

# ANTIASSIGNMENT CLAUSES, MERGERS, AND THE MYTH ABOUT FEDERAL PREEMPTION OF APPLICATION OF STATE CONTRACT LAW TO PATENT LICENSE AGREEMENTS

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## I. INTRODUCTION

An industry is dominated by two large corporate players, Company A and Company B. There are also several smaller, less significant players, including Small Company C. Company A discovers and patents a technology that gives it a measurable market advantage over its major competitor, Company B. Believing that Small Company C may help further develop and advance the technology, Company A weighs the risks of allowing Small Company C access to its patented technology. Company A determines that Small Company C is not

a real competitive risk to its market power and even may help further the technology's potential.

Company A then issues a patent license to Small Company C, giving it permission to use the patented technology in exchange for certain fees and royalties. Concerned that Company B, its major competitor, may attempt to purchase the patent license from Small Company C, Company A includes a generally drafted antiassignment clause in the license agreement prohibiting assignment of the patent license without its consent. Several months after forming the license agreement with Small Company C, Company A learns that Company B has merged with Small Company C.

Under state contract law holding mergers not to violate antiassignment clauses, Company A's major competitor has now acquired access to Company A's patented technology. In this situation, Company A would certainly like to argue that the merger was a violation of the consent-first antiassignment clause in the license agreement. Unfortunately, state contract law precedent does not support this argument. To prevail, Company A must successfully contend that patent license agreements are an exception to state contract law. There is an ongoing debate regarding whether federal patent law preempts state contract law when parties contract for a patent license, thereby creating an exception to the widespread state contract law rule that mergers do not usually violate contractual antiassignment clauses.<sup>1</sup>

Contracting parties attempt to ensure the integrity of their contractual relationships by including antiassignment clauses in their contracts.<sup>2</sup> Historically, corporate mergers do not violate contractual antiassignment clauses because there is not a transfer of assets, and therefore nothing is assigned.<sup>3</sup> The assets of merging companies are vested in the surviving company by the operation of state merger law.<sup>4</sup> Prominent treatises state that rights under a patent license owned by a constituent corporation pass to the consolidated

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1. Compare *Everex Sys., Inc. v. Cadtrak Corp. (In re CFLC, Inc.)*, 89 F.3d 673, 677-78 (9th Cir. 1996); *PPG Indus., Inc. v. Guardian Indus. Corp.*, 597 F.2d 1090, 1093 (6th Cir. 1979); *Unarco Indus., Inc. v. Kelley Co.*, 465 F.2d 1303, 1305 (7th Cir. 1972) with *Farmland Irrigation Co. v. Dopplmaier*, 308 P.2d 732, 740-41 (Cal. 1957); *TXO Prod. Co. v. M.D. Mark, Inc.*, 999 S.W.2d 137, 142 (Tex. App. 1999); Carole A. Quinn & R. Scott Weide, *Violation of the Erie Doctrine: Application of a Rule of Federal Common Law to Issues of Patent License Transferability*, 32 CREIGHTON L. REV. 1121, 1141-45 (1999); Daniel A. Wilson, Note, *Patent License Assignment: Preemption, Gap Filling and Default Rules*, 77 B.U. L. REV. 895, 909-17 (1997).

2. See *infra* Part II.A.

3. See *infra* Part II.B.

4. See *infra* Part II.B.

corporation in the case of a consolidation<sup>5</sup> and to the new corporation in the case of a merger.<sup>6</sup> Yet federal courts are developing an exception to this state common law rule for patent license agreements.<sup>7</sup> They argue that federal patent law preempts state contract law for patent license agreements.<sup>8</sup>

This Note discusses the federal courts' arguments and their validity and ultimately argues that the federal patent system does not completely preempt state contract law as it applies to patent license agreements.<sup>9</sup> Part II of this Note discusses contractual antiassignment clauses, mergers, and how the language of an antiassignment clause could affect the relevance of this analysis. Part III discusses how state contract law treats antiassignment clauses in the case of a merger in various types of contracts, such as leases and insurance policies. Part IV briefly discusses federal case law holding patent licenses to be governed by a federal rule of nonassignability. Further, Part IV argues state law should govern whether a merger violates an antiassignment clause in a patent license agreement. Part V concludes that the federal patent system should not preempt state contract law as it applies to whether corporate mergers are assignments of patent license agreements.

## II. ANTIASSIGNMENT CLAUSES AND MERGERS GENERALLY

### A. Antiassignment Clauses

An assignment is the transfer by a party of all of its rights to some kind of property, usually intangible property.<sup>10</sup> The modern state law approach to contracts favors free assignability of contractual rights and obligations.<sup>11</sup> Contracting parties can protect their contractual interests by limiting their

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5. 15 WILLIAM MEADE FLETCHER ET AL., FLETCHER CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 7089, at 138 (perm. ed. 1999). A consolidation is "[t]he unification of two or more corporations by dissolving the existing ones and creating a single new corporation." BLACK'S LAW DICTIONARY 304 (7th ed. 1999).

6. A. DELLER, WALKER ON PATENTS § 409 (2d ed. 1965). See *infra* Part B for merger discussion.

7. See *infra* Part IV.A.

8. See *infra* Part IV.A.

9. See *infra* Part IV.B.

10. BLACK'S LAW DICTIONARY 115 (7th ed. 1999).

11. *Rumbin v. Utica Mut. Ins. Co.*, 757 A.2d 526, 531 (Conn. 2000) (citing RESTATEMENT (SECOND) OF CONTRACTS § 317, at 15 (1981)). The United States Court of Appeals for the Federal Circuit recently stated in dicta that the general rule of free assignability does not apply to patent license agreements. *Rhone-Poulenc Agro, S.A. v. DeKalb Genetics Corp.*, 271 F.3d 1081, 1088 (Fed. Cir. 2001), vacated and superceded on reh'g by 284 F.3d 1323 (4th Cir. 2002). Read broadly, this dicta may render this Note's discussion useless. See *id.* The Federal Circuit reheard *Rhone-Poulenc* and narrowed its holding but the dicta survived. *Rhone-Poulenc Agro, S.A. v. DeKalb Genetics Corp.*, 284 F.3d at 1328.

assignment through an antiassignment clause in the contracts themselves.<sup>12</sup> Antiassignment clauses may either prohibit an assignment outright or delineate the terms under which a contract may be assigned.<sup>13</sup> A well-written antiassignment clause specifically lists all of the prohibited assignments.<sup>14</sup> Those antiassignment clauses delineating the terms under which a transfer may occur often require consent.<sup>15</sup> Ambiguity in the transfer or consent requirements of antiassignment clauses may create questions about whether a corporate merger will violate its provisions.<sup>16</sup>

### B. Mergers

A statutory merger is "the absorption of one company . . . that ceases to exist into another that retains its own name and identity and acquires the assets

12. See *N. Ins. Co. of N.Y. v. Allied Mut. Ins. Co.*, 955 F.2d 1353, 1358 (9th Cir. 1992) (recognizing that antiassignment clauses protect insurers from the possibility of increased risk of exposure resulting from the transfer of an insurance policy). *But see Rumbin v. Utica Mut. Ins. Co.*, 757 A.2d at 531-32 (allowing party to assign annuity contract despite an antiassignment clause because the clause limited only the right to assign the contract, not the power to do so).

