in *Gardner* concluded that a licensee must seek a licensor's consent to assign an exclusive copyright license to ensure that the licensor can monitor the use of its copyright (*Gardner, at 781)*).

TRADEMARK LICENSES

In evaluating the assignability of trademark licenses, the concern is less that a competitor may gain control of the license, thereby undermining the benefits that the patent or copyright "monopoly" is meant to provide to authors and inventors. Rather, the trademark owner is viewed as having an important interest in the party to whom its trademark is licensed so that it can maintain the goodwill, quality and value of its product and, therefore, its trademark (see *XMH, at 696*, *N.C.P., at 236* and *McCarthy § 25:33*). In *Miller v. Glenn Miller Prods., Inc.*, a presumption against sublicensing of trademarks without the licensor's consent was extended to rights of publicity on similar grounds (*454 F.3d 975 (9th Cir. 2006)* (*Miller*)).

The uniqueness of trademarks compared to other types of IP was recognized indirectly by the Supreme Court, when the Court denied a petition of certiorari from the US Court of Appeals for the Ninth Circuit's decision affirming the district court decision in *N.C.P.* (*In re N.C.P. Mktg. Grp. Inc., 279 F. App'x 561 (9th Cir. 2008)*). The bankruptcy issue before the Court was whether a non-assignable contract is assumable by a debtor-in-possession. Justice Kennedy, joined by Justice Breyer, explained in a statement that he agreed not to grant certiorari because the contract at issue was a trademark license (*N.C.P. Mktg. Group, Inc. v. BG Star Prods., Inc., 129 S. Ct. 1577 (2009)* (*N.C.P. S. Ct.*)). This would require the Court to first interpret "antecedent questions under state law and trademark-protection principles" (*N.C.P. S. Ct., at 1578*). By contrast, Justices Kennedy and Breyer noted that patent and copyright licenses are examples of non-assignable contracts.

Non-exclusive Trademark Licenses

Non-exclusive trademark licenses have been generally treated the same as non-exclusive copyright and patent licenses (see *N.C.P., at 236-37*).

Courts have applied the same deference to a trademark licensor's rights to select its licensees that courts have applied to patent and copyright licensors (see *N.C.P., at 236*, *Tap Publ'ns, Inc. v. Chinese Yellow Pages (New York) Inc., 925 F. Supp. 212, 218 (S.D.N.Y. 1996) (Tab Publ'ns)*; see also *McCarthy, § 25:33*).

Exclusive Trademark Licenses

Recent decisions have included broad pronouncements regarding the presumptive non-assignability of trademark licenses that do not distinguish exclusive and non-exclusive licenses (see *XMH, at 695*; see also *Miller*).

However, a few courts have treated exclusive trademark licenses like ordinary contracts concerning their assignability, although the exclusivity of the license did not control the analysis. These decisions allowed the licensee's assignment of an exclusive trademark license because:

- In *Regal Ware, Inc. v. Global Home Prods. LLC (In re Global Home Prods. LLC)* and *In re Rooster, Inc.* the courts did not find the trademark license to be similar to a personal services contract (*No. 06-10340, 2006 WL 2381918, at *1 (D. Del. Aug. 17, 2006)* and *100 B.R. 228, 233-35 (Bankr. E.D. Pa. 1989)*).
- In *In re Rooster Inc.* the court also found that the licensor's interest in the quality of the licensee's goods was addressed by the licensor's right to stringently supervise the licensee (see also *In re Sunrise Restaurants Inc., 135 B.R. 149, 152-53 (Bankr. M.D. Fla. 1991)*).

TRADE SECRET LICENSES

If a license agreement solely covers trade secrets, which are established under state law, then the relevant state law governing the agreement should control its interpretation (see *Pitney-Bowes, Inc. v. Mestre, 517 F. Supp. 52, 59 (S.D. Fla. 1981)* and cases cited in that decision). For example, in *M.D. Mark, Inc. v. Kerr-McGee Corp.*, the US Court of Appeals for the Tenth Circuit upheld a jury's finding that the transfer by merger of a non-transferable trade secret license was prohibited, without reference to federal IP policies (*565 F.3d 753, 762-63 (10th Cir. 2009)* (*M.D. Mark*)).

For agreements licensing both trade secrets and patents, there may be conflict between federal patent law and state trade secret law. Based on supremacy principles, federal law should determine the rights under the agreement to the extent that enforcement of trade secret law conflicts with the enforcement of patent law (see *Pitney-Bowes, Inc. v. Mestre, 701 F.2d 1365, 1372 n.12 (11th Cir. 1983)*). The same result would be expected in the less common case of a hybrid copyright and trade secret license agreement.

Trade secret licenses typically contain confidentiality provisions that limit the use and disclosure of the secrets.

Some courts have found that confidentiality provisions provide a separate basis to prohibit the assignment of a trade secret license without the licensor's consent (see *Buildnet, at *4-5, *16*; see also *M.D. Mark, at 755-64*).

Cases have reached differing outcomes on the assignability of trade secret licenses based on evaluation of harm to the licensor arising from the transfer, the interpretation of the applicable merger statutes and contract construction principles:

- The Texas Courts of Appeals noted that, a merger between related entities did not necessarily constitute a prohibited transfer of licensed trade secrets because the contract did not address mergers (*TXO Prod. Co. v. M.D. Mark, Inc., 999 S.W.2d 137, 141-43 (Tex. App. 1999)* (*TXO*)).
- The Delaware Court of Chancery did not prevent a licensor's transfer of a confidential technology and related license agreement because the alleged harm to the licensee was not related to the disclosure of any secrets under that particular transaction (*Eastman Kodak Co. v. Cetus Corp., No. 12,249, 1991 Del. Ch. LEXIS 197, at *16-17 (Del. Ch. Dec. 3, 1991)* (*Eastman Kodak*)).
- The Massachusetts Superior Court found that a reverse merger with a subsidiary of the licensor's competitor did not cause an impermissible assignment of trade secret license, in part, because no disclosure of confidential information to the competitor actually occurred (*PharMetrics, Inc. v. Source Healthcare Analytics, Inc., No. 054791BLS1, 2006 WL 3201065, at *3, *5 (Mass. Super. Sept. 5, 2006)* (*PharMetrics*)).
- The New York State Supreme Court of New York County noted that an impermissible assignment of the license posed a risk of irreparable injury that the licensor's confidential information will fall into the hands of a competitor (*Biosynexus, Inc. v. Glaxo Group Ltd., 11 Misc. 3d 1062(A), 816 N.Y.S.2d 693, at *7 (Sup. Ct. N.Y. County 2006)* (*Biosynexus*)).

