

# In the Name of Patent Stewardship

## *The Federal Circuit's Overreach in Commercial Law*

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**Abstract:** *While the Federal Circuit has admirably commandeered its stewardship of patent law, as Congress bestowed the Court with the exclusive jurisdiction over patent appeals since 1982, the Court has unabashedly and unwelcomingly extended its reach into commercial law. Camouflaged in the name of patent stewardship, the Court's foray in commercial law yields unexpected and unjustifiable results. This article argues that paradoxically, to maintain its stewardship of patent law, the Court should not evoke patent law to rationalize its decisions concerning commercial law that dramatically alters established commercial law. The encroachment of commercial law, which is within the provenance of state law, destabilizes federalism causing uncertainty in state law areas. The Federal Circuit must refrain itself, as it has no authority to inject itself into state law making.*

### INTRODUCTION

Consider two scenarios. Your Client has emptied her net worth by pumping a total of \$10 million in loans to a startup company of which the Client is the founder. The startup could not obtain funding from outside sources lately. The struggling company, however, still must pay its employees and essential creditors in order to keep the nascent business in operation. Neither white knight nor kind angel has come to the rescue. The Client has no other option but to use her own financial resources in making the necessary loans to the startup. To secure the preexisting loans, the startup grants to the Client a security interest in the startup's patents, pursuant to a security agreement. You help draft the agreement and perfect the Client's security interest in the patents by recording the security interest in all appropriate registration offices. Subsequently, matters become worse for the struggling company as it faces a hefty judgment in a patent litigation that it has asserted earlier against a third party, and the third party now levies the patents. Arming yourself with thorough understanding of secured transaction law and priority rules, you assist the Client to foreclose on the patents, as you know that under established secured transaction law, the Client has priority over the third party's subsequent judicial lien on the patents. The third party opposes the Client's foreclosure on the patents. The dispute between the Client and the third party finds its way eventually in the Federal Circuit. To your astonishment, the Federal Circuit holds against your Client. Unequivocally, the Court states that your Client's security interest in the patents for the \$10 million loans is a fraudulent transfer of the struggling company's asset. In other words, under Federal Circuit law, a grant of security interest in patents for

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preexisting loans is fraudulent transfer.<sup>1</sup>

The chilling message sent by the Federal Circuit in the above scenario reaches down the spines of battle-tested founders of startup companies and causes them to think twice before they pour all of their net worth into their own struggling companies.

In the next scenario, your Client wants to make an acquisition of a target company without acquiring any attached liability. As an experienced corporate transactions attorney, you avoid the liability for your Client by negotiating a deal to acquire only the target company's assets, including patents for \$500 million. Assets purchases often require extensive due diligence of which your team of experienced lawyers has labored many hours to complete. Like any corporate transactions attorney, you know state contract law very well and employ best practices in the field. You know that mistakes may happen during due diligence which results in some assets not being properly identified and transferred at closing, therefore, you have drafted the master Purchase Agreement and ancillary agreements with utmost care. You include common provisions in these agreements to retroactively recognize the assets that are accidentally being left out and subsequently discovered after closing, to have the same effective date of transfer as stated in the master Purchase Agreement. After all, the Client has already paid \$500 million for the target company's assets, and both contracting parties to the transaction agree that the Client is the owner of the assets as of the effective date. After closing, you learn from the Client that it does not have one of the transferred patents, though the disclosure schedule includes the patent. You inform the Client about the provisions for retroactivity of the ownership of any transferred assets and assuage the Client's concern. The original seller immediately cooperates with you to address the mistake, and the Client is happy again, as it now owns the transferred patent as of the effective date pursuant to the master Purchase Agreement. The Client's happiness, however, is short-lived because when it later asserts patent infringement action against an alleged infringer, it faces a challenge mounted by the defendant for lack of standing to bring suit in the first place due to lack of ownership in the patent at issue. In fact, the Federal Circuit ignores well-established state contract law on retroactivity of ownership of assets transferred pursuant to a sale and purchase agreement; it rules that your Client is not the owner of the patent on the date of filing the complaint because ownership cannot be dated retroactively under the Federal Circuit's contract law for patents!<sup>2</sup>

You are speechless. How can you inform the Client that their \$500 million acquisition fails to give them ownership of the patent that they had already bought and paid for a while back? How can you explain to the Client that state law has now become irrelevant when the Federal Circuit sees patents in the transaction and insists on the application of the Federal Circuit's own law,

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<sup>1</sup> See *Aptix Corp. v. Quickturn Design Systems, Inc.*, 148 F. App'x 924 (Fed. Cir. 2005).

<sup>2</sup> See *Abraxis Bioscience, Inc. v. Navinta LLC*, 672 F.3d 1239 (Fed. Cir. 2011); *Morrow v. Microsoft*, 499 F.3d 1332 (Fed. Cir. 2007).

displacing state law?

Unfortunately, the above scenarios and others are not the imaginary work of an erudite academic; they are the results of the Federal Circuit's extensive reach into commercial law, including state contract law, secured transaction law, fraudulent conveyance law, and trust law. This article is part of my broader inquiry into the Federal Circuit's patent exception approach; it is a follow up on my recent article on *Patent Prudential Standing*.<sup>3</sup> In reviewing the Federal Circuit cases on patent prudential standing, I observe that while the Court has admirably commandeered its stewardship of patent law, as Congress bestowed the Court with the exclusive jurisdiction over patent appeals since 1982, the Court has unabashedly and unwelcomingly extended its reach into state law areas, disturbing the balance carefully struck under federalism. Often, in the name of patent stewardship, the Court's foray in established state law areas yields unexpected and unjustifiable results.