13. The modern approach to interpreting antiassignment clauses makes a distinction between clauses limiting a party's *right* to assign contractual rights or obligations and a party's *power* to assign the contractual rights or obligations. *Rumbin v. Utica Mut. Ins. Co.*, 757 A.2d at 531. Those clauses limiting the *right* to assign allow only for recovery of damages caused by the assignment but do not invalidate the assignment itself. *Id.* at 531-33. Clauses limiting the power to assign are more difficult to draft effectively but make any assignment of the contract void. *Id.* at 533-34.

14. See discussion *infra* Part II.C.

15. See, e.g., *Parrish Chiropractic Ctrs., P.C. v. Progressive Cas. Ins. Co.*, 874 P.2d 1049, 1051 (Colo. 1994) ("Interest in this policy may not be assigned without our written consent.") (emphasis omitted); *Cloughly v. NBC Bank-Sequin, N.A.*, 773 S.W.2d 652, 655 (Tex. App. 1989) ("Seller . . . shall not have the right to make any assignment . . . under this Agreement without the prior written consent of the Purchaser . . .").

16. See, e.g., *Packard Instrument Co. v. ANS, Inc.*, 416 F.2d 943, 944 n.1, 945 (2d Cir. 1969). In *Packard*, the United States Court of Appeals for the Second Circuit declared the following antiassignment clause ambiguous and required the admission of parole evidence:

The rights and privileges under license grants and covenant not to sue herein given by Packard to ANS are personal, and shall not be transferred or assigned, except (a) if Packard shall give prior written consent to ANS for the transfer or assignment of such rights and privileges, (b) if the entire ownership and business of ANS is transferred by sale, merger, or consolidation, such rights and privileges of ANS may be assigned to its successor, or (c) if the entire manufacturing know-how, assets and product line of ANS relating to liquid scintillation spectrometers is sold, such rights and privileges of ANS may be assigned to the purchaser.

*Id.* Although the above antiassignment clause seems clear because the exceptions to its prohibition of assignment or transfer are specifically described, the court's finding of ambiguity illustrates that drafting an unambiguous antiassignment clause is challenging. See *id.* at 944-45. For further discussion of antiassignment clause drafting, see discussion *infra* Part II.C.

and liabilities of the former."<sup>17</sup> This absorption occurs by operation of state law.<sup>18</sup> There is a theory of continuity underlying a merger.<sup>19</sup> State merger statutes often provide that the rights, privileges, immunities, and franchises of the merging corporations are vested in the surviving corporation without further act or deed.<sup>20</sup> Therefore, the state statutes provide for the surviving corporation's possession of the merging corporations' assets, without a real transfer of the assets.<sup>21</sup> Under state law therefore, mergers should not generally violate contractual antiassignment clauses because they are not a transfer or sale of assets.<sup>22</sup>

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17. BLACK'S LAW DICTIONARY 1002 (7th ed. 1999).

18. See *Dodier Realty & Inv. Co. v. St. Louis Nat'l Baseball Club, Inc.*, 238 S.W.2d 321, 324-25 (Mo. 1951) (holding a merger did not violate antiassignment clause because the "separate existence" of the merging corporations would cease by operation of the state merger law).

19. See *Vulcan Materials Co. v. United States*, 446 F.2d 690, 694 (5th Cir. 1971) ("In a merger, [the] attributes of corporate life are transferred to the surviving corporation and are there continued and preserved."). But see *PPG Indus., Inc. v. Guardian Indus. Corp.*, 597 F.2d 1090, 1095-96 (6th Cir. 1979) (arguing that the theory of continuity underlying a merger "does not mean that there is no transfer of particular assets from a constituent corporation to the surviving or resultant one").

20. MODEL BUS. CORP. ACT § 11.07 (2000); see, e.g., ARK. CODE ANN. § 4-26-1005(b)(4) (Michie 2001) ("The surviving or new corporation shall possess all the rights, privileges, immunities, and franchises, of a public as well as of a private nature, of each of the merging or consolidating corporations.") (emphasis added); IDAHO CODE § 53-664(3)-(4) (Michie 2000) ("The surviving entity . . . shall . . . possess all the rights, privileges, immunities and powers of each constituent entity . . . ; (4) All property, real, personal and mixed, . . . and all and every other interest of or belonging to or due to each of the constituent entities shall be vested in the surviving entity . . .") (emphasis added); IOWA CODE § 491.110(4) (2001) ("[A]ll property, real, personal and mixed, . . . and all and every other interest, of or belonging to or due to each of the corporations so merged or consolidated, shall be taken and deemed to be . . . vested in such single corporation without further act or deed.") (emphasis added); MINN. STAT. ANN. § 302A.641(2)(c) (West 1985 & Supp. 2002) ("The surviving . . . corporation . . . possesses all the rights, privileges, immunities, and franchises . . . of each of the constituent organizations. All property, real, personal, and mixed . . . and every other interest of or belonging to . . . each of the constituent organizations vests in the surviving organization without any further act or deed.") (emphasis added); OHIO REV. CODE ANN. § 1701.82(A)(3) (Anderson 2001) ("The surviving . . . entity possesses all assets and property of every description . . . and the rights, privileges, immunities, powers, franchises, and authority . . . of each constituent entity, . . . all of which are vested in the surviving or new entity without further act or deed.") (emphasis added).

21. See MODEL BUS. CORP. ACT § 11.07 cmt. ("The survivor automatically becomes the owner of all real and personal property [of the merging corporation. However, a] merger is not a conveyance, transfer, or assignment.").

22. See *id.* ("[A merger] does not give rise to a claim that a contract with a party to the merger is no longer in effect on the ground of nonassignability, unless the contract specifically provides that it does not survive a merger."); see also *TXO Prod. Co. v. M.D. Mark, Inc.*, 999 S.W.2d 137, 139-40 (Tex. App. 1999) (explaining that mergers do not violate antiassignment clauses in leases, insurance policies, and various other types of contracts).

### C. Language of the Antiassignment Clause

An interesting preliminary question is the precise language of the antiassignment clause. As indicated earlier, a well-drafted antiassignment clause would specifically list the assignments it seeks to prohibit.<sup>23</sup>

However, drafting an antiassignment clause providing for all possible assignments and describing them with adequate specificity requires careful research and contemplation of every circumstance. For example, the antiassignment clause in the lease in *Standard Operations, Inc. v. Montague*<sup>24</sup> prohibited transfers "by operation of law" and cited examples of involuntary transfers by operation of law in the case of financial difficulties, such as bankruptcy.<sup>25</sup> The court held a merger was not an assignment "by operation of law" as prohibited by the lease because it was a voluntary transaction as opposed to the involuntary transactions listed in the antiassignment clause.<sup>26</sup> The court did not hold the merger violated the antiassignment clause because the lease did not specifically mention it as an event requiring lessor's prior consent.<sup>27</sup>

This Note assumes that, under state contract law, antiassignment clauses may be drafted with enough specificity to protect contracting parties' rights. Based on this assumption, this Note argues that federal courts should allow state contract law to operate on ambiguous antiassignment clauses in patent license agreements.<sup>28</sup>

23. See *supra* notes 14-16 and accompanying text.

24. *Standard Operations, Inc. v. Montague*, 758 S.W.2d 442 (Mo. 1988).

25. *Id.* at 443-45.

26. *Id.* at 445.