WHAT CORPORATE TRANSACTIONS CONSTITUTE AN ASSIGNMENT?

The second prong of the analysis of whether an IP license is assignable is the nature of the transaction purporting to effect the transfer.

ASSET SALES

In an asset sale, the seller transfers specified assets and liabilities to the buyer. An asset sale that purports to include IP rights that the seller licenses from a third party will violate the related license agreement to the extent that it prohibits the assignment of the licensee's rights.

If the license agreement is silent on its assignability, or deemed silent as a result of the licensee's bankruptcy (see *Bankruptcy Issues*), then analyzing whether the licensee can assign its rights without the licensor's consent may depend on the type of licensed IP and exclusivity of the grant (see *Type of IP License Agreement*) and, to a lesser extent, other factual circumstances.

If a licensee sells most of its assets but retains the license, then the licensor may argue that this is a *de facto* assignment of the IP license because of the change in the character of the licensee.

However, in *General Mills, Inc. v. Kraft Foods Global, Inc.*, the US Court of Appeals for the Federal Circuit held an asset sale of this kind was not an assignment of a covenant-not-to-sue on a patent because the agreement did not expressly require the retention of any assets (*487 F.3d 1368 (Fed. Cir. 2007)*).

STOCK SALES

A pure stock sale involves the transfer of the target company's shares or other equity interests to the buyer without transferring any of the target company's assets. Because the target company remains the same legal entity following the transaction, a stock sale is typically not found to cause an assignment of the target company's license rights (see, for example, *Hitachi, at *5, *8-9*; see also *PPG, at 1097*, *Institut Pasteur v. Cambridge Biotech Corp., 104 F.3d 489, 494 (1st Cir. 1997)* (*Insitut Pasteur*) (patent), and *Review Directories Inc. v. McLeod USA Publ'g, Co., No. 1:99-CV-958, 2001 U.S. Dist. LEXIS 9807, at *7, *10 (W.D. Mich. July 23, 2001)* (*Review Directories*) (trademark)).

Stock sales generally do not pose an issue where a license agreement is silent on assignment or includes a mere prohibition on assignment.

However, in certain circumstances, a court may find a stock sale violates an anti-assignment provision in an IP license, if the sole meaningful asset of the target company is the license agreement (see *In re Alltech Plastics, Inc., No. 86-23673-B, 1987 Bankr. LEXIS 2259, at *19 (Bankr. W.D. Tenn. Dec. 30, 1987)* and *Westinghouse Elec. & Mfg. Co. v. Radio-Craft Co., 291 F. 169, 173 (D.N.J. 1923)*). Outside the IP license context, the prohibition of "direct and indirect" transfers of a partnership agreement was relevant to determining whether the sale of stock of a party to the agreement violated the provision (*In re Asian Yard Partners, Nos. 95-333-PJW, 95-334-PJW, 1995 WL 1781675, at *7 (Bankr. D. Del. Sept. 18, 1995)* and *Hake*).

A stock sale may trigger a change-of-control provision (see *Change-of-Control Provisions*).

MERGERS

If a license does not include a provision that expressly prohibits mergers, then the evaluation of assignability in a merger context may require an interpretation of state merger statutes (see *State Merger Statutes*). The merger structure will also have an impact on the evaluation (see *Forward Mergers* and *Reverse Mergers*).

State Merger Statutes

Whether a merger effects an automatic assignment or transfer of contract rights is a matter of state law (*Evolution, Inc. v. Prime Rate Premium Fin. Corp., No. Civ.A. 03-2315-KHV, 2004 WL 1824389, at *5 (D. Kan. Aug. 13, 2004)* (*Evolution*)). This, in turn, can depend on the relevant state merger statute (see, for example, *Netbula, at 1148* and *Meso Scale Diagnostics, LLC v. Roche Diagnostics GMBH, No. 5589-VCP, 2011 WL 1348438, at *9 (Del. Ch. Apr. 8, 2011)* (*Meso Scale*)).

Merger statutes are not identical and can vary from state to state. For example, the New York merger statute provides that all real and personal property assets and causes of action of the constituent entities "vests" in the surviving corporation without further act or deed (*N.Y. Bus. Corp. Law § 906(b)(2)*). The Delaware merger statute is similarly worded (*Del. Code Ann. tit. 8, § 259(a)*). A Kansas federal court noted that, under the Kansas merger statute, rights are transferred to and vested in the surviving entity *(Evolution, at *6)*.

In addition, courts can interpret the same merger statute differently. The US Court of Appeals for the Sixth Circuit determined that "vesting" under the Ohio merger statute is equivalent to a transfer (*Cincom, at 438*). The court in *TXO* held that under the Ohio, Texas, and Delaware merger statutes, "vesting" is not equivalent to a transfer (*TXO, at 143*).

Whether the applicable merger statute or statutes renders the transaction the equivalent of a "transfer" of one or both of the constituent entities' contracts is, therefore, a part of the analysis, but a detailed examination of this issue is beyond the scope of this Note.

Determining Which State's Law Applies

A further question in determining whether a transfer has occurred as a result of a merger transaction is whether to apply the law governing the IP license or the law governing the merger agreement.

The more common approach is for courts to apply the law governing the license agreement (see, for example, *Netbula, at 1149* and *Nat'l Bank of Can. v. Interbank Card Assn, 507 F. Supp. 1113, 1123-24 (S.D.N.Y. 1980)* (*Interbank*); see also *PharmMetrics, at *2*).

However, some courts have applied the law of the states whose merger statutes govern the transaction. In *PPG*, the US Court of Appeals for the Sixth Circuit held that Ohio and Delaware merger statutes determined the effect of a forward merger on a patent license (*PPG, at 1093*). The court in *Evolution* denied a summary judgment motion because the states of incorporation of the merging entities and the law governing the merger agreement were not identified (*Evolution, at *6*).