This article will focus on a number of commercial law cases where the Court has overreached its patent hands. This article argues that paradoxically, to steady its stewardship of patent law, the Court should not evoke patent law to rationalize its decisions concerning state commercial law that dramatically alters established state law. Encroachment of state law destabilizes federalism, causing uncertainty in state law areas where the Federal Circuit must refrain itself as it has no authority to inject itself into state law making.<sup>4</sup> As the Supreme Court has long instructed, federal courts must not exercise judicial preemption of state law, absent explicit federal policies or reasons justifying the exclusion of state law. It is time for the Federal Circuit to retract its extensive reach into areas exclusively controlled by state law.<sup>5</sup>

Part I of this Article provides a comprehensive analysis of the Federal Circuit's overreach in state contract law, particularly in the area concerning sale and purchase of property assets. There are three subparts in this section of this Article. The first subpart presents the established contract law and best practices in corporate assets transactions. The second subpart focuses on a Federal Circuit's decision against the backdrop of established contract law and best practices. The last subpart offers a critique of the Federal Circuit's decision, judicial preemption of state commercial law, and potential consequences of its unfettered reach under the guise of patent law.

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<sup>3</sup> See Xuan-Thao Nguyen, *Patent Prudential Standing*, 21 GEORGE MASON L. REV. 17 (2013).

<sup>4</sup> Federalism is the cornerstone of the U.S. governance structure where dual or divided sovereignty operates to "preserve individual freedom, regional autonomy, political experimentation, and the representational advantages of republicanism." Anthony Kammer, *Privatizing the Safeguards of Federalism*, 29 J.L. & POL. 69, 69 (2013) (observing that the Constitution reflects federalism "principles in its design and, as it is currently interpreted, contains a number of mechanisms—both structural conflicts and judicially enforced checks—to ensure that power remains dispersed among state and federal governments with separate and competing jurisdictions").

<sup>5</sup> See generally *O'Melveny & Myers v. F.D.I.C.*, 512 U.S. 79, 87 (1994); *Wheeldin v. Wheeler*, 373 U.S. 647, 651 (1963). See also *Wallis v. Pan Am. Petroleum Corp.*, 384 U.S. 63, 68 (1966).

Similarly, Part II focuses on the Federal Circuit's overreach in state secured transactions law and fraudulent conveyance law. This part examines the established secured transactions law and practices in commercial financing, analyzes the Federal Circuit's case on the acceptance of security interest in patent, and discusses the chilling message emanated from the Federal Circuit's new law on secured transactions and fraudulent conveyance.

Likewise, Part III identifies and discusses the Federal Circuit's overreach in state trust law, particularly in cases concerning liquidating trust formed under bankruptcy's confirmation or liquidation plan. This part explains how and why a liquidating trust is created in bankruptcy. This part also examines the relationship between the trust and its beneficiary and how the relationship is for the benefit of the beneficiary. With this background, this part dissects the Federal Circuit's case in this area and critiques its new trust law.

In Part IV, the Article turns to federalism principles to offer its critique of the Federal Circuit's overreach in commercial law. The Article concludes that destabilization of federalism must promptly end in order to foster the richness of existing state law and preserve the vision of governance as dictated by and in the Constitution.

## I. SALE AND PURCHASE OF ASSETS AND THE FEDERAL CIRCUIT'S CONTRACT LAW

### A. *The Law of Sale and Purchase of Assets*

In the competitive marketplace, companies acquire other target companies for strategic reasons.<sup>6</sup> There are two common ways a company acquires a target.<sup>7</sup> The company may wish to conduct a stock acquisition of the target or the company may wish to purchase only the assets from the target. The stock acquisition means the company will assume the target's liability,<sup>8</sup> whereas the assets purchase may permit the company to cherry-pick the desirable assets and therefore avoid liability.<sup>9</sup>

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<sup>6</sup> For a report on technology companies engaged in acquisition activities in 2012, see *2012 M&A Activity Report-Private Company Acquisitions*, CB INSIGHTS (Jan. 29, 2013) <http://www.cbinsights.com/blog/acquisitions/tech-mergers-acquisitions-deals-2012-report> (indicating that 2277 private technology companies were acquired globally in 2012 and the acquirers paid \$46.8 billion dollars for the targets). See Samuel Wagreich, *Private Tech Company Acquisitions Are Up* (Jan. 30, 2013) <http://www.inc.com/samuel-wagreich/private-tech-company-acquisitions-are-up-report.html>.

<sup>7</sup> Another form of acquisition is merger. See Wilson Chu, *Negotiated Acquisitions of Company Shares and Assets in the United States—Pitfalls and How to Avoid Them*, 13 U.S.-MEX. L.J. 55, 57 (2005) (noting that “acquisition agreements take one of three basic forms: stock deals, asset deals, and merger agreements”).

<sup>8</sup> See generally Sharon L. Cloud, *Purchase of Assets and Successor Liability: A Necessarily Arbitrary Limit*, 11 DEL. J. CORP. L. 791, 794 (1986) [hereinafter Sharon L. Cloud] (discussing stock acquisition and liability).