27. *Id.*

28. Ostensibly clear and specific language is often the subject of debate. For example, the meaning of a common antiassignment phrase, "by operation of law," is still debated. Compare *Essex Int'l, Inc. v. Clamage*, 440 F.2d 547 (7th Cir. 1971) (holding "by operation of law" does not include corporate mergers); *Koppers Coal & Transp. Co. v. United States*, 107 F.2d 706 (3d Cir. 1939) (holding "by operation of law" does not include corporate mergers); *Standard Operations, Inc. v. Montague*, 758 S.W.2d at 442 (holding "by operation of law" does not include corporate mergers and has not been assigned a particular legal meaning) with *Pac. First Bank v. New Morgan Park Corp.*, 876 P.2d 761 (Or. 1994) (holding "by operation of law" includes corporate mergers). For a discussion of the possible ambiguities in the following detailed assignment clause in a lease agreement, see Richard M. Frome, *Handling Assignment Clauses in an Age of Chameleon Entities*, PRAC. REAL EST. LAW., Jan. 2000, at 49, 49:

Provided Tenant shall not be in default under this Lease following notice and the expiration of applicable grace periods provided for in this Lease, this Lease may, without any right of recapture or profit sharing by Landlord, be assigned without the consent of Landlord to any corporation into which or with which Tenant may be merged or consolidated, or which shall purchase substantially of the assets of Tenant, or assigned or sublet in whole or in part to any Affiliated Person of Tenant . . . or any successor entity created by merger, reorganization, recapitalization or

### III. EXAMPLES OF THE EFFECT OF MERGERS ON ANTIASSIGNMENT CLAUSES

Under rules of state contract law, mergers do not violate antiassignment clauses in leases, insurance policies, and other types of contracts.<sup>29</sup>

#### A. Leases

Courts have held that mergers do not violate antiassignment clauses in leases.<sup>30</sup> In *Dodier Realty & Investment Co. v. St. Louis National Baseball Club, Inc.*,<sup>31</sup> the antiassignment clause provided the lease could be terminated for breach of the antiassignment clause's terms.<sup>32</sup> When the lessee merged into another corporation, the lessor sought to terminate the lease for breach of the antiassignment clause.<sup>33</sup> Finding that the merger did not breach the antiassignment clause, the court noted the applicable state merger statute dissolved the merging corporations by operation of law.<sup>34</sup> Thus, there was no assignment in violation of the lease's antiassignment clause.<sup>35</sup>

acquisition of Tenant, provided each of the following conditions shall be complied with:

- (i) If the assignment shall be to a successor by merger, consolidation, reorganization or recapitalization or acquisition of assets, the successor shall have acquired all or at least 95 percent of the assets, and assumed all of the liabilities of the assignor, and shall have total assets and total net worth . . . at least equal to the total of the assets and total net worth, respectively, as of a date 12 months before the date of the assignment, of the assignor.
- (ii) If the assignment or sublease shall be to an Affiliated Person of Tenant, that Affiliated Person of Tenant shall have assumed all of the liabilities under this Lease of the assignor, and the assignor shall have expressly agreed to continue to remain jointly and severally liable as Tenant under this lease . . .

*Id.* at 49-50 (internal references omitted).

29. TXO Prod. Co. v. M.D. Mark, Inc., 999 S.W.2d 137, 139-40 (Tex. App. 1999).

30. See, e.g., *id.* (listing *Giaise v. Guccia*, 420 So. 2d 700 (La. Ct. App. 1982); *Standard Operations, Inc. v. Montague*, 758 S.W.2d 442 (Mo. 1988); *Dodier Realty & Inv. Co. v. St. Louis Nat'l Baseball Club, Inc.*, 238 S.W.2d 321 (Mo. 1951); *Segal v. Greater Valley Terminal Corp.*, 199 A.2d 48 (N.J. Super. Ct. App. Div. 1964); *Brentsun Realty Corp. v. D'Urso Supermarkets, Inc.*, 582 N.Y.S.2d 216 (App. Div. 1992); *Santa Fe Energy Res. v. Manners*, 635 A.2d 648 (Pa. Super. Ct. 1993)).

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

32. *Id.* at 323 n.1-2.

33. *Id.* at 322.

34. *Id.* at 325.

35. *Id.*

In a more recent case, a court similarly held that a merger did not breach an antiassignment clause requiring the lessor's consent before assignment because the merger of a corporation into its parent corporation did not change the ownership, possession, or control of the property.<sup>36</sup>

Although leases are perhaps distinguishable from other contracts because restraints on alienation of real property are disfavored,<sup>37</sup> case law rarely uses this distinction as a factor in favor of deciding that a merger does not violate an antiassignment clause.<sup>38</sup> Instead, courts use a more formalistic approach, looking to the language of the state merger statutes to find a continuing interest such that all rights, privileges, and assets become vested in the surviving corporation and there is therefore not a transfer as prohibited by the antiassignment clause.<sup>39</sup>

### B. Insurance Policies

Courts generally hold mergers do not violate antiassignment clauses in insurance policies when they pose no increased risk to the insurer.<sup>40</sup> The

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36. *Brentsun Realty Corp. v. D'Urso Supermarkets, Inc.*, 582 N.Y.S.2d 216, 217 (App. Div. 1992).

37. A restraint on alienation is "a restraint, usually in a deed of conveyance, on a grantee's ability to sell or transfer real property. . . . Restraints on alienation are generally unenforceable as against public policy favoring the free alienability of land." BLACK'S LAW DICTIONARY 1316 (7th ed. 1999); *see PPG Indus., Inc. v. Guardian Indus. Corp.*, 597 F.2d 1090, 1095 (6th Cir. 1979) (noting the "deep-rooted policy against restraints on alienation"); *see also Dodier Realty & Inv. Co. v. St. Louis Nat'l Baseball Club, Inc.*, 238 S.W.2d at 321 (noting forfeiture of leaseholds is disfavored).

38. *See TXO Prod. Co. v. M.D. Mark, Inc.*, 999 S.W.2d 137, 139-40 (Tex. App. 1999) (listing *Giaise v. Guccia*, 420 So. 2d 700 (La. Ct. App. 1982); *Standard Operations, Inc. v. Montague*, 758 S.W.2d 442 (Mo. 1988); *Dodier Realty & Inv. Co. v. St. Louis Nat'l Baseball Club, Inc.*, 238 S.W.2d at 321; *Segal v. Greater Valley Terminal Corp.*, 199 A.2d 48 (N.J. Super. Ct. App. Div. 1964); *Brentsun Realty Corp. v. D'Urso Supermarkets, Inc.*, 582 N.Y.S.2d at 216; *Santa Fe Energy Res. v. Manners*, 635 A.2d 648 (Pa. Super. 1993)).

39. *See Dodier Realty & Inv. Co. v. St. Louis Nat'l Baseball Club, Inc.*, 361 S.W.2d at 321; *Essex Int'l, Inc. v. Clamage*, 440 F.2d 547 (7th Cir. 1971). *But see* Steven E. Ballew, *The Assignment of Rights, Franchises, and Obligations of the Disappearing Corporation in a Merger*, 38 BUS. LAW. 45, 46-50 (1982) (criticizing this formalistic approach because it does not help an attorney predict whether a court will recognize the definitional distinctions). Ballew contends that both formalist and functional approaches "are akin to determining whether, pursuant to common law assignment principles, contractual rights so involve the personal trust and confidence of the contracting parties that the contract cannot be assigned without the non-transferring party's consent." *Id.* at 45-46.