If the merger is equivalent to a transfer under the applicable state merger statute, then, as with other assignments, the type of licensed IP and the exclusivity of the grant is relevant to the analysis of whether the transfer is permissible (see *Type of IP License Agreement*).

Restrictions on Assignment "By Operation of Law"

In some cases, an IP license agreement expressly prohibits "assignments by operation of law" but otherwise does not expressly prohibit a merger. Whether a merger is an assignment by operation of law depends on the interpretation of the applicable merger statute and the intent of the parties concerning the contractual language.

Courts have not been uniform in their resolution of this issue. Some have held that a contractual limitation on assignment by operation of law can include a merger (see, for example, *Tenneco Auto. Inc. v. El Paso Corp., No. Civ.A. 18810-NC, 2002 WL 453930, at *2 (Del. Ch. Mar. 20, 2002)*, *Meso Scale, at *12-19* and *In re Asian Yard Partners, Nos. 95-333-PJW, 95-334-PJW, 1995 WL 1781675, at *3 (Bankr. D. Del. Sept. 18, 1995)*). The court in *PharMetrics* held that an IP license prohibiting assignment by operation of law did not include a reverse merger because the applicable merger statute's use of the term "vesting" was not equivalent to an assignment (see *PharMetrics, at *4-5*).

Assignments or transfers by foreclosure or inheritance may also be considered assignments by operation of law (see, for example, *Sky Technologies LLC v. SAP AG, 576 F.3d 1374, 1379, 1381 (Fed. Cir. 2009)*).

FORWARD MERGERS

Whether a transaction is a forward or reverse merger also affects the analysis of transferability.

In a forward merger, the target company merges into the acquirer. The acquirer, now called the "survivor" of the merger, assumes the target company's assets, rights and liabilities. In a forward triangular merger, the target company merges into a subsidiary of the acquirer.

A forward merger is more likely to be treated as equivalent to an assignment of the target's IP license agreements than a reverse merger because the target company ceases to exist as a separate entity, for example:

- **Patent.** The court in *PPG* held that a forward merger violated an anti-assignment clause in a non-exclusive patent license, finding that a transfer by operation of law is still an assignment (*PPG, at 1096*; see also *Board of Regents, at *47-49*).
- **Trademark.** The court in *Council of Better Bus. Bureaus, Inc. v. Better Bus. Bureau, Inc.* held a forward merger resulted in impermissible assignment of non-exclusive trademark license that was the sole basis for the licensee's business (*No. 99-CV-282, 1999 WL 288669, at *3 (N.D.N.Y. Mar. 30, 1999)*).
- **Copyright (software).** In *Cincom*, a non-exclusive "non-transferable" license was breached by the forward merger of the licensee with its sister corporation (*Cincom, at 439-40*).
- **Trade Secrets (data).** The court in *M.D. Mark* held that a non-transferable license for seismic data protected as a trade secret was breached by forward merger (*M.D. Mark, at 760-62*).

REVERSE MERGERS

In a reverse merger, the acquirer merges into the target company and disappears. The target company is the survivor of the merger. A reverse triangular merger structure is the most commonly used version of this structure. The acquirer creates a wholly-owned subsidiary which then merges into the target company. As a result, the target company becomes a wholly-owned subsidiary of the acquirer.

Because the target company survives the merger, reverse mergers are widely assumed not to violate non-assignment provisions in the target company's contracts.

There are relatively few cases addressing the effect of reverse mergers, whether or not in the IP license context. In addition, the existing decisions on this issue are highly fact-specific.

Several case rulings support a reverse merger not constituting a transfer of a license agreement:

- The court in *PharMetrics* applied the Georgia merger statute to find that the reverse merger did not effect an assignment of a data license agreement (*PharMetrics, at *3-4.*).
- The court in *Forry, Inc. v. Neundorfer, Inc.* found no transfer of a copyright occurred where the copyright owner was the survivor of a reverse merger (*837 F.2d 259, 262 (6th Cir. 1988)*).

Several case rulings support the conclusion that a reverse merger violates an anti-assignment provision in a license agreement:

- The court in *SQL Solutions, Inc. v. Oracle Corp.* found a reverse merger violated a non-assignment provision in a non-exclusive copyright license (*No. C-91-1079 MHP, 1991 WL 626458, at *2 (N.D. Cal. Dec. 18, 1991) (SQL)*). While this decision is unpublished and, therefore, considered not precedential, it has been given credence over the years by practitioners, particularly where California law applies.
- The Delaware Court of Chancery in *Meso Scale*, in denying a motion to dismiss, found a reverse triangular merger may violate a non-assignment clause in a consent agreement which was construed to cover the target's assignment of its IP and licenses. The anti-assignment clause prohibited assignments by "operation of law" and, soon after the transaction, the acquirer caused the target to cease operating, making it essentially a shell company that held the IP and licenses. The Court of Chancery found plausible, on contract interpretation grounds, that "by operation of law" was intended to cover a merger that effectively operated as an assignment (*Meso Scale, at *13*).

FACTUAL CIRCUMSTANCES

Factual considerations have influenced some courts in determining whether to allow the transfer of an IP license.

ADVERSE IMPACT ON NON-ASSIGNING PARTY

Under state law, an adverse impact on the non-assigning party is a major consideration in determining whether a contract is assignable.

Some courts have focused on whether the proposed successor is a competitor of the licensor. The court in *SQL* noted that, as a result of the impeding reverse triangular merger, the licensor's competitor would effectively control the licensee (*SQL, at *6*; see also *PPG, at 1095-97* and *Biosynexus, at *7*). However, the court in *PharMetrics* held that a merger where the licensor's competitor was the parent of the surviving entity did not breach a license that was expressly non-assignable to that competitor (*PharMetrics, at *4*).

In *Interbank*, the fact that the combined entity resulting from a trademark licensee's amalgamation with another entity was much larger in size and asset value than the original licensee was viewed as an adverse effect on the licensor (*Interbank, at 1124-1125*).

Where a state statute on the assignment of automobile dealership franchises required the manufacturer's reasonable consent, a court held that the franchisor's consent was reasonably withheld where the proposed assignee was in less desirable location and had lower customer satisfaction ratings (*In re Van Ness Auto Plaza, Inc., 120 B.R. 545, 547-50 (Bankr. N.D. Cal. 1990)*).