<sup>9</sup> There are limits to avoiding liability in an assets purchase. For example, successor liability may hold the corporate successor liable for the predecessor's defective products. See *id.* at 796-800 (identifying four different exceptions to the non-liability rule in assets purchase).

Although the non-liability rule in asset purchases seems attractive,<sup>10</sup> conducting an asset purchase is often time consuming because the business and legal teams of advisors must often engage in extensive due diligence prior to the closing of the deal.<sup>11</sup> Mistakes are sometimes made in identifying and transferring all the assets from the seller to the acquirer in the transaction. Parties often include provisions in the various sale and purchase agreements to address in post-closing the discovery of inadvertent mistakes made during the due diligence investigation phase.<sup>12</sup>

A closer look at common practices in asset purchases reveals that in a typical asset purchase, the seller and acquirer generally enter into a master Asset Purchase Agreement (“APA”) and several ancillary documents.<sup>13</sup> The APA sets forth the terms of the transaction and provisions for the assets to be transferred. For example, in a technology assets purchase, the APA typically includes Intellectual Property provisions for the general scope of the purchased Intellectual Property assets, rights and liabilities, and covenants “governing the parties’ conduct relating to the purchased” Intellectual Property assets after signing relevant contractual agreements and closing the transaction.<sup>14</sup> The APA Intellectual Property provisions also typically reference ancillary documents, such as Intellectual Property Assignment and License Agreement, which contain much greater details that the parties will execute at the closing time of the deal.<sup>15</sup>

Parties to a sale and purchase of assets often anticipate potential problems which may arise in the future after the transaction occurs. Therefore, they routinely draft the Intellectual Property Assignment to “typically include a ‘further assurances’ clause that obligates the seller to work with the buyer” to insure that the buyer will obtain all assets of which the seller has already

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<sup>10</sup> See generally Sharon L. Cloud, *supra* note 8, at 794 (discussing the general rule of non-liability in asset purchase deals).

<sup>11</sup> See generally W. Ashley Hess, *Recent Developments and Trends in Middle Market M & A Due Diligence Practices*, 2013 WL 2137397 (2013). Due diligence review is important to the acquisition process:

The due diligence review and findings affect the way the parties negotiate and draft the transaction agreement--a fact that may seem obvious, but is not always fully appreciated. In some instances, the due diligence review uncovers deal-breakers or “show-stoppers,” and the parties decide not to complete the transaction. In deals that move forward, the findings from due diligence help the parties assess the risks of the transaction and allocate responsibility for those risks in the transaction agreements. In this way, the due diligence review plays a role in shaping the representations and warranties, covenants, closing conditions, and other provisions in the transaction agreements. In addition to disclosure schedule content, issues identified in due diligence may give rise to carve-outs or exceptions to certain deal provisions.

<sup>12</sup> See Daniel Glazer, *Intellectual Property: Asset Purchases*, 102 TRADEMARK REP. 1314, 1345-46 (2012) [hereinafter Daniel Glazer] (explaining various post-closing issues)

<sup>13</sup> For sample Asset Purchase Agreements, see ONECLE, <http://contracts.onecle.com/type/19.shtml> (last visited Feb. 14, 2014).

<sup>14</sup> Daniel Glazer, *supra* note 12, at 1343-45.

<sup>15</sup> *Id.* at 1343-45.

contractually sold to the buyer.<sup>16</sup> Lawyers for the contracting parties recognize that there are post-closing actions that must be taken in order “to document the transfer of the purchased IP assets in connection with the transaction”.<sup>17</sup> This means the lawyers will file assignment documents with the appropriate Intellectual Property registries, whether in the United States or abroad, to update the ownership of the Intellectual Property assets included in the purchased assets pursuant to the APA.<sup>18</sup>

The parties also generally contemplate when the closing day will be for the transaction and draft the APA with the “Effective Time” to be the closing day,<sup>19</sup> an earlier date, or a date after the closing date.<sup>20</sup> The “Effective Time” is binding on the parties, ensuring that the assets transfer contractually occurs between the parties.<sup>21</sup> The “Effective Time” is also used to calculate and ascertain whether a claim that the buyer may have against the seller after the assets sale transaction as occurred, is still within the zone of protection.<sup>22</sup>

To encourage corporate commercial transactions such as assets transfers, courts routinely treat these transactions simply as transfers of property by contract governed by state law.<sup>23</sup> Contract law of the jurisdiction selected by the parties to the assets transfer agreement governs claims and disputes arising from

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<sup>16</sup> *Id.* at 1345.

<sup>17</sup> *Id.*

<sup>18</sup> *Id.* at 1345-46.

<sup>19</sup> See *Severstal U.S. Holdings, LLC v. RG Steel, LLC*, 865 F. Supp. 2d 430, 433 (S.D.N.Y. 2012 (noting that “Effective Time” is the closing day); *Marzoll v. Marine Harvest US, Inc.*, 2009 U.S. Dist. LEXIS 120270, \*96 (D.Me. Nov. 29, 2009) (noting that “Effective Time” is the closing day); *Marathon Projects Ltd. v. Creative Designs Int’l, Ltd.*, 2011 U.S. Dist. LEXIS 27079, at \*5 (S.D.N.Y. Mar. 16, 2011) (noting that the Asset Purchase Agreement is where the “Effective Time is defined as ‘11:59 p.m. on the Closing Date’”).