40. *TXO Prod. Co. v. M.D. Mark, Inc.*, 999 S.W.2d at 139 (listing *Imperial Enters., Inc. v. Fireman's Fund Ins. Co.*, 535 F.2d 287 (5th Cir. 1976); *Brunswick Corp. v. St. Paul Fire & Marine Ins. Co.*, 509 F. Supp. 750, 753 (E.D. Pa. 1981); *Paxton & Vierling Steel Co. v. Great Am. Ins. Co.*, 497 F. Supp. 573 (D. Neb. 1980)); *see also Gopher Oil Co. v. Am. Hardware Mut. Ins. Co.*, 588 N.W.2d 756 (Minn. 1999) (holding consent-first antiassignment clause in insurance policy for environmental liabilities unenforceable).

antiassignment clause in *Imperial Enterprises, Inc. v. Fireman's Fund Insurance Co.*<sup>41</sup> required the insurer's consent before an assignment of the insurance policy at issue.<sup>42</sup> Without seeking the insurer's consent, the insured corporation merged after the insurance policy became effective.<sup>43</sup> When a fire destroyed an insured plant, the surviving corporation sought coverage under the policy.<sup>44</sup> The court based its holding that the merger was not an assignment requiring the insurance company's prior consent on the fact that state merger law was to the contrary, that there was no increased risk to the insurer due to the merger, and that the transfer was by operation of law, not personal assignment.<sup>45</sup> According to case law, mergers do not violate antiassignment clauses in insurance policies unless there is an increased risk to the insurer because the policy was considered to be transferred to the surviving corporation by operation of law.<sup>46</sup>

### C. Other Cases

Courts disfavor forfeiture in insurance policies and leases, which may explain why cases holding a merger does not violate antiassignment clauses when the contract at issue is an insurance policy or lease are common.<sup>47</sup> There are, however, other circumstances under which courts have been equally reluctant to hold a merger breached an antiassignment clause.<sup>48</sup> For example, the United States Court of Appeals for the Seventh Circuit found that a merger did not violate an antiassignment clause in a railroad trackage rights agreement.<sup>49</sup> Moreover, state courts have found that mergers did not violate antiassignment clauses in construction contracts<sup>50</sup> and printing contracts.<sup>51</sup>

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41. *Imperial Enters., Inc. v. Fireman's Fund Ins. Co.*, 535 F.2d 287 (5th Cir. 1976).

42. *Id.* at 290.

43. *Id.* at 289.

44. *Id.*

45. *Id.* at 291-93.

46. *TXO Prod. Co. v. M.D. Mark, Inc.*, 999 S.W.2d 137, 139 (Tex. App. 1999) (citing *Imperial Enters., Inc. v. Fireman's Fund Ins. Co.*, 535 F.2d at 291-93; *Paxton & Vierling Steel Co. v. Great Am. Ins. Co.*, 497 F. Supp. 573, 581 (D. Neb. 1980)).

47. *Id.* at 139-40.

48. *Id.* at 140 (listing *In re Chi., Milwaukee, St. Paul & Pac. R.R.*, 799 F.2d 317, 337 (7th Cir. 1986); *Winchester Constr. Co. v. Miller County Bd. of Educ.*, 821 F. Supp. 697, 698, 702 (M.D. Ga. 1993); *Sun World Corp. v. Pennysaver, Inc.*, 637 P.2d 1088, 1089, 1092 (Ariz. 1981); *Trubowitch v. Riverbank Canning Co.*, 182 P.2d 182, 184, 190 (Cal. 1947); *Alexander & Alexander, Inc. v. Koelz*, 722 S.W.2d 311, 313, 314 (Mo. Ct. App. 1986); *Docudata Records Mgmt. Servs., Inc. v. Wieser*, 966 S.W.2d 192, 198 (Tex. App. 1998)); *see also* *Rainbow Oil Co. v. Christmann*, 656 P.2d 538, 544 (Wyo. 1982).

49. *In re Chi., Milwaukee, St. Paul & Pac. R.R.*, 799 F.2d at 337.

50. *Winchester Constr. Co. v. Miller County Bd. of Educ.*, 821 F. Supp. at 702.

51. *Sun World Corp. v. Pennysaver, Inc.*, 637 P.2d at 1092.

Other unique holdings indicate the inclination courts have to hold mergers do not violate contractual antiassignment clauses.<sup>52</sup> A merger was held not to be a sale of real property so as to trigger another's right of first refusal in *Rainbow Oil Co. v. Christmann*.<sup>53</sup> Another state court required the surviving corporation of a merger to adhere to an arbitration clause in a contract despite the antiassignment agreement in that contract.<sup>54</sup> Still another state court held the surviving corporation of a merger could enforce a covenant not to compete in a contract between one of the merged corporations and its former employee, despite the court's recognition of the general rule against assigning personal contracts.<sup>55</sup>

#### IV. ASSIGNMENT OF PATENT LICENSE AGREEMENTS

Construction of patent license agreements is a matter of state contract law.<sup>56</sup> It should thus follow that state common law rules applied to other types of contractual antiassignment clauses should also apply to antiassignment clauses in patent license agreements.<sup>57</sup> However, companies seeking to prevent major competitors from obtaining license to their patents through a merger, like Company A from the hypothetical above, disagree.<sup>58</sup> These companies argue that federal patent law preempts the long state common law history allowing assignment of contract rights in the case of a merger despite an antiassignment clause.<sup>59</sup>

##### A. Case Law

*PPG Industries, Inc. v. Guardian Industries Corp.*<sup>60</sup> involved a patent infringement action between two competing glass product manufacturers.<sup>61</sup> PPG

52. See *Trubowitch v. Riverbank Canning Co.*, 182 P.2d at 182; *Alexander & Alexander, Inc. v. Koelz*, 722 S.W.2d at 311; *Rainbow Oil Co. v. Christmann*, 656 P.2d at 543.

53. *Rainbow Oil Co. v. Christmann*, 656 P.2d 538, 543-44 (Wyo. 1982).

54. *Trubowitch v. Riverbank Canning Co.*, 182 P.2d at 190.

55. *Alexander & Alexander, Inc. v. Koelz*, 722 S.W.2d at 313-14.

56. *Lear, Inc. v. Adkins*, 395 U.S. 653, 661-62 (1969); *McCoy v. Mitsubishi Cutlery, Inc.*, 67 F.3d 917, 920 (Fed. Cir. 1995); *Power Lift, Inc. v. Weatherford Nipple-Up Sys., Inc.*, 871 F.2d 1082, 1085-86 (Fed. Cir. 1989).

57. See *TXO Prod. Co. v. M.D. Mark, Inc.*, 999 S.W.2d 137, 139 (Tex. App. 1999).

58. See *supra* Part I.

59. See *infra* notes 73-85 and accompanying text. Companies favoring preemption have convinced at least two federal courts to agree. See *PPG Indus., Inc. v. Guardian Indus. Corp.*, 597 F.2d 1090, 1093 (6th Cir. 1979) ("Questions with respect to the assignability of a patent license are controlled by federal law."); *Unarco Indus., Inc. v. Kelley Co.*, 465 F.2d 1303, 1306 (7th Cir. 1972) (holding "that the question of assignability of a patent license is a specific policy of federal patent law," and therefore "federal law applies to the question . . .").

60. *PPG Indus., Inc. v. Guardian Indus. Corp.*, 597 F.2d 1090 (6th Cir. 1979).