Likewise, where the assignment has no discernable adverse effect, it can influence a court to allow it. In *Superbrace*, decided under California state law, a patent license was found assignable where the original licensee had no particular expertise in manufacturing the licensed product and the licensor received a fixed payment, rather than royalties based on the licensee's sales.

CONTINUATION OF THE LICENSEE'S BUSINESS

Courts have also focused on whether the successor licensee will effectively continue the original licensee's business in determining the transferability of an IP license agreement.

In *Syenergy Methods, Inc. v. Kelly Energy Systems, Inc.*, the licensee's retention of the same management was a factor in allowing a non-transferable license to survive the licensee's internal reorganization by forward merger (*695 F. Supp. 1362, 1364-65 (D.R.I. 1988)*).

Conversely, in *Meso Scale*, it was critical to the court's decision that a reverse triangular merger may have breached a contractual prohibition on assignment when, soon after the merger, the target company (which was the survivor of the merger) fired its employees and discontinued its product lines (*Meso Scale, at *13*).

AFFILIATION OF ENTITIES

If the licensee and the successor are affiliated entities, this relationship may influence a court's determination of whether the transaction violated an anti-assignment clause.

The court in *TXO* found that a merger of a subsidiary into its parent did not violate an anti-assignment clause in a non-disclosure agreement (*TXO, at 143*). Conversely, the court in *Cincom* held that a forward merger of two sibling corporations breached a non-transferable copyright license (*Cincom, at 439-40*).

PIERCING THE CORPORATE VEIL

If the corporate veil between the buyer and the licensee acquired in a stock purchase or merger can be pierced under applicable corporate law, then a court may decide to disregard the separate existence of the target company and conclude that an assignment to the buyer occurred. In such a case, anti-assignment clauses in the target company's IP licenses may be deemed violated after the fact (see *Hitachi, at *22 and Review Directories, at *8-10*).

BANKRUPTCY ISSUES

The evaluation of assignability of an IP license in a licensee's bankruptcy raises considerations comparable to those in a corporate transaction, but in a different context.

A licensee's bankruptcy raises conflicting federal policies, namely:

- The policy underlying Chapter 11 of the Bankruptcy Code to maximize the value of the bankrupt's estate for the benefit of its creditors (see generally *In re Quantegy, Inc., 326 B.R. 467, 470-71 (Bankr. M.D. Ala. 2005)* (*Quantegy*)).
- The policy disfavoring the assignability of IP license rights.

In harmonizing the two policies, a licensor's consent may be required before a debtor-licensee may assign or, in some jurisdictions, even assume, its rights under an executory license agreement, to a similar extent as consent would be required outside the bankruptcy context.

EXECUTORY CONTRACTS

The Bankruptcy Code generally permits a debtor-in-possession to reject, assume, or assume and assign its in furtherance of its right to free itself from burdensome arrangements (*11 U.S.C. § 365(a)*).

Although the Bankruptcy Code does not define "executory contract," it is generally understood to be a contract where the obligations of "both the bankrupt and the other party to the contract are so far unperformed that the failure of either to complete performance would constitute a material breach excusing the performance of the other" (*Vern Countryman, Executory Contracts in Bankruptcy: Part 1, 57 Minn. L. Rev. 439, 460 (1973)*).

IP License agreements are often considered to be executory contracts (see *Practice Note, IP Licenses and Bankruptcy, Is the IP License an Executory Contract? (http://us.practicallaw.com/1-504-3602)*). This is because each party generally has duties yet to be performed, for example the licensor's duty to refrain from suing the licensee for infringement or the licensee's duty to pay royalties, indemnify the licensor or maintain quality standards (see, for example, *Buildnet, at *8-9* and *Golden Books, at 311, 314*).

However, there are cases finding that particular IP licenses were not executory. For example, in *In re Exide Techs.*, the licensee acquired a perpetual royalty-free trademark license as part of acquisition of a business (*607 F.3d 957, 964-65 (3d Cir. 2010)*). The US Court of Appeals for the Third Circuit held that the license was non-executory because the licensee was considered to have performed all material obligations.

ANTI-ASSIGNMENT LANGUAGE UNENFORCEABLE

In furtherance of the federal policy of allowing the debtor to maximize the value of its assets, Section 365(f)(1) of the Bankruptcy Code renders unenforceable any anti-assignment language in an executory contract to which the debtor is a party (*11 U.S.C. § 365(f)(1)*).

However, under Section 365(c)(1) of the Bankruptcy Code, if "applicable law" excuses the other party to the contract from accepting performance from anyone other than the debtor, then assignment of the agreement by the debtor will not be allowed, whether or not the contractual language prohibits assignment, unless the other party consents (*11 U.S.C. § 365(c)(1)(A)*).

This opens the door to arguments that IP licenses are, by nature, non-assignable under "applicable law", namely federal common law (see, for example, *In re Catapult Entm't, Inc., 165 F.3d 747, 754 (9th Cir. 1999)* (*Catapult*), *CFLC Inc., at 677*, *Supernatural Foods, at 759, 792*, *Patient Educ., at 242*, and *Hernandez, at 440-42*).

ASSUMPTION OF IP LICENSE BY DEBTOR LICENSEE

Hypothetical and Actual Tests

Before a debtor licensee may assign its IP license rights, it or its bankruptcy trustee, must assume them.

The proposition that a bankrupt licensee's contractual rights cannot be assigned if contrary to applicable law has led to two approaches when a debtor-licensee moves to assume IP license agreements in bankruptcy:

- Under the "hypothetical test," the debtor-licensee may not assume an IP license as a debtor-in-possession, even if it does not intend to assign its license rights to a third party, if the contract could not otherwise be assigned by the debtor-licensee under applicable law (see, for example, *RCI Tech. Corp. v. Sunterra Corp. (In re Sunterra Corp.), 361 F.3d 257, 271-72 (4th Cir. 2004)* (*Sunterra*), *Catapult, at 747, 752* and *In re W. Elecs., Inc., 852 F.2d 79, 83 (3d Cir. 1988)*).