<sup>20</sup> See *VisionChina Media Inc. v. Shareholder Representative Servs., LLC*, 109 A.D.3d 49, 59 (N.Y. App. Div. 1st Dep’t 2013) (noting that the closing date was two months before the “Effective Date”).

<sup>21</sup> For example, in *In re Old T.B.R., Inc.*, No. 07-52890-ASW, 2011 WL 5402506, at \*12 (Bankr. N.D. Cal. Oct. 31, 2011) the Asset Purchase Agreement provides:

On the terms and subject to the conditions set forth in this Agreement, at the Closing (but effective as of the Effective Time) Seller [Debtor] shall sell, convey, assign, transfer and deliver to Purchaser [New TBR], and Purchaser shall purchase, acquire and accept from Seller, free and clear of all liens, claims and encumbrances (except for the Assumed Liabilities), all of Seller’s right, title and interest in and to all of the assets, properties and business of every kind and description, wherever located, real, personal or mixed, tangible or intangible, owned or held by Seller as the same existed immediately prior to the Closing other than the Excluded Assets . . .

<sup>22</sup> For example, in *VisionChina Media Inc. v. Shareholder Representative Services, LLC*, 109 A.D.3d 49, 59 (N.Y. App. Div. 1st Dep’t 2013) the buyer brought action against the seller, alleging that the buyer’s claims against the seller were within the one year period from Effective Time as negotiated by the parties to the Asset Purchase Agreement.

<sup>23</sup> Sales of assets or acquisitions are today’s modern corporate contracts. *GRT, Inc. v. Marathon GTF Tech., Ltd.*, No. CIV.A. 5571-CS, 2011 WL 2682898, n.65 at \*12 (Del.Ch. July 11, 2011); *In re Fitch*, 174 B.R. 96, 101 (Bankr. S.D. Ill.1994) (stating that “[d]etermination of the significance of the remaining obligations is made by looking to state law, as state law controls with regard to property rights in assets of a debtor’s estate”).

the contract.<sup>24</sup> Courts recognize that the primary rule of contract law is that when the parties express their intent in clear terms,<sup>25</sup> courts “will not resort to construction”.<sup>26</sup> For instance, if the parties have intended and stated in the contract that the transaction will be effective “as of” an earlier date, courts would hold that the contract is retroactive to the earlier date.<sup>27</sup>

Indeed, courts look at the plain language of the contract and hold that the transfer is deemed to occur at the “Effective Time.”<sup>28</sup> Illustratively, *VisionChina Media Inc. v. Shareholder Representative Services* is an example of how the court looks to “Effective Time” for the calculation of the critical period that the buyers can assert claims against the sellers as negotiated by the parties.<sup>29</sup> In that

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<sup>24</sup> See *Postlewaite v. McGraw-Hill, Inc.*, 411 F.3d 63, 67 (2d Cir. 2005) (applying New York law where “the parties do not dispute that New York law applies” pursuant to the contract); *M/S Bremen v. Zapata Off-Shore Co.*, 407 U.S. 1, 11-12 (1972) (accorded presumptive validity to choice of law provisions in the contract); *Corporacion Venezolana de Fomento v. Vintero Sales Corp.*, 629 F.2d 786, 793 (2d Cir. 1980) (applying New York law where the contract at issue contained a New York choice of law provision).

In cases where the contract fails to include a choice of law provision, courts still look to state contract law to determine the meaning of a patent assignment contract. See *Euclid Chern. Co. v. Vector Corrosion Techs., Inc.*, No. 1:05CV080, 2007 WL 4460628 (N.D. Ohio Dec. 14, 2007) (applying Ohio law to determine the meaning of a patent assignment contract), *vacated and remanded sub nom.*, *Euclid Chem. Co. v. Vector Corrosion Technologies, Inc.*, 561 F.3d 1340 (Fed.Cir. 2009).

<sup>25</sup> For example, “[u]nder New York law, a written contract is to be interpreted so as to give effect to the intention of the parties as expressed in the unequivocal language they have employed.” *Terwilliger v. Terwilliger*, 206 F.3d 240, 245 (2d Cir. 2000) (citing *Breed v. Ins. Co. of N. Am.*, 385 N.E.2d 1280 (1978)).

<sup>26</sup> See, e.g., *Mt. Hawley Ins. Co. v. Azia Contractors, Inc.*, 886 S.W.2d 640, 642 (Mo. Ct. App. 1994) (“Where there is no ambiguity in a contract, the intent of the parties is to be determined from the contract alone and the courts will not resort to construction where the intent of the parties is expressed in clear and unambiguous language.”); *Goldstein v. Ipswich Hosiery Co.*, 122 S.E.2d 339, 345 (Ga. Ct. App. 1961) (“It is elemental that contracting parties may agree to give retroactive effect, between themselves, to their contracts as they may see fit.”); *FH Partners, LLC v. Complete Home Concepts, Inc.*, 378 S.W.3d 387, 395 (Mo. Ct. App. 2012) (“The primary rule in interpretation of contracts is to ascertain the intent of the parties and give effect to that intent.”); *Am. Cyanamid Co. v. Ring*, 286 S.E.2d 1, 3 (Ga. 1982) (stating that “the effective date of a contract is not the date of execution where the contract expressly states that its terms are to take effect at an earlier date.”). See also 2 WILLISTON ON CONTRACTS, § 6:60 (4th ed.) (stating “it seems clear that, where the parties themselves agree that a contract between them should be given effect as of a specified date, absent the intervention of third party rights, there is no sound reason why that agreement should not be given effect”); *Massey v. Exxon Corp.*, 942 F.2d 340, 344 (6th Cir. 1991) (“Kentucky law clearly allows parties to a contract to predate a contract and both parties will be bound by that agreement.”).

