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SULLIVAN & WORCESTER LLP INTELLECTUAL PROPERTY ADVISORY

Bad News for Technology Licensees? Sixth Circuit Rules that Internal Restructurings May Result in a Breach of IP Licenses

The United States Court of Appeals for the Sixth Circuit recently ruled that internal corporate restructurings cause IP licenses to be transferred as a matter of law and may inadvertently breach the underlying license if the transaction was effected without consent. Relying on federal common law, the court in *Cincom Systems Inc. v. Novellis Corp.*, 581 F.3d 431 (2009), held that patent and copyright licenses are nontransferable in the absence of express provisions to the contrary. The *Cincom Systems* decision was noteworthy because it applied the presumption of non-assignability even in the case of an internal reorganization, after which the licensed IP remained on the same computer and was owned indirectly by the same parent company.

THE LICENSE AND SUBSEQUENT RESTRUCTURING

In 1989, Cincom Systems Inc., an Ohio corporation that develops and licenses software for corporate customers, licensed two of its software programs to Alcan Rolled Products Division (Alcan Ohio) under a non-exclusive, non-transferable license. Under the license agreement, which was expressly governed by Ohio law, the software could only be installed on specifically-listed computers, and Alcan Ohio could not “transfer its rights or obligations” without Cincom’s prior written approval.

In 2003, Alcan Ohio merged with and into a Texas affiliate that was wholly owned by the same parent company. In 2005, the Texas company changed its name to Novellis. The software licensed from Cincom remained on the same computer located in New York, and Alcan Ohio never sought or obtained Cincom’s approval to continue to use the licensed software following the restructuring.

After learning of the restructuring, Cincom sued Novellis for copyright infringement, alleging Novellis’ actions violated the license agreement. The parties stipulated facts and filed separate motions of summary judgment, and the district court granted Cincom’s motion. Novellis appealed to the Sixth Circuit.

FEDERAL PREEMPTION

Relying on *PPG Industries, Inc. v. Guardian Industries Corp.*, 597 F.2d 1090 (6th Cir. 1979), the court ruled that federal common law

IF YOU WOULD LIKE ADDITIONAL INFORMATION, PLEASE CONTACT:

Kimberly B. Herman
617 338 2943
kherman@sandw.com

Michael A. Matzka
617 338 2874
mmatzka@sandw.com

Jonathan Vaas
617 338 2802
jvaas@sandw.com

BOSTON

Sullivan & Worcester LLP
One Post Office Square
Boston, MA 02109

NEW YORK

Sullivan & Worcester LLP
1290 Avenue of the Americas
New York, NY 10104

WASHINGTON, DC

Sullivan & Worcester LLP
1666 K Street, NW
Washington, DC 20006

ISRAEL

Zysman, Aharoni, Gayer &
Ady Kaplan & Co. / S&W LLP
41-45 Rothschild Blvd., Beit Zion
Tel Aviv, 65784 Israel

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WORCESTER

governs questions regarding the assignability of patent and copyright licenses, preempting any inconsistent state laws. In *PPG Industries*, the court held that a license is presumed to be non-assignable and nontransferable in the absence of express provisions to the contrary, reasoning that to hold otherwise would undermine the incentives for invention created by federal patent and copyright laws.

Because there is no general federal corporate law, whether a merger actually results in a transfer of an IP license remains a question of state law. The Sixth Circuit accordingly turned to Ohio law to determine whether Alcan Ohio's restructuring resulted in a transfer of the software license.

THE SIXTH CIRCUIT HOLDING

Novelis argued that the merger did not amount to a transfer of the software license under Ohio law. The circuit court disagreed.

Subsequent to the *PPG Industries* decision, Ohio revised its statutory merger law. Notwithstanding the revised statute, which no longer included the words "transfer to," the court in *Cincom Systems* reasoned that, because Alcan Ohio's license automatically vested in the surviving company by operation of law, the license must have been transferred to Novelis.

Due to the non-transfer provision of the software license, the only legal entity that could hold the license from Cincom was Alcan Ohio. By transferring the license without consent, Alcan Ohio breached the plain meaning of the prohibition against transfer. Novelis' subsequent use of the software, which remained on the same computer in New York, amounted to infringement of Cincom's copyright. The appellate court therefore affirmed the district court's grant of summary judgment in favor of Cincom.

In reaching this holding, the Sixth Circuit rejected Alcan Ohio's arguments regarding absence of damages, policy considerations or parole evidence relating to the contracting parties' original intent. The court concluded that because the license terms were clear, it need not stray outside the terms of the license itself.

WHAT THIS MEANS FOR YOUR BUSINESS

The *Cincom Systems* decision applies to any type of copyright or patent license. Although the opinion is controlling only for federal courts in the Sixth Circuit, it has attracted significant attention beyond the borders of its jurisdiction.

If other courts adopt the *Cincom Systems* approach, technology, Internet and traditional media companies (especially those with holding company structures) located outside the Sixth Circuit may find that essential IP rights have become unintentionally invalidated following internal restructurings.

As a result, prior to an internal restructuring, any company that licenses IP rights should perform in-house due diligence including the type of contract audit that is customarily done when contemplating the acquisition of or merger with a third party. If the license terms do not clearly permit restructurings, consideration should be given to obtaining the advance consent of the licensor.

When negotiating license agreements, companies should confirm with their attorneys that assignment and non-transfer provisions use precise language that specifically deals with internal reorganizations, external mergers, changes of control, assignment (direct or indirect, by operation of law or otherwise), and other foreseeable events. As illustrated by *Cincom Systems*, silence or the lack of specificity in an IP license may be interpreted against the licensee.

If you have any questions or would like to learn more about the issues raised by this Advisory, please contact any of the attorneys listed above.

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