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[Internal Reorganization Results in Improper Assignment of Software License Agreement with Damage Award of Almost Half Million Dollars](#)

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Internal reorganizations are not at all uncommon and usually are viewed as relatively simple transactions with few implications for a company's intellectual property. A recent decision by the Sixth Circuit, *Cincom v. Novelis*, 581 F.3d 431 (6th Cir. 2009), is a reminder of why it is important, even in such "simple" transactions, to consider the potential for hidden intellectual property pitfalls. At least some of these risks can be reduced by undertaking a review of your company's licensing agreements, especially any model forms your company may use.

The Facts:

Novelis's predecessor, Alcan Ohio, licensed software from Cincom. The license prohibited transfer of the license absent Cincom's consent. Alcan Ohio merged into a sister company. Following a number of additional intra-group mergers, Novelis emerged as the surviving corporate entity. Novelis continued to use the copyrighted software - on the same computer and at the same location — but without ever obtaining Cincom's consent. Cincom claimed that this continued use constituted copyright infringement.

Novelis defended by claiming that its internal reorganization was merely a merger of various wholly owned companies and, as a result, there was no transfer of rights.

The trial court granted summary judgment in Cincom's favor and awarded stipulated damages of almost \$500,000. The Sixth Circuit affirmed.

Legal Principles:

Assignment of Certain Intellectual Property Licenses Is Not Allowed Absent Specific Authorization in License

Traditionally, contracts are presumed to be freely assignable or transferable unless they expressly provide otherwise. However, many federal courts have held that patent licenses are not assignable or transferable by the licensee without the licensor's express consent. These courts consider that the goal of the legal monopoly granted by a patent — namely to foster innovation — would be undermined if a licensor lost control over how (and by whom) its patent was exploited. A handful of federal courts have extended this analysis by analogy from patent licenses to copyright licenses, holding that, absent specific authorization in the license it is a breach to assign it (or transfer it by operation of law) without licensor consent. As a result, an assignee or transferee would be an infringer.

Because there is no federal common law on what constitutes an assignment or transfer, past federal decisions have looked to state law to determine whether a transfer of the license had occurred, and often reached different outcomes based on different statutory language. If there was no transfer or assignment under state law, then the federal rule against assignment or transfer did not come into play.

The Sixth Circuit's decision in *Cincom* is notable for its expansion of existing law. While the no transfer rule had been most frequently applied to transfers to unrelated entities (such as in the acquisition

context), the Sixth Circuit expressly held that the same rule applies to corporate restructuring — even when ownership ultimately stays vested in the same controlling parties as before. According to the Sixth Circuit, whenever a different legal entity ends up holding a patent or copyright license, there has been a "transfer" that is prohibited under federal law absent the licensor's consent.

What Types of Agreements Does This Decision Impact?

While the *Cincom* decision involved a software license, the same reasoning could also apply to a variety of agreements, including licenses of federal trademark registrations. The decision most likely also applies to other types of agreements dealing with federally protected intellectual property interests, even when not labeled as "licenses." For instance, many companies pay a professional photographer for the right to use photographs in their annual report using a document entitled "Copyright Consent" or "Limited Use Agreement." These are, at their core, copyright licenses, and it is very likely that the same reasoning would apply. If a company that signed such an agreement merges into an affiliated entity, the continued use of the photograph by the surviving entity could give the photographer a cause of action against the company. It is also possible that a court would find that a "consent" agreement with respect to a trademark is, for these purposes, a form of license, and that whatever consent was given did not extend to the successor entity.

Steps You Can Take Now To Avoid Problems In The Future:

While there is no uniform solution to this problem, there are certain steps a company can take now that entail very little time and expense.

First, licensees should consider creating a model provision that allows them to restructure without the licensor's consent, provided that ultimate control of the business remains unchanged. Under *Cincom*, the transfer of patent or copyright license rights as part of a merger, including an internal corporate restructuring, requires that the original agreement expressly permit such a transfer, or that the licensor consent. A licensee's leverage to obtain such consent is much higher at the outset of the relationship (when the licensor is looking to seal the deal and book the revenue). Given the pressure to maintain profitability during the current economic downturn, many licensors have become quite aggressive about seeking additional payments from successors-by-merger, particularly where the successor does not have a broader commercial relationship with the licensor that it can leverage to secure the needed consent.

Second, this decision has significant due diligence implications for mergers and acquisitions and may also impact the representations and warranties companies may want to give (or receive) in M&A transactions. These issues are often overlooked in internal restructurings. Yet the *Cincom* decision makes clear that appropriate due diligence is a critical component of even purely internal restructurings and transactions with affiliates. Issues can also arise where the attorneys performing the due diligence are not familiar with intellectual property issues. Any time that a corporation is merged or sold, attorneys should consider the impact on the intellectual property assets involved, especially rights licensed from third parties. To the extent that your company has any preexisting due diligence checklists, forms or procedures that it uses in connection with acquisitions, divestitures, joint ventures or similar transactions, update those documents now to reflect the need to review the target company's licenses to ensure they authorize assignment or transfer. Be sure that these forms highlight the necessity of obtaining specific consent for any transfer of federally recognized intellectual property that may result from the contemplated transaction if the relevant agreement is silent on the subject.

Of course, depending on the nature of your business and the specific transaction being contemplated, there may be other steps to consider. Kilpatrick Stockton's attorneys are well versed in these issues and are available to assist our clients in developing strategies to avoid the pitfalls described above.

For more information about these issues, please contact the author(s) of this Legal Alert or your existing firm contact.

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