<sup>27</sup> *Viacom Intern. Inc. v. Tandem Productions, Inc.*, 368 F.Supp. 1264, 1270 (S.D.N.Y. 1974) (“When a written contract provides that it shall be effective ‘as of’ an earlier date, it generally is retroactive to the earlier date.”). Some courts go further that “[t]he law does not support the blanket conclusion that a retroactive effective date in a contract is only enforceable when the evidence demonstrates that the parties had agreed to the material terms of their contract as of the retroactive date.” *FH Partners*, 378 S.W.3d at 395. Courts are willing to consider “where a contract is ambiguous with respect to its effective date, the absence of an explanation for a retroactive effective date, and evidence that the parties had not agreed to the material terms of their contract as of the purported retroactive effective date, are relevant considerations in resolving the ambiguity.” *Id.*

<sup>28</sup> *VisionChina Media Inc.*, 967 N.Y.S.2d at 357-58.

<sup>29</sup> *Id.*

case, the buyers purchased assets from the sellers pursuant to the Asset Purchase Agreement which contains a number of representations and warranties.<sup>30</sup> The contractual provisions provide that the buyers can bring claims against the sellers upon finding any of the representations or warranties to be untrue or inaccurate within the one year period before the “Effective Time.”<sup>31</sup> The buyers have failed to timely assert claims against the sellers during the allotted period, as the court found:

Thus, the buyers negotiated terms that would have allowed them to discover the alleged fraud and to cancel the agreement but they then failed to take advantage of these terms. Moreover, the documentary evidence which allegedly reveals the fraud, that is, the E & Y report, was undisputably in the buyers' possession within the one-year contractually negotiated period for making a claim against the sellers, but the buyers chose not to make a notice of claim.<sup>32</sup>

The *VisionChina Media* court looks to state contract law to resolve the dispute relating to assets transfer pursuant to the agreement. Likewise, if a sale and purchase transaction includes the transfer of intellectual property assets, courts recognize that “because patents have the attributes of personal property, the transfer of patents and property rights ... in patents are governed by state law.”<sup>33</sup> Transfer of patents and ownership of patents are matters governed by state contract law.<sup>34</sup> Indeed, courts must apply state law “when determining the contractual obligations and transfers of property rights including those relating to patents.”<sup>35</sup> For example, according to state contract law, in a case where the

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<sup>30</sup> *Id.*

<sup>31</sup> *Id.*

<sup>32</sup> *Id.*

<sup>33</sup> *St. John's Univ., New York v. Bolton*, 757 F. Supp. 2d 144, 190 (E.D.N.Y. 2010) (citing *Bd. of Trustees of Stanford Junior Univ. v. Roche Molecular Sys., Inc.*, 583 F.3d 832, 841 (Fed.Cir. 2009)).

<sup>34</sup> *See Jim Arnold Corp. v. Hydrotech Sys., Inc.*, 109 F.3d 1567, 1571-72 (Fed. Cir. 1997) (“It may seem strange at first blush that the question of whether a patent is valid and infringed ordinarily is one for federal courts, while the question of who owns the patent rights and on what terms typically is a question exclusively for state courts. Yet that long has been the law.”). *See also Sky Technologies. LLC v. SAP AG*, 576 F.3d 1374, 1376-79 (Fed. Cir. 2009).

Similarly, when federal bankruptcy law intersects with contract law, courts look to state law to govern contractual issues. The Supreme Court has strongly emphasized the enforceability of state contract law:

Indeed, we have long recognized that the ‘basic federal rule’ in bankruptcy is that state law governs the substance of claims, Congress having ‘generally left the determination of property rights in the assets of a bankrupt’s estate to state law.’ [*Travelers Cas. & Sur. Co. of Am. v. Pac. Gas & Elec. Co.*, 549 U.S. 443, 448 (2007) (quoting *Butner v. United States*, 440 U.S. 48, 57 (citation omitted).] Accordingly, when the Bankruptcy Code uses the word ‘claim’—which the Code itself defines as a ‘right to payment,’ 11 U.S.C. § 101(5)(A)—it is usually referring to a right to payment recognized under state law.

*Chinese Yellow Pages Co. v. Chinese Overseas Mktg. Serv. Corp.*, 170 Cal. App. 4th 868, 883 (Cal. Ct. App. 2008).