Industries, Inc. (PPG) and Permaglass, Inc. (Permaglass) independently developed and patented new processes for shaping sheets of glass.<sup>62</sup> They negotiated a license agreement for each other's patent rights to the processes.<sup>63</sup> The agreement granted PPG an exclusive license to Permaglass' patented technology, subject to Permaglass' reservation of nonexclusive rights to use the technology.<sup>64</sup> It also granted Permaglass a nonexclusive license to PPG's patented technology.<sup>65</sup> The agreement stated that the license PPG granted to Permaglass was "personal to [Permaglass] and nonassignable except with the consent of PPG first obtained in writing."<sup>66</sup> The license Permaglass granted to PPG was "assignable by PPG to any successor of the entire flat glass business of PPG but . . . otherwise . . . nonassignable except with the consent of [Permaglass] first obtained in writing."<sup>67</sup>

Permaglass then merged with Guardian Industries Corp. (Guardian) under state merger statutes.<sup>68</sup> The merger agreement listed the patents to which Permaglass had granted an exclusive license to PPG but retained a nonexclusive right to use and those to which PPG had granted a nonexclusive license to Permaglass.<sup>69</sup>

PPG filed a patent infringement suit, claiming that Guardian, the surviving corporation of the merger, did not have license to use the patented technologies.<sup>70</sup> The district court held the parties did not intend that Permaglass' rights under the license agreement would not pass to a successor by merger.<sup>71</sup> PPG appealed the ruling.<sup>72</sup>

The Sixth Circuit stated, without deciding, that federal law controls questions relating to the assignment of patent license agreements.<sup>73</sup> It then continued with an analysis of the facts under the presumed federal rule against assignment of patent license agreements.<sup>74</sup> It distinguished the analogy Guardian drew to shop rights<sup>75</sup> cases because an express license agreement such as the agreement between PPG and Permaglass does not contain the element of estoppel

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61. *Id.* at 1091.

62. *Id.*

63. *Id.* at 1091-92.

64. *Id.* at 1092.

65. *Id.*

66. *Id.*

67. *Id.*

68. *Id.*

69. *Id.* at 1093.

70. *Id.*

71. *Id.*

72. *Id.* at 1090.

73. *Id.* at 1093; Quinn & Weide, *supra* note 1, at 1141-45.

74. PPG Indus., Inc. v. Guardian Indus. Corp., 597 F.2d at 1093-97.

75. For a definition and further discussion of shop rights, see *infra* Part IV.B.5.

present in an implied license through shop rights.<sup>76</sup> It distinguished Guardian's analogy to lease cases by noting the policy against restraints on alienation.<sup>77</sup> The Sixth Circuit also discounted the argument under the theory of continuity of mergers that Permaglass did not assign its rights under the patent license agreement to Guardian, that the merger effectuated a vesting by operation of state law, not a sale or transfer as the antiassignment clause prohibited.<sup>78</sup> The court stated that the fact that the merger was by operation of state law "indicate[d only] that the transfer [was] by operation of law, not that there [was] no transfer of assets."<sup>79</sup>

More recently, in *Everex System Inc. v. Cadtrak Corp. (In re CFLC, Inc.)*,<sup>80</sup> the Ninth Circuit held federal law applied to the assignability of patent license agreements "because of the conflict between federal patent policy and state laws . . . [allowing] assignability."<sup>81</sup> It criticized the reasons that federal law should apply to patent license agreements set forth by the Seventh Circuit in *Unarco Industry, Inc. v. Kelley Co.*,<sup>82</sup> holding instead that the state law rule of free assignment of contracts as applied to patent license agreements would "undermine the reward that encourages invention."<sup>83</sup>

Neither the Sixth nor the Ninth Circuit adequately addressed the relevant arguments to the preemption of state contract law as it applies to the effect of a merger on a patent license agreement containing an ambiguous antiassignment clause.<sup>84</sup>

76. PPG Indus., Inc. v. Guardian Indus. Corp., 597 F.2d at 1094.

77. *Id.* at 1095.

78. *Id.* at 1095-96.

79. *Id.* at 1096.

80. *Everex Sys., Inc. v. Cadtrak Corp. (In re CFLC, Inc.)*, 89 F.3d 673 (9th Cir. 1996).

81. *Id.* at 679.

82. *Unarco Indus., Inc. v. Kelley Co.*, 465 F.2d 1303 (7th Cir. 1972).

83. *Everex Sys., Inc. v. Cadtrak Corp. (In re CFLC, Inc.)*, 89 F.3d at 677-79 (citing *Unarco Indus., Inc. v. Kelley Co.*, 465 F.2d at 1306). *Unarco's* reasons for applying federal law to patent license agreements were that the holding in *Sola Electric Co. v. Jefferson Electric Co.*, 317 U.S. 173 (1942), limited the *Erie* doctrine in the case of a patent license and that a patent license is a "use of a monopoly authorized by the Constitution and enacted by Congress" and the federally-authorized monopoly demands the application of federal law. *Everex Sys., Inc. v. Cadtrak Corp. (In re CFLC, Inc.)*, 89 F.3d at 678-79 (citing *Unarco Indus., Inc. v. Kelley Co.*, 317 U.S. 173 (1942)). The Ninth Circuit noted the *Sola* decision was a mischaracterization of the Court's holding. *Id.* at 678. Indeed, the Supreme Court later held *Sola* created an "anti-trust exception" to the *Erie* doctrine, not a patent license exception. *Id.* (citing *Lear, Inc. v. Adkins*, 395 U.S. 653, 666 (1969)). The Ninth Circuit then criticized the *Lear* decision as being "insupportably broad given the general rule that most questions with respect to the construction of patent licenses are governed by state law." *Id.* at 679.

84. PPG Indus., Inc. v. Guardian Indus. Corp., 597 F.2d 1090 (6th Cir. 1979); *Everex Sys., Inc. v. Cadtrak Corp. (In re CFLC, Inc.)*, 89 F.3d at 673; see discussion *infra* Parts IV.B.1-2. District courts have already begun limiting these decisions. See, e.g., *Synergy Methods, Inc. v.*

### B. Arguments Against Preemption

The Constitution provides supremacy to itself and congressional legislation enacted within its limits.<sup>85</sup> States have authority to govern in areas where the Constitution has not endowed Congress with exclusive power.<sup>86</sup> States may also govern when the Constitution has endowed Congress with power to act, but not exclusive power, and Congress has not acted to the full constitutional limits of its power.<sup>87</sup>

Preemption occurs when Congress . . . expresses a clear intent to pre-empt state law, when there is outright or actual conflict between federal and state law, where compliance with both federal and state law is in effect physically impossible, where there is implicit in federal law a barrier to state regulation, where Congress has legislated comprehensively, thus occupying an entire field of regulation and leaving no room for the States to supplement federal law, or where the state law stands as an obstacle to the accomplishment and execution of the full objectives of Congress.<sup>88</sup>

The Constitution delegates to Congress the power to promote progress and invention by granting patents.<sup>89</sup> Congress enacted its patent laws in pursuit of this constitutional directive.<sup>90</sup> A federal patent preemption discussion must focus on the intended purposes behind the federal patent system.<sup>91</sup> Did Congress intend to preclude all state law relating to patents, including state contract law governing contracts over patent licenses, or only those laws with which its legislation directly conflicts?

#### 1. *The Erie Doctrine*

Relying on the decisions in *PPG Industries, Inc. v. Guardian Industries Corp.*<sup>92</sup> and *Unarco Industries, Inc. v. Kelley Co.*,<sup>93</sup> *In re Alltech Plastics Inc.*<sup>94</sup>

Kelly Energy Sys., Inc., 695 F. Supp. 1362, 1366 (D.R.I. 1988) (holding the rules promulgated in *PPG Indus., Inc. v. Guardian Indus. Corp.*, 597 F.2d at 1090, and *Unarco Indus., Inc. v. Kelley Co.*, 465 F.2d at 1303, do not control when the "assignment results from a transformation of the legal form of the assignee").