- Under the "actual test," the debtor-licensee may assume an IP license as a debtor-in-possession that otherwise cannot be assigned under applicable law unless it actually intends to assign that contract to a third party (see, for example, *Institut Pasteur, at 493-95*, *In re Aerobox Composite Structures, LLC, 373 B.R. 135, 141 (Bankr. D.N.M. 2007)* and *In re GP Exp. Airlines, Inc., 200 B.R. 222, 231-33 (Bankr. D. Neb. 1996)*; see also *In re Footstar, Inc., 323 B.R. 566, 575-78 (Bankr. S.D.N.Y. 2005)* (debtor-in-possession, but not its trustee, may assume a non-assignable contract)).

In 2009, the Supreme Court, by declining to review the US Court of Appeals for the Ninth Circuit's decision affirming *N.C.P.*, bypassed the opportunity to resolve the split in the Circuit Courts over the hypothetical and actual tests. In a statement accompanying the denial of certiorari, Justices Kennedy and Breyer noted their sympathy for the debtor's position but that resolving the assumption issue in the context of a trademark license complicated the issues (*N.C.P. S. Ct., at 1577-78*).

Consent to Assignment

A licensor's consent to assignment of the license agreement can defeat the operation of Section 365(c)(1) of the Bankruptcy Code, making "applicable law" irrelevant, if the proposed transfer complies with the consent terms.

Consent may be within the license agreement itself, such as where assignment is permitted under certain circumstances which are met (see, for example, *Supernatural Foods, at 804-05* and *Quantegy, at 470-71*).

However, in one case, a license agreement that permitted assignment by the debtor-licensee was held not equivalent to consent to the debtor's assumption of the agreement (*Sunterra, at 271*).

Adequate Assurances of Future Performance

As a condition of assuming or assigning an executory contract, the Bankruptcy Code requires that the other party will have "adequate assurance of future performance" (*11 U.S.C. § 365(b)(1)(C)*). This condition also applies to IP licenses, for example:

- The court in *In re GlycoGenesys, Inc.* found that adequate assurances existed where the proposed assignee had sufficient cash to pay licensor's royalties and patenting costs, as well as adequate scientific expertise (*352 B.R. 568, 578 (D. Mass. 2006)*).
- By contrast, in *In re Luce Indus., Inc.*, the debtor's assumption of a trademark license was not allowed where the reorganized debtor intended to outsource its manufacturing and sales functions to a discount clothing jobber (*14 B.R. 529, 531-32 (S.D.N.Y. 1981)*).

NON-ASSIGNABLE IP LICENSES IN M&A TRANSACTIONS

LICENSOR CONSENT

If an acquirer cannot succeed to a target company's IP license rights based on the terms of the agreement or applicable law, then seeking consent from the licensor is an option.

The obligation to obtain the consent is typically undertaken by the seller, who has an existing relationship with the licensor.

Consent may be pursued pre- or post-closing:

- **Pre-closing consent.** If the license is material to the target company's business, then getting the licensor's consent to the transaction may be a condition precedent to closing.
- **Post-closing consent.** If the acquirer is willing to close without the licensor's consent, then getting consent may be a post-closing covenant on the seller's part. Where a transaction is confidential, requiring the seller to seek consent as a post-closing covenant may be the only practical option. The licensor will understandably want to know the identity of the acquirer when evaluating the impact of the transfer.

The parties may agree that the seller's obligation to get the licensor's consent to transfer an IP license, whether pre- or post-closing, requires only the exercise of commercially reasonable efforts.

CONTRACTUAL REMEDIES

If the licensor is unwilling or the parties have decided not to pursue consent, then the buyer may seek to negotiate contractual remedies from the seller. These may include one or more of the following:

- A price discount for the lost value of the licensed IP.
- An indemnity for any infringement claims arising from continued use of the IP.
- Reimbursement of the buyer's cost for acquiring either a replacement license or alternate IP.

OTHER OPTIONS

If the licensor's consent is not obtained and any remedies offered by the seller are inadequate, then the buyer and seller may need to consider other options.

New License

The acquirer or the licensee's successor may be able to obtain its own license from the licensor. It may already have the benefit of a license, most commonly where the license concerns commercial software. Where the acquirer has an enterprise license for its entire corporate group, the acquirer's agreement may cover new affiliates.

Ceasing Use

The acquirer or successor can elect not to use the licensed IP. This may, however, be difficult to achieve for licensed information and know-how, which are not always readily separable from other IP.

Sublicense

If the licensee itself is not being sold or merged out of existence, then it may be able to retain its license rights and sublicense the licensed IP to the acquirer.

To consider this option, the license agreement should expressly allow sublicensing as a licensee's right to sublicense is not necessarily implied (see, for example, *Miller v. Glenn Miller Prods., 318 F. Supp. 2d 923, 933 (C.D. Cal. 2004)*, *Gardner, at 781*, *CFLC, at 679*, *Tap Publ'ns, at 212, 218* and *In re Travelot Co., 286 B.R. 447, 455 (Bankr. S.D. Ga. 2002)*).

In addition, if the sublicense grants rights and imposes obligations which mirror the license, particularly if the sublicensee's obligations are pefromed directly for the licensor, then the sublicense could potentially be recharacterized as an assignment and deemed subject to applicable anti-assignment clauses (see *Biosynexus, at *3-6*).

Sublicensing may not be the most desirable option for a seller because it remains a middleman and may continue to have liability to the licensor for the sublicensee's performance of its obligations under the sublicense.

Multi-step Transaction

Anti-assignment clauses in IP licenses often permit assignment to either:

- The licensee's affiliates.
- The successor of the relevant business.

In such a case, a divestiture strategy may be to assign the IP license agreement to a subsidiary, and then sell the stock of the subsidiary to the buyer (see, for example, *Hitachi, at *5* and *Transamerica Commercial Finance Corp. v. Stockholder Sys., Inc., No. 89 C 917, 1990 WL 186088, at *2 (N.D. Ill. Nov. 8, 1990)*).