<sup>35</sup> *Regents of Univ. of New Mexico v. Knight*, 321 F.3d 1111, 1118 (Fed. Cir. 2003).



patentee has already assigned its invention to the assignee within the scope of the assignment, the former patentee cannot later claim that it still owns the transferred invention that has subsequently been granted patent.<sup>36</sup> Likewise, state law controls the outcome in a case involving foreclosure sale of patents by a secured creditor at an auction, and change of title of ownership with respect to the purchased patents.<sup>37</sup> Similarly, actions vindicating property rights in patents are subject to state statutes of limitations and doctrines in determining when a limitations period may be tolled.<sup>38</sup>

### B. *Abraxis Bioscience, Inc. v. Navinta LLC*

Contrary to established state contract law governing sales and purchases of assets, the Federal Circuit has its own approach. The Federal Circuit has recently ignored the contracting parties' choice of law provision in the contract, created its own contract law in disregard of the long standing choice-of-law rules which "accord significant weight to a choice of law provision in a contract."<sup>39</sup> *Abraxis Bioscience, Inc. v. Navinta LLC* is a glaring example of the Federal Circuit's expansive reach under the guise of exclusive jurisdiction over patents into state contract law for commercial sale and purchase transactions involving patent property.<sup>40</sup>

The case centers on a commercial transaction involving assets sale and purchase. Here, the transaction was between two pharmaceutical companies, seller AstraZeneca ("AZ-UK") and buyer Abraxis. According to the press release about the important sale, the transaction included eight anaesthetics and analgesic drugs products and their patents,<sup>41</sup> as part of a larger \$350 million assets sale.<sup>42</sup>

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<sup>36</sup> See *Reid v. Gen. Motors Corp.*, 489 F. Supp. 2d 614, 621 (E.D. Tex. 2007) (holding that the patent at issue "is within the scope of the IP Assignment. Such an assignment automatically transfers title "by operation of law" once an invention comes into being. Plaintiffs are without title and, therefore, without standing to bring the instant suit, and Defendants' motions to dismiss for lack of subject matter jurisdiction should be granted.").

<sup>37</sup> See *Sky Techs. LLC v. SAP AG*, 576 F.3d 1374, 1376-79 (Fed. Cir. 2009) (holding that the chain of title in the purchased patents was not broken from the defaulted debtor to the secured creditor to the subsequent purchaser of the foreclosed patents).

<sup>38</sup> See *St. John's Univ., New York v. Bolton*, 757 F. Supp. 2d 144, 190 (E.D.N.Y. 2010) ("Because Defendants invoke constructive notice of the Lquisolid Patents to defeat Plaintiff's claim to equitable tolling of New York statutes of limitations and trigger the fraud discovery accrual rule on the date of the Lquisolid Patents' issuance, the issue is controlled by New York State law, and the court must determine whether a New York court would impute knowledge of the Lquisolid Patents' existence to Plaintiff.").

<sup>39</sup> See *Advani Enterprises, Inc. v. Underwriters at Lloyds*, 140 F.3d 157, 162-63 (2d Cir. 1998) (noting that federal choice-of-law rules accord significant weight to a choice of law provision in a contract). See also *KLATMW, INC. v. Elec. Sys. Prot., Inc.*, No. 09-CVS-16393, 2011 WL 1675633, at \*1 (N.C. Super. May 2, 2011) (finding that the case "arises from the sale of assets of an ongoing business pursuant to an asset purchase agreement containing certain warranties, incorporating a choice of law ... [and that] the consensual choice of law clause in the purchase contract dictates the application of New York law to the contract claims").

<sup>40</sup> *Abraxis Bioscience, Inc. v. Navinta LLC*, 625 F.3d 1359, 1361 (Fed. Cir. 2010).

<sup>41</sup> The deal was announced in AstraZeneca's press release that AstraZeneca will receive \$350 million dollars from Abraxis for this part of the deal involving anaesthetics and analgesic products,

The transaction unfolded in a typical fashion that commercial lawyers are intimately familiar.<sup>43</sup> The parties entered into a master Purchase Agreement dated on April 26, 2006 and selected New York as their choice of law.<sup>44</sup> Under the master Purchase Agreement, AZ-UK “shall or shall cause one or more of its Affiliates to, Transfer to the Purchaser ... all of the right, title and interests of the Seller and its Affiliates in and to” the transferred assets.<sup>45</sup> Among various ancillary documents executed as parts of the assets acquisition by Abraxis, on June 28, 2006, the parties signed the Intellectual Property Assignment Agreement which referenced back to the master Purchase Agreement that the “provisions of this instrument are subject to the terms and conditions of the Purchase Agreement”.<sup>46</sup> The Intellectual Property Assignment Agreement also included a “Further Assurances” clause affirming that the seller AZ-UK will “do, execute, acknowledge and deliver, or will cause to be done, executed, acknowledged and delivered, any and all further acts, conveyances, transfers, assignments, and assurances as necessary to grant, seller, convey, assign, transfer, set over to or vest in Buyer any of the Transferred Intellectual Property.”<sup>47</sup>

The Intellectual Property Assignment Agreement listed the transferred patents, including patent numbers 4,870,086, 5,670,524 and 5,834,489 (‘086, ‘524 and ‘489, respectively) on Schedule A. The transaction, however, was incomplete as the seller AZ-UK subsequently discovered that some of its affiliates had failed to formally assign their patents, ‘086, ‘524 and ‘489 that are parts of the transferred assets to Abraxis.<sup>48</sup> To correct their mistakes, in early 2007, these affiliates (transferor) immediately transferred the pertinent patents to AZ-UK (transferee) and AZ-UK then conveyed the patents to Abraxis (the original buyer) in accordance with the “Further Assurances” clause by executing additional assignment documents.<sup>49</sup> The assignment documents each stated that “this instrument is being executed by the parties to enable the Transferee to further convey to Buyer that portion of the Transferred Assets” that should have been included in the master Purchase Agreement, “dated as of April 26, 2006 ... pursuant to which Transferee agreed to sell to Buyer and Buyer agreed to purchase from Transferee the Transferred Assets, all as more particularly set out in the Purchase Agreement,” with “consummation of the transactions ... deemed to occur at the Effective Time” on the Closing Date.<sup>50</sup> Subsequently, the original