85. U.S. CONST. art. VI, cl. 2.

86. U.S. CONST. amend. X.

87. *Id.*

88. La. Pub. Serv. Comm'n v. FCC, 476 U.S. 355, 368-69 (1986) (citations omitted).

89. U.S. CONST. art I, § 8, cl. 8.

90. 35 U.S.C. §§ 1-376 (2000); see FLOYD L. VAUGHAN, THE UNITED STATES PATENT SYSTEM: LEGAL AND ECONOMIC CONFLICTS IN AMERICAN PATENT HISTORY 18-20 (1972).

91. See, e.g., Joan E. Schaffner, *Patent Preemption Unlocked*, 1995 WIS. L. REV. 1081 (proposing an understanding of patent preemption based on the Lockean theory of labor as a paradigm for assessing congressional intent).

92. *PPG Indus., Inc. v. Guardian Indus. Corp.*, 597 F.2d 1090 (6th Cir. 1979).

held the assignment of a patent license was controlled by federal common law.<sup>95</sup> These courts reached their holdings relying mostly on the state of law before *Erie Railroad Co. v. Tompkins*<sup>96</sup> was decided in 1938.<sup>97</sup>

*Erie* held "[t]here is no federal general common law."<sup>98</sup> This holding implied that questions not governed directly by the Constitution of the United States or by Acts of Congress must be governed by state law.<sup>99</sup>

The federal patent statutes allow for patent licenses.<sup>100</sup> Section 261 of Title 35 of the United States Code provides "patents shall have the attributes of personal property. Applications for patent . . . or any interest therein, shall be assignable in law by an instrument in writing."<sup>101</sup> Section 261 creates the ability to transfer patent rights by assigning them the attributes of personal property.<sup>102</sup> Some may argue that § 261's mention of "any interest therein" brings patent license agreements within the purview of federal law and is therefore meant to preclude state contract law, allowing contractual rights to pass to the surviving corporation of a merger despite an antiassignment clause from applying to patent license agreements.<sup>103</sup> Section 261 mentions neither mergers nor antiassignment clauses.<sup>104</sup> It does not even directly mention patent license agreements.<sup>105</sup> It also does not mention the affect of mergers on patent license agreements.<sup>106</sup> Most importantly, it does not prescribe whether contracts conveying interests in patents shall be governed by state or federal law.<sup>107</sup> If Congress meant to preempt state

93. *Unarco Indus., Inc. v. Kelley Co.*, 317 U.S. 173 (1942).

94. *In re Alltech Plastics Inc.*, 5 U.S.P.Q.2d 1806 (Bankr. W.D. Tenn. 1987).

95. *Id.* at 1811; accord *In re Access Beyond Techs., Inc.*, 237 B.R. 32, 45 (Bankr. D. Del. 1999).

96. *Erie R.R. Co. v. Tompkins*, 304 U.S. 64 (1938).

97. For a thorough discussion of courts' failure to consider federal preemption of state contract law as it applies to patent license agreements, see Quinn & Weide, *supra* note 1, at 1141-45.

98. *Erie R.R. Co. v. Tompkins*, 304 U.S. at 64. The *Erie* doctrine arguably was limited to only apply to vertical choice of law problems faced by federal courts sitting in diversity. See *id.* (addressing the issue of the applicability of federal common law in a diversity of citizenship case). On the other hand, the Court did not qualify its statement that "[e]xcept in matters governed by the Federal Constitution or by acts of Congress, the law to be applied in any case is the law of the state" by limiting it to federal courts sitting in diversity of citizenship. *Id.* at 78 (emphasis added).

99. *Id.*

100. 35 U.S.C. § 261 (2000).

101. *Id.* (emphasis added). Section 261 also provides all assignments, grants, and conveyances of patents must be recorded with the Patent and Trademark Office. *Id.*

102. *Id.*

103. See *id.*

104. See *id.*

105. See *id.*

106. See *id.*

107. See *id.*

contract law as it applies to patent license agreements with § 261, it would have done so more directly.<sup>108</sup> Instead, § 261 leaves a gap which, under the holding of *Erie*, federal common law should not fill.<sup>109</sup> Thus, *Erie* requires federal courts to apply state contract law to the transferability of patent license agreements.<sup>110</sup>

## 2. Federal Patent Policy

There are extraordinary cases "where there is a 'significant conflict between [a] federal policy or interest and the use of state law,'" allowing a federal rule of decision to be recognized.<sup>111</sup> Thus, the federal patent system may still preclude state contract law from applying to patent license agreements.<sup>112</sup>

Though the federal patent system could preclude the use of state contract law to govern patent license contracts if state law "'significant[ly] conflict[s] with] a federal policy or interest,'"<sup>113</sup> the United States Supreme Court has determined that state intellectual property rights are not automatically preempted by the federal patent system.<sup>114</sup> A court must consider whether the state law frustrates the purposes of the federal patent system before it can be held to be preempted.<sup>115</sup>

The purposes of the federal patent system to consider when determining preemption involving federal patent law are: (1) providing an incentive for invention; (2) providing an incentive for disclosure of new ideas; and (3) keeping

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108. See *id.*; see also *Everex Sys., Inc. v. Cadtrak Corp. (In re CFLC, Inc.)*, 89 F.3d 673, 677 n.3 (9th Cir. 1996) (stating the statute speaks to assignments of patents, not to patent licenses).

109. See *Wilson*, *supra* note 1, at 908-20 (discussing the proper role the courts must take to fill gaps in the area of patent license agreements).

110. *Quinn & Weide*, *supra* note 1, at 1133-45 (arguing that patent licenses do not fall under an exception to the *Erie* Doctrine and criticizing federal patent license decisions for failing to analyze cases under the *Erie* Doctrine before promulgating federal common law).

111. *O'Melveny & Myers v. FDIC*, 512 U.S. 79, 87 (1994) (quoting *Wallis v. Pan Am. Petroleum Corp.*, 384 U.S. 63, 68 (1966)).

112. See, e.g., *Everex Sys., Inc. v. Cadtrak Corp. (In re CFLC, Inc.)*, 89 F.3d 673, 679 (9th Cir. 1996); *PPG Indus., Inc. v. Guardian Indus. Corp.*, 597 F.2d 1090, 1093 (6th Cir. 1979); *Unarco Indus., Inc. v. Kelley Co.*, 465 F.2d 1303, 1306 (7th Cir. 1972).

113. See *O'Melveny & Myers v. FDIC*, 512 U.S. at 87 (quoting *Wallis v. Pan Am. Petroleum Corp.*, 384 U.S. at 68).

114. *Kewanee Oil Co. v. Bicron Corp.*, 416 U.S. 470, 474 (1974).