However, there is a risk a court may collapse the transactions and view them together as an indirect assignment of the IP license. There are cases involving other types of agreements where this has occurred, for example, in a case involving a right of first refusal and another involving a lease (see *Williams Gas Processing-Wamsutter Co v. Union Pacific Resources Co., 25 P. 3d 1064 (Sup. Ct. Wyo 2001)* and *Pioneer Trust & Savings Bank v. Zayre Corp., No. 89 C 3773, 1989 U.S. Dist. Lexis 10832 (N.D. Ill. Sept. 13, 1989)*). In *Fina Oil & Chem Co. v. Amoco Production Corp.*, the Louisiana Court of Appeals upheld a multi-step transaction involving oil field leases, where the divested subsidiary was not created for the acquisition of the contracts at issue and had other assets (*673 So. 2d 668 (La Ct. App. 1st Cir. 1996)*).

A multi-step approach may not be possible if the IP license includes a change-of-control provision, as the transfer of the licensee's equity interest in the second step may trigger it.

Transition Services

Under a separate transition services agreement between the seller and the target company (or, in an asset purchase, between the seller and the acquirer), the seller can agree to provide products or services which incorporate the licensed IP, generally on a short-term basis, while the target or acquirer transitions to other IP.

The parties should consider any contractual obstacles to this approach. For example, some license agreements:

- Limit the licensee's right to use the licensed IP only for "internal" or other specified purposes (see, for example, *Automation by Design, Inc. v. Raybestos Prods. Co., 463 F.3d 749, 758 (7th Cir. 2006)* and *Storage Tech. Corp. v. Custom Hardware Eng'g & Consulting, Inc., 421 F.3d 1307, 1316 (Fed. Cir. 2005)*).
- Prohibit use of the IP for the operation of a "service bureau" or for the provision of products or services to third parties.

CHANGE-OF-CONTROL PROVISIONS

A common misconception in drafting and interpreting contracts, including IP licenses, is that an anti-assignment clause covers a party's change of control. However, prohibitions on changes of control are likely not implied from a simple anti-assignment clause (see *Hitachi, at *17-18*). Restrictions on changes of control must therefore be separately addressed.

A change-of-control provision gives a party, certain rights in connection with the other party's transaction. Although some change-of-control provisions purport to void the transaction, the more direct approach is to provide that a change of control is equivalent to a material breach of the agreement or grounds for termination, or both.

DEFINING CHANGE OF CONTROL

The term "change of control" can be defined in several ways, for example, as one or both of the following:

- A transfer of more than 50% of a party's voting stock.
- A change in a majority of a party's board members.

The Delaware business combinations statute includes a definition of "control" as the "possession directly or indirectly of the power to direct or cause the direction of management and policies of a person, whether through the ownership of stock by contract or otherwise," with a rebuttable presumption of control arising from the ownership of 20% or more of the outstanding voting stock (*Del. Code Ann. tit. 8, § 203(c)(4)*).

As in other cases of contract interpretation, if no statute or case law is dispositive, a court will need to construe the phrase "change of control". For example, in one case, a court used dictionary references to find that it contemplates "a substitution or replacement of [an entity's] regulating or governing body" (*Caffrey v. Four Oaks Bank & Trust Co., No. 5:10-CV-341-FL, 2011 U.S. Dist. LEXIS 70713, at *23 (E.D.N.C. June 29, 2011)*).

WHAT CORPORATE TRANSACTIONS CAUSE A CHANGE OF CONTROL?

In the absence of a determinative definition of a change of control in an IP license:

- An asset purchase does not appear to be a change of control because, technically, neither the old nor the new licensee changes its ownership or management in the transaction. However, there are some change-of-control clauses which define the sale of substantially all assets as a change of control.
- A stock sale may or may not cause a change of control, depending how much of the stock the buyer is acquiring and whether the buyer can actually exercise control over the seller.
- A merger may or may not constitute a "change of control" of the target company, depending on the structure of the merger and the resulting stockholders. An analysis of this issue under the relevant state law is beyond the scope of this Note.

Parent Company's Change of Control

A change of control of the licensee's parent company is not automatically a change of control of the licensee (see, for example, *Former Shareholders v. Browning-Ferris Indus., No. HO27435, 2005 WL 2820594, at *2 (Cal. Dist. Ct. App. Oct. 28, 2005)*, *Lincoln Fin. Media Co. v. CBS Broad., Inc., 3:07CV062, 2008 U.S. Dist. LEXIS 31041, at *22 (W.D.N.C. Mar. 24, 2008)* and *de Celis v. CAI Wireless Sys., Inc., No. 95-5539, 1996 U.S. Dist. LEXIS 2704, at *9 (E.D. Pa. Mar. 5, 1996)*).

However, the result may be different if the license agreement prohibits "direct or indirect" changes of control or, possibly, even direct or indirect assignments (see *Hake, at 335*).

LIENS

A license agreement may expressly prohibit the granting of a lien, pledge or encumbrance in a party's rights under the agreement.

Where the license agreement does not expressly address liens but prohibits assignments, does a licensee's pledge of its rights under a non-assignable IP license as collateral for a loan trigger the provision?

- One theory is that the grant of a lien is not an assignment because the transfer is conditional, becoming absolute only on foreclosure after an event of default.
- An alternate theory is that, because the lien matures into an absolute assignment on an event of default without a further grant on the debtor's part, the grant of lien should be considered an assignment at the outset. By extension, then, the default rule weighing against a licensee's ability to assign its rights may also cover its grant of liens.

UCC APPROACH

For most contracts, Article 9 of the Uniform Commercial Code (UCC) resolves the issue. Article 9 was revised in 2001 to make clear that the grant of a lien does not violate an anti-assignment clause in a general intangible or accounts. (References to UCC sections in the rest of this section are to the New York Uniform Commercial Code.)

IP Licenses as General Intangibles or Accounts

For a licensee, a license agreement is likely to be considered a general intangible under the UCC. The definition of "general intangible" is a catch-all that includes any personal property other than specifically excluded items (*N.Y. UCC § 9-102(a)(42)*). The term is generally understood to cover most business contracts.

For a licensor, a license agreement may be either a general intangible or an account under the UCC. The definition of "account" includes the right to payment of monetary obligations for property that has been sold, leased, licensed, assigned or otherwise disposed of (*N.Y. UCC § 9-102(a)(2)*).