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Xylocaine, Polocaine, Naropin, Nesacaine, Sensorcaine, Astramorph, Emla Cream, and Diprivan. See *AstraZeneca and Abraxis Bioscience to co-promote cancer therapy ABRAXANE; Abraxis Bioscience to acquire AstraZeneca’s U.S. Anaesthetic and Analgesic Product Portfolio*, ASTRAZENECA (Apr. 27, 2006), <http://www.astrazeneca.com/Media/Press-releases/Article/20060427--AstraZeneca-and-Abraxis-BioScience-to-copromote-canc>

<sup>42</sup> See *Abraxis Bioscience, Inc. v. Navinta LLC*, No. CIV.A. 07-1251JAP, 2009 WL 904043, \*1 (D.N.J. Mar. 30. 2009).

<sup>43</sup> See Daniel Glazer, *supra* note 12, at 1333, 1343-46 (describing assets purchase transactions and necessary documents).

<sup>44</sup> See *Abraxis Bioscience, Inc.*, 625 F.3d at 1361.

<sup>45</sup> *Id.* at 1369.

<sup>46</sup> *Id.*

<sup>47</sup> *Id.*

<sup>48</sup> *Id.*

<sup>49</sup> *Abraxis Bioscience, Inc.*, 625 F.3d at 1369.

<sup>50</sup> *Id.*

seller A-Z UK and buyer Abraxis confirmed with each other that Abraxis now had owned all “right, title, and interest” to the patents “since no later than June 28, 2006”, the Closing Date that the original Intellectual Property Assignment Agreement was executed as part of the assets acquisition dated on April 26, 2006.

The above transaction is a typical transfer of property by contracts within the provenance of state law. As the contracting parties to the transaction selected New York for their choice of law, courts must apply New York law.<sup>51</sup> The transferred patents at issue were subsequently subject of a patent infringement litigation brought by Abraxis against a third party, Navinta, and within the appellate jurisdiction of the Federal Circuit.<sup>52</sup> Navinta challenged Abraxis for lack of standing in bringing the infringement case in the district court. Navinta lost at the district court level and then appealed to the Federal Circuit.<sup>53</sup> Instead of applying New York state contract law on the transfer of patents pursuant to the master Purchase Agreement as the district court had correctly done,<sup>54</sup> the Federal Circuit panel majority had a different idea.<sup>55</sup>

The panel majority asserted that because the transfer of property in this case involved patents and whether there was an assignment of patents or not would affect the buyer Abraxis’s standing to bring an infringement suit against others, the case is “as a matter of federal law” and therefore must be “resolved by Federal Circuit law”.<sup>56</sup> Accordingly, the panel majority applied a string of Federal Circuit decisions on patent assignments and promises to assign. These decisions have nothing to do with commercial sales or transfers of corporate assets that included patent assets under state contract law.<sup>57</sup>

The panel majority completely ignored New York law on contracts for transfers of property assets, as its opinion neither discussed nor cited to a New York state court decision on the transfer of assets contract.<sup>58</sup> Applying Federal Circuit law on patent assignment of future inventions, the panel majority treated the \$350 million assets sale and purchase merely as one of assignments of future

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<sup>51</sup> See *Abraxis Bioscience, Inc. v. Navinta LLC*, No. CIV.A. 07-1251JAP, 2009 WL 904043, \*1 (D.N.J. Mar. 30. 2009), *rev’d, vacated*, and *remanded* 625 F.3d 1359 (Fed Cir. 2010), *en banc* denied, 672 F.3d 1239 (Fed. Cir. 2011).

<sup>52</sup> Abraxis brought its patent infringement litigation against Navinta on March 15, 2007, after Abraxis acquired the assets of \$350 million from AZ-UK and affiliates in the April 26, 2006 transaction with the closing date of June 28, 2006. See *Abraxis Bioscience, Inc. v. Navinta LLC*, No. CIV.A. 07-1251JAP, 2009 WL 904043, at \*1-2 (D.N.J. Mar. 30. 2009).

<sup>53</sup> *Id.* at \*3-4.

<sup>54</sup> *Id.*

<sup>55</sup> See *Abraxis Bioscience, Inc.*, 625 F.3d at 1359 (Newman, J., *dissenting*).

<sup>56</sup> *Id.* at 1364.

<sup>57</sup> *Id.* at 1364-65 (citing *Bd. of Trustees of Leland Stanford Junior Univ. v. Roche Molecular Sys., Inc.* 583 F.3d 832 (Fed. Cir. 2009)); *DDB Technologies, LLC v. ML Advanced Media, LP*, 517 F.3d 1284 (Fed. Cir. 2008); *IP Venture, Inc. v. ProStar Computer, Inc.*, 503 F.3d 1324 (Fed. Cir. 2007); *Shreiber Foods, Inc. v. Beatrice Cheese, Inc.*, 402 F.3d 1198, 1203 (Fed. Cir. 2005); *Speedplay, Inc. v. Bebop, Inc.*, 211 F.3d 1245 (Fed. Cir. 2000); *Arachnid, Inc. v. Merit Indus., Inc.*, 939 F.2d 1574 (Fed. Cir. 1991). Similar to Judge Newman’s dissent, these cases focused on assignments of future invention.