115. *Id.* at 478-79. *Kewanee Oil Co.* is arguably distinguishable from this Note's discussion because it involved state *intellectual property* law, not state *contract* law. *Id.* at 472. However, if the Court was unwilling to find that the federal patent system automatically preempted state trade secret law, a body of law essentially in tension with the federal patent system because it encourages secrecy while the patent system encourages disclosure, it would be even more inclined to find that the federal patent system does not automatically preempt state contract law as it applies to patent license agreements. See *id.* at 491-93.

information in the public domain.<sup>116</sup> Allowing the state contract rule of free assignability and, more specifically, the state contract rule that corporate mergers do not violate contractual antiassignment clauses to apply to patent licenses not only does not hinder these purposes, but it also serves them.<sup>117</sup>

a. *Providing an Incentive for Invention.* In *Everex Systems, Inc. v. Cadtrak Corp. (In re CFLC, Inc.)*,<sup>118</sup> the Ninth Circuit supported its refusal to allow the transfer of a patent license with the argument that allowing state law to provide for free assignability of patent licenses would "undermine the reward that encourages invention."<sup>119</sup> To the contrary, there are situations in which the assignability of a patent license would "create an incentive to invent."<sup>120</sup> Licensing patents gives a patent holder access to markets that she may not be able to exploit without the license agreement.<sup>121</sup> "The potential licensees who believe that they can best exploit the license will attempt to purchase [it]."<sup>122</sup> If the license agreement has a well-drafted royalty structure, the patent holder will maximize her return on the license.<sup>123</sup> Finally, "the [patent holder]'s costs of finding a licensee are reduced when the market allocates licenses efficiently."<sup>124</sup> Inventors therefore will be encouraged to invent because the free assignment of license to their patents will enable them to reap the highest possible rewards for their inventions.

More specifically, vesting a patent license in the surviving corporation of a merger furthers this purpose. The merged corporation will be capable of reaching more markets for the patented invention. With an appropriately drafted fee or royalty structure, an inventor would gain benefits from markets available to the merged corporation, but not to her or to the pre-merger licensee, providing a greater incentive to invent. Moreover, parties will have the certainty of years of state contract law precedent on antiassignment clauses and mergers behind them in drafting their antiassignment clauses. Federal courts would have to develop a body of federal contract law about antiassignment clauses and mergers in patent license agreements. Although federal courts may use both state contract and case

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116. *Id.* at 480-81; see *Bonito Boats, Inc. v. Thunder Craft Boats, Inc.*, 489 U.S. 141, 146, 149-51 (1989).

117. See *Wilson*, *supra* note 1, at 912-16 (advocating the application of state contract law to assignments of patent license agreements as a means to maximize the value of the patent to the parties and to society).

118. *Everex Sys., Inc. v. Cadtrak Corp. (In re CFLC, Inc.)*, 89 F.3d 673 (9th Cir. 1996).

119. *Id.* at 679.

120. *Wilson*, *supra* note 1, at 913.

121. *Id.* (referring to Note, *An Economic Analysis of Royalty Terms in Patent Licenses*, 67 MINN. L. REV. 1198, 1200 (1983)).

122. *Id.*

123. *Id.* at 913-14 n.133.

124. *Id.* at 913-14.

law as a guide, the eventual rules are uncertain. This uncertainty about the effectiveness of a contractual agreement may chase inventors away from creation because their access to rewards will be uncertain.

In Company A's case, Company A's incentive to invent was arguably discouraged by merged Company B's acquisition of access to its patented technology. They occupy the same market and Company A would gain no additional benefit from Company B's use of the patented technology. Company A may even suffer from Company B's competitive use of the technology. Company A could have more carefully drafted specific antiassignment provisions to prevent Company B from acquiring access to its patented technology through a merger.

Situations in which the inventor will benefit from the continuation of a patent license agreement in the case of a merger are more likely than the hypothetical above. Furthermore, tightly drafted antiassignment clauses are available.<sup>125</sup> So, allowing a patent license to survive a merger and become vested in the surviving corporation supports the federal patent system's purpose of creating an incentive for invention more often than it could hurt it.

b. *Providing an Incentive for Disclosure of New Ideas.* When considered in a vacuum, it may seem that free assignability of patent licenses frustrates the second purpose.<sup>126</sup> If the state contract law of free assignability of patent license agreements prevents inventors from patenting and then licensing their discoveries for fear that they will not have enough control over their inventions, it could arguably violate the purpose of providing an incentive for the disclosure of new ideas.<sup>127</sup> Inventors do not, however, make the decision whether to obtain a patent for their inventions and then whether to license them in a vacuum. Patent law provides the strongest form of intellectual property protection for innovations.<sup>128</sup> "If an invention is not patented . . . , the initial inventor could lose the ability to benefit from that invention if another inventor invents the same or a similar device" because there is no prohibition on reverse engineering.<sup>129</sup> So, even when free assignability of license agreements is permitted, an inventor has strong incentives to patent his inventions to achieve the strongest form of protection for them.

Licenses are also a form of disclosure. The free assignability of patent licenses does not frustrate the incentive to disclose patented inventions via

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125. See *supra* Part II.C.

126. Wilson, *supra* note 1, at 914-15.

127. *Id.*

128. See *Kewanee Oil Co. v. Bicron Corp.*, 416 U.S. 470, 476 (1974).

129. *Id.* (noting *Bonito Boats, Inc. v. Thunder Craft Boats, Inc.*, 489 U.S. 141, 168 (1989), struck down a state law prohibiting a form of reverse engineering because it interfered with federal patent policy).

licenses.<sup>130</sup> If an inventor is truly concerned about losing control of who owns licenses to her patent, she can limit her patent licenses by including antiassignment clauses that specifically prohibit not only the transfer of the license by sale and involuntary operation of law, but also by merger and bankruptcy. Finally, application of state contract law to patent license agreements furthers this protection because of the certainty of the settled state law on antiassignment clauses and mergers.

c. *Keeping Information in the Public Domain.* The third purpose, keeping the information in the public domain, is also not frustrated by the assignability of patent licenses.<sup>131</sup> Patent licenses necessarily keep information in the public domain because they extend access to it beyond the inventor, while still providing an incentive to exploit the invention through royalties and other fee arrangements.<sup>132</sup>

The only situation in which this purpose may be frustrated is when a direct competitor acquires an exclusive patent license agreement and then refuses to use the patented technology.<sup>133</sup> However, even if the competitor refuses to use the patented invention in the marketplace, it will remove only the use of the patent from the marketplace, not the knowledge of the invention itself.<sup>134</sup> In any case, this situation is unlikely to occur because an inventor will most likely still apply for a patent.<sup>135</sup> In addition, difficulties in drafting a license agreement to avoid this unusual situation are rare.<sup>136</sup> Application of state contract law regarding the assignment of patent license agreements in the case of mergers does not change the analysis for this purpose; indeed, it bolsters the argument for no frustration because of the certainty it brings.

### 3. *Public Domain*

Another facet of patent law preemption is the idea that nothing, not even contractual agreements, may provide protection for an item that the federal patent law has left in the public domain.<sup>137</sup> For example, patent license agreements

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130. *See id.* at 916.

131. *See id.*

132. *See id.* at 915.

133. *Id.* at 916.

134. *Id.*

135. *Id.*

136. *Id.*

137. *See Compcorp v. Day-Brite Lighting, Inc.*, 376 U.S. 234, 237 (1964) (stating that the law may not prohibit the copying of an article that is not protected by a patent or copyright); *Sears Roebuck & Co. v. Stiffel Co.*, 376 U.S. 225, 231 (1964) ("Just as a state cannot encroach upon the federal patent laws directly, it cannot, under some other law, such as that forbidding fair competition, give protection . . .").

extending royalty payments beyond the life of the patent are "unlawful *per se*," because projecting royalties beyond the life of the patent is analogous to enlarging patent protection.<sup>138</sup> The refusal to allow existing state contract law to operate on patent license agreements would remove an avenue of access to patents left open by federal patent law.<sup>139</sup> Federal patent law does not restrict assignment of patent license agreements.<sup>140</sup> By restricting assignments that would normally be available under state contract law, federal courts will expand protection of patent holders' control of their patent licenses beyond the limits contemplated by federal law.<sup>141</sup>

#### 4. Contract Law

Some courts have determined federal law should not preempt state contract law because contracts are unique and different.<sup>142</sup> Contracts are distinguishable from state statutes because they "define[] rights between parties to the agreement, while [intellectual] property right[s] creat[e] rights against all the world. They are not equivalent."<sup>143</sup> Under this right to contract argument, federal patent law should not preempt contract law because they are essentially different in that one applies to private parties and, the other, to all the world.<sup>144</sup>

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138. *Brulotte v. Thys Co.*, 379 U.S. 29, 32 (1964).