Non-assignable General Intangibles and Accounts

The 2001 revisions to the UCC provide that contract terms in general intangibles or accounts that prohibit or restrict, or require the other party's consent to, either an assignment of the debtor's rights or the creation of a security interest therein are ineffective to:

- Impair the creation, attachment or perfection of a lien.
- Give rise to any default, breach or right of termination or other remedy on the debtor's assignment or transfer, or the creation, attachment, perfection or enforcement of a lien in the general intangible or account.

(*N.Y. UCC § 9-406(d)* (for accounts) and *N.Y. UCC § 9-408(a)* (for general intangibles).)

To protect the non-debtor party's interest under the agreement, other UCC provisions adopted at the same time limit a lender's remedies regarding general intangibles, but not accounts, that would be considered non-assignable under other law. These limitations include that the lien:

- Is not enforceable by the lender against either the debtor or the non-debtor party to the agreement.
- Does not impose any obligations on the non-debtor party.
- Does not require the non-debtor party to render to or accept performance from the lender.
- Does not allow the lender to use or assign the debtor's rights under the general intangible.
- Does not allow the lender to use, assign or possess any of the non-debtor party's confidential information.

(*N.Y. UCC § 9-408(c)*.)

In light of these stringent limitations, the primary value of non-assignable contracts as collateral lies in the secured party's ability to enforce its lien in the proceeds thereof. If the non-debtor party consents to the sale of the contract to a buyer after an event of default, then the proceeds received by the debtor from the transfer will be available to the lender (*N.Y. UCC § 9-408 official comments 7 and 8*).

NON-ASSIGNABLE IP LICENSES

Article 9 does not necessarily resolve the uncertainties surrounding granting liens in non-assignable IP licenses. Because the assignability of the licensee's rights under an IP license is widely recognized as a federal law issue, state law, such as the UCC, may be preempted.

In recognition of this, Section 9-408 of the New York UCC contains a footnote thought to apply to IP licenses:

> 9. Contrary Federal Law. This section does not override Federal law to the contrary. However, it does reflect an important policy judgment that should provide a template for future Federal law reforms.

(*N.Y. UCC § 408, note 9*.)

No case law appears to address the intersection of UCC Section 9-408 and the federal law applicable to the assignment of IP license agreements.

Many cases, however, address whether federal IP laws preempt the UCC on the method of perfecting liens in patents, trademarks and copyrights. These cases have held that the UCC requirements for filing financing statements are not preempted, at least against the competing lien of a bankruptcy trustee, except with respect to federally registered copyrights. This is because the federal IP laws (except for the Copyright Act) only address assignments, but do not address liens (see, for example, *In re Cybernetic Servs., Inc., 252 F.3d 1039, 1058 (9th Cir. 2001)* (patents), *In re Coldwave Sys., LLC, 368 B.R. 91, 97 (Bankr. D. Mass. 2007)* (patents), *Trimarchi v. Together Dev. Corp., 255 B.R. 606, 610 (D. Mass. 2000)* (trademarks) and *In re World Auxiliary Power Co., 303 F.3d 1120, 1125-26 (9th Cir. 2002)* (*World Auxiliary Power*) (copyrights)).

By extension, it could be argued that, because the perfection of liens in IP is subject to the UCC provisions that apply to general intangibles, the grant of liens in IP licenses should also be subject to the UCC provisions that apply to general intangibles.

The limitations of the secured party's remedies under UCC Section 9-408(c) (see *Non-assignable General Intangibles and Accounts*), offer a licensor practical comfort that, despite its lien, the lender will neither be able to operate as a licensee under a non-assignable license nor be able to transfer the licensee's rights to a third party without the licensor's consent. Accordingly, there is a reasonable argument that the UCC does not conflict with the federal policies disfavoring the free assignability of IP licensees and therefore it should not be preempted.

One consideration is that UCC Section 9-408(a) applies to contracts that contain "terms" prohibiting or restricting assignment. If the IP license agreement is silent and thereby deemed non-assignable without the licensor's consent, it is unclear whether these UCC provisions would apply, even if the UCC is not preempted by federal law.

PRACTICAL APPROACH

Despite the growing body of precedent favoring the UCC over the federal IP laws in the area of perfecting liens, many practitioners comply with both the UCC rules relating to general intangibles and federal IP laws pertaining to recording assignments.

Likewise, many practitioners are concerned that IP license agreements may not be covered by the UCC provisions that apply to other non-assignable contracts.

For this reason, security agreements commonly include a "savings clause" that excludes from the lien any non-assignable contracts or contracts that are breached by the grant of security, except to the extent that the applicable contractual terms would be rendered ineffective under UCC Sections 9-406 through 9-408.

If an IP license is extremely material, the lender may require the licensor's express consent to the grant of lien and to the lender's exercise of foreclosure remedies.

Less concern exists among practitioners over whether federal IP laws preempt the UCC concerning a licensor's grant of a lien in its rights under a license agreement. The federal policies that protect a licensor's right to choose its licensees do not carry the same force in the other direction (see *Federal Policy Reasons*).

In addition, under many license agreements, the licensor's rights are primarily financial, that is, the right to receive royalties. A court may therefore be more inclined to treat a license agreement in the licensor's hands as an ordinary contract or an account.

DRAFTING CONSIDERATIONS

Parties negotiating IP license agreements typically directly address assignment and, in some instances, changes of control, in the agreement.

LICENSOR-FRIENDLY PROVISIONS

Anti-assignment Clauses

A licensor generally seeks to prohibit a licensee from assigning its rights. In its simplest form, an anti-assignment provision states that the prior consent of the licensor is required for the licensee's assignment of the agreement.

However, a provision of this nature may not adequately cover all types of transactions that the licensor wishes to prohibit. A more detailed anti-assignment provision may:

- Specify that mergers or stock sales will be deemed a form of assignment that is subject to the restriction.
- Prohibit assignments by "operation of law" and "directly or indirectly", which could possibly be interpreted to cover mergers and stock sales (although this is less direct than mentioning them specifically).
- Prohibit assignments "in whole or in part." This makes clear that the agreement cannot be divided in the event that one business is sold by the licensee since having multiple licensees can increase the logistical demands on the licensor.
- Prohibit assignments whether in connection with a single transaction or a series of transactions, to discourage multi-step transactions.