139. *See supra* notes 90-109. Congress last amended § 261 in 1982. Act of Aug. 27, 1982, § 14(b), Pub. L. No. 97-247, 96 Stat. 317, 321 (codified as amended at 35 U.S.C. § 261 (2000)). The Sixth Circuit had already held patent license agreements did not pass to the surviving corporation in a corporate merger. *PPG Indus., Inc. v. Guardian Indus. Corp.*, 597 F.2d 1090, 1095 (6th Cir. 1979). There was also significant state law precedent that contracts pass to the surviving corporation of a merger. *See supra* Part III. Yet, the 1982 amendment to § 261 did not mention or clarify the conflicting case law. *See* § 14(b), 96 Stat. at 321. The most recent bill recommending amendment of the federal patent laws also made no mention of the conflicting case law, despite the fact that the Texas Court of Appeals had already rejected the Sixth Circuit's holding in *PPG Industries, Inc. v. Guardian Industries Corp.* by ruling that a patent license agreement passed to the surviving corporation of a merger under Texas merger laws, despite an antiassignment clause in the license agreement. *See Intellectual Property Protection Restoration Act*, S. 1835, 106th Cong. § 2 (1999); *see also* *TXO Prod. Co. v. M.D. Mark, Inc.*, 999 S.W.2d 137, 139-41 (Tex. Ct. App. 1999).

140. *See* 35 U.S.C. § 261 (2000).

141. *See, e.g.*, *Meehan v. PPG Indus., Inc.*, 802 F.2d 881, 883 (7th Cir. 1986) (refusing to enforce the royalty terms of a patent license agreement because they extended beyond the life of the patent).

142. Mark A. Lemley, *Beyond Preemption: The Law and Policy of Intellectual Property Licensing*, 87 CAL. L. REV. 111, 147-48 (1999) (citing *ProCD, Inc. v. Zeidenberg*, 86 F.3d 1447, 1455 (7th Cir. 1996) and *Lattie v. Murdach*, 42 U.S.P.Q.2d 1240, 1244 (N.D. Cal. 1997)).

143. U.C.C. art. 2B Preface (Draft Aug. 1, 1998) (emphasis in original).

144. *But see* Lemley, *supra* note 142, at 147-49 (criticizing the argument that contracts are unique because, among other weaknesses, the "viability of the distinction between private contracts and public legislation is diminishing day by day").

### 5. Shop Rights

The doctrine of shop rights originated in equity.<sup>145</sup> The right stems from an employer's contribution of materials, time, and equipment to an invention or discovery.<sup>146</sup> It also stems from an estoppel theory that an employee grants an implied patent license to his employer when he conceives of an invention applicable to his employer's business, sees the employer use the invention, and does not demand any compensation for its use.<sup>147</sup> Shop rights arise from "any permissive use of the invention, and particularly so where the inventor instigates such use and participates in it."<sup>148</sup> Thus, a shop right is an implied patent license, imposed on employee-inventors who invent while using their employer's resources.<sup>149</sup>

Shop rights are deemed to pass to the surviving corporation of a merger.<sup>150</sup> When the whole of the employer's business is acquired by another entity, shop rights pass to the new or surviving entity.<sup>151</sup> This rule even applies when a corporation purchases the employer's business but does not continue all the facets of that business.<sup>152</sup>

In holding patent license agreements containing ambiguous antiassignment clauses do not pass to the surviving corporation of a merger, the Sixth Circuit distinguished shop rights from express license agreements because shop rights are based on an element of estoppel not present in an express license agreement.<sup>153</sup> Conversely, the element of estoppel in the doctrine of shop rights implies a license when the inventor has not made a clear expression of his intent to create one.<sup>154</sup> Allowing shop rights to pass in a merger gives the inventor less control over the exploitation of the invention than an express agreement, in which a merger may be contemplated and provided for, because the inventor has less control over the acquisition of shop rights than over an expressly-negotiated license. Allowing shop rights to pass in a merger therefore seems more likely to

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145. Cal. E. Labs., Inc. v. Gould, 896 F.2d 400, 402 (9th Cir. 1990).

146. *Id.* (citing *United States v. Dubilier Condenser Corp.*, 289 U.S. 178, 188-89 (1933)).

147. *Neon Signal Devices, Inc. v. Alpha-Claude Neon Corp.*, 54 F.2d 793, 794 (W.D. Pa. 1931) (citing 1 WALKER ON PATENTS 442 (6th ed. 1929)).

148. *Id.*

149. *Cal. E. Labs., Inc. v. Gould*, 896 F.2d at 402; *Neon Signal Devices, Inc. v. Alpha-Claude Neon Corp.*, 54 F.2d at 794.

150. *See, e.g., Papazian v. Am. Steel & Wire Co.*, 155 F. Supp. 111, 120 (N.D. Ohio 1957) (holding shop rights pass to surviving corporations of a merger).

151. *Cal. E. Labs., Inc. v. Gould*, 896 F.2d at 402-03.

152. *Id.*

153. *PPG Indus., Inc. v. Guardian Indus. Corp.*, 597 F.2d 1090, 1094 (6th Cir. 1979).

154. *Id.*

frustrate the purposes behind the federal patent system than allowing an express license to pass.<sup>155</sup>

#### V. CONCLUSION

States regard the free exchange of contractual obligations as essential to the nation's economy and commercial methods. When an antiassignment clause does not specifically prohibit mergers, state contract law prefers to allow the contractual rights and obligations to vest in the surviving corporation. Even for personal contracts, like insurance policies, in which the identity of the insured is vitally important to the insurer's liability, state contract law does not hold a merger violates an antiassignment clause, so long as the merger does not affect the insurer's risk.

Although some federal courts have been convinced that the federal patent system preempts the application of state contract law to patent license agreement antiassignment clauses as they apply to mergers, state law neither directly conflicts with federal patent law nor frustrates the purposes of federal patent policy. Failure to apply state contract law that allows mergers without violating contractual antiassignment clauses would remove inventions from the public domain that federal patent laws allowed to remain there, much like agreements extending royalty payments beyond the life of the patent extend patent protection beyond the limits contemplated by Congress.

Moreover, state law has a strong interest in governing patent license agreements because they are often commercial agreements affecting the general welfare of the public. This interest is accentuated by the operation of state merger statutes whenever the issue of whether a merger violates an antiassignment clause in a patent license agreement is raised. Therefore, it is most appropriate to apply state contract law, which can even accommodate for significant prejudice to the nonmerging party, much like it does for insurers in the event of the merger of an insured.<sup>156</sup>

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155. *See supra* Part IV.B.2.

156. TXO Prod. Co. v. M.D. Mark, Inc., 999 S.W.2d 137, 141-42 (Tex. Ct. App. 1999).