A strict anti-assignment provision should state that any transfer in violation of the provision is void or constitutes grounds for termination of the license. Without this clause, the assignment may remain effective and the licensor may only have a breach of contract claim for damages, if any (see *Bel-Ray Co., Inc. v. Chemrite (Pty) Ltd., 181 F.3d 435, 442 (3d Cir. 1999)*) and see also *Pravin Banker Assocs., Ltd. v. Banco Popular del Peru, 109 F.3d 850, 856 (2d Cir. 1997)*, *Cent. Trans. Int'l, Inc. v. Global Advantage Distrib., Inc., No. 2:06-cv-401, 2007 U.S. Dist. LEXIS 92531, at * 9-11 (M.D. Fla. Dec. 17, 2007)* and *Evolution, Inc, at *9*).

In addition, attention should be paid to whether there are potentially contradictory provisions elsewhere in the agreement, such as a clause that unequivocally states that the agreement is binding on the parties' successors and assigns (see *Clubcorp. Inc. v. Pinhurst, LLC, C.A. No 5120-VCP, 2011 Del. Ch. LEXIS 176 at *28-20 (Del. Ch. Nov. 15, 2011)*).

Conditions on Assignment

If the licensor agrees to allow certain assignments by the licensee, then it can specify in the agreement that:

- The licensee will provide written notice either before or promptly after a permitted assignment.
- The transferee will expressly agree in writing to comply with the terms and conditions of the agreement.
- The licensee will remain liable for the transferee's performance of the obligations under the agreement.
- The transferee cannot be a competitor of the licensor. Note that while this restriction may be acceptable in principle, it can be difficult to draft and negotiate. In particular, it can be challenging to define who constitutes a competitor of the licensor, especially if the transferee's affiliates are taken into consideration.
- The agreement can be assigned to an affiliate of the licensee but only on one or both the following conditions:
  - the licensor's consent remains valid only for so long as the transferee remains affiliated with the original licensee; and
  - the license agreement will terminate in the event that the original licensee and the transferee are no longer affiliated.

Licensor's Right to Assign

While there appears to be no default rule that prohibits the licensor's ability to assign its rights under an IP license that is silent on assignability (see *Default Rules: IP Licenses*), a licensor-favorable assignment provision can expressly permit the licensor to assign its own rights under the agreement. This would foreclose the argument that the license is not assignable by the licensor.

Change of Control

In drafting licensor-favorable agreements, one can include a separate change-of-control provision to add further restrictions on the licensee (see *Change-of-Control Provisions*).

Consideration should be given to the definition of "change of control", including whether to specify a percentage of equity ownership that triggers the provision or to rely on the legal interpretation of the phrase under the applicable state law.

Another area for consideration is whether changes in control of the licensee's parent company should fall within the scope of the provision.

LICENSEE-FRIENDLY PROVISIONS

A licensee may object to an anti-assignment provision in its entirety or more likely will seek particular exceptions.

Typical licensee counter-proposals include:

- Specifying that the licensor's consent to the licensee's transfer of the license cannot be unreasonably withheld or delayed.
- Expressly permitting assignment to one or more of the following:
  - to a successor by merger or "in connection with a merger";
  - to the acquirer of, or "in connection with," the transfer of all or substantially all of the licensee's assets. In a more licensee-favorable form, assignment is also allowed in connection with the transfer of the assets associated with the license agreement or with a specific line of business;
  - to the licensee's affiliates; or
  - to specific third parties or for specific purposes.
- Permitting assignments "in part" so that the license rights to be split in connection with the licensee's divestiture of divisions.
- Allowing the licensee to grant liens in its rights under the agreement as collateral to a specific lender or generally, with the lender being able to assign the rights in connection the exercise of its remedies (see *Liens*).

MUTUAL RESTRICTIONS

To accommodate a licensee's request for mutuality, a licensor may be tempted to restrict its own ability to assign the agreement. Yet, the identity of the licensor may be immaterial to the licensee, if the licensee can continue using the licensed IP on the same terms (see *Default Rules: IP Licenses*). Therefore, the licensor may be giving up the valuable right to freely transfer the agreement without a corresponding benefit to the licensee.

One court has suggested that a broad reading of a mutual anti-assignment clause may prohibit the licensor's assignment of the licensed IP itself (see *Eastman Kodak Co., at *14-15*). Therefore, a licensor that agrees to a restriction on its ability to assign an IP license agreement should consider expressly reserving its rights to transfer the licensed IP.

LICENSOR AND LICENSEE PERSPECTIVES ON ASSIGNABILITY

Licensors and licensees generally have competing perspectives on the assignability of each party's rights under a license agreement.

Each party typically favors assignability of its own rights. The license may be a valuable asset and each party will want to retain the flexibility to assign it to a third party or an affiliate in connection with a corporate reorganization.

Licensors typically oppose free transferability of license rights by licensees for the following reasons:

- The licensor may have chosen the licensee for its specific characteristics. For example, the licensee may have a particular ability to:
  - commercialize the IP;
  - enforce the licensor's rights;
  - produce high quality goods;
  - sustain a certain level of production;
  - create improvements to the IP; or
  - enhance the licensor's reputation.
- The terms of the license may have also been based on the particular licensee's operations, for example:
  - the field of use or territory; or
  - the pricing and expected volume of sales.
- A licensor may not want the licensed IP to end up in the hands of its competitor or the licensee's bankruptcy trustee.

Licensees generally do not have equivalent concerns over the licensor's assignment of its rights under a simple IP license agreement. A successor owner of the licensed IP can presumably grant the same license on the same terms (see *Default Rules: IP Licenses*).

A licensee may have a legitimate objection to the licensor's transfer of a license agreement if the agreement includes obligations to provide services that the original licensor is uniquely qualified to provide, such as training, maintenance or development of new IP.

Another potential objection to the licensor's transfer of an IP license (or to the transfer of the related IP) is where the transferee is the licensee's competitor. In such a case, the licensee may have concerns about perceived relationship issues, loss of competitive advantages or the transferee's commitment to sustaining the IP (see, for example, *Eastman Kodak, at *18-19*).

Contact Us

PRACTICAL LAW COMPANY®

Practical Law Company
747 Third Avenue, 36th Floor
New York, NY 10017
646.562.3405
plcinfo@practicallaw.com
www.practicallaw.com