<sup>58</sup> See *Abraxis Bioscience, Inc. v. Navinta LLC*, 625 F.3d 1359, 1364-65 (Fed. Cir. 2010)..

invention cases and ruled that under the patent assignment documents, Abraxis didn't own the patents until November 12, 2007.<sup>59</sup> Therefore, the panel majority concluded that Abraxis had no standing to bring the patent infringement suit against Navinta in the complaint filed on March 15, 2007.<sup>60</sup>

If the panel majority had adhered to federalism principles<sup>61</sup> and applied New York contract law on transfers of property assets, as it should have done, there would be a different outcome. Under New York contract law, a written contract with a provision of an effective date before or after the date the parties sign the contract, is valid.<sup>62</sup> That means if the parties select a date to be the "Effective Date" for the property conveyance, the Effective Date will govern the transaction, marking the date the buyer becomes the owner of the transferred assets.<sup>63</sup> Likewise, if the parties to a sale of property execute a contract with a particular Closing Date as the "Effective Date", the Closing Date will become the effective date for purpose of conveying the property from the seller to the buyer.<sup>64</sup>

Consequently, the conveyance of patent property, among the transferred assets, from AZ-UK to Abraxis for \$350 million, was elected by the sellers and buyers pursuant to the master Asset Purchase Agreement to occur on Closing Date, June 28, 2006,<sup>65</sup> and the instrument—the Intellectual Property Assignment Agreement as part of the acquisition transaction—is binding on the parties.<sup>66</sup> June 28, 2006 is the date when Abraxis became the new owner of the transferred assets, including the patents.<sup>67</sup> Both AZ-UK and Abraxis, like other sophisticated parties in a complex commercial sale transaction, understood that inadvertent mistakes are sometimes made and that parties to the transaction generally include provisions like "Further Assurances" to correct the mistakes in order to effectuate the parties' intent in the original contract.<sup>68</sup> In this case, the Intellectual Property Assignment Agreement contains the "Furtherance Assurances" provision in which the seller contractually must deliver to the buyer all the properties that the seller had already sold to the buyer pursuant to the master Purchase Agreement.<sup>69</sup> When the mistake was discovered that not all the patents have been conveyed as of the Closing Date, the parties corrected the

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<sup>59</sup> *Id.*

<sup>60</sup> *Id.*

<sup>61</sup> *See infra* Part IV.

<sup>62</sup> *See Viacom Intern. Inc. v. Tandem Productions., Inc.*, 368 F.Supp. 1264, 1270 (S.D.N.Y. 1974), *aff'd* 526 F.2d 593 (2d Cir. 1975).

<sup>63</sup> *See Mut. Life Ins. Co. of New York v. Hurni Packing Co.*, 263 U.S. 167, 175-76 (1923) (applying New York law, "It was competent for the parties to agree that the effective date of the policy should be one prior to its actual execution or issue; and this, in our opinion, is what they did.").

<sup>64</sup> *See, e.g., Viacom Intern., Inc.*, 368 F.Supp. at 1270.

<sup>65</sup> *See Abraxis Bioscience, Inc. v. Navinta LLC*, No. CIV.A. 07-1251JAP, 2009WL 904043, \*1 (D.N.J. Mar. 30. 2009) *rev'd, vacated, and remanded* 625 F.3d 1359 (Fed Cir. 2010), *en banc denied*, 672 F.3d 1239 (Fed. Cir. 2011).

<sup>66</sup> *See Abraxis Bioscience, Inc. v. Navinta LLC*, 625 F.3d 1359, 1370 (Fed. Cir. 2010).

<sup>67</sup> *Id.*

<sup>68</sup> *Id.* at 1369.

<sup>69</sup> *Id.*

mistake pursuant to the “Further Assurances” provision and the buyer was deemed to own the transferred patents as of the Closing Date, June 28, 2006.<sup>70</sup>

The “Further Assurance” provision allows for the patent conveyance to be retroactive. This is consistent with New York law.<sup>71</sup> New York law on contracts allows written contracts to be retroactive if the contract so provides in relevant provisions.<sup>72</sup> Furthermore, New York law of contracts permits retroactivity to correct unintended omission or mistake in an earlier agreement.<sup>73</sup> Applying New York contract law on retroactivity, Abraxis was the owner of all the transferred assets, including the patents identified in Schedule A but were inadvertently omitted as of the Closing Date, June 28, 2006.<sup>74</sup>

The panel majority, however, ignored New York law of contracts when it noted the transaction involved patent assignments, immediately extending its patent reach. With its exclusive jurisdiction to hear patent appeal cases, the panel majority committed a grave error when it zealously applied Federal Circuit law to a sale contract and disregarded parties’ choice of law contract provision. Sales of patents are simply sales of property and such property conveyances are governed by state contract law.<sup>75</sup> The commercial sale of existing patents in the present case must be governed by New York law of contracts, absent any preemption or federal interest or policy.<sup>76</sup> The panel majority wielded its patent hand too far when it completely abandoned state law in interpreting the sale contract.<sup>77</sup>

By ignoring the long standing rule that a construction of a patent assignment agreement is a matter of state law, the Federal Circuit dictates a new rule that if a

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<sup>70</sup> *Id.* at 1369-70.

<sup>71</sup> New York law of contracts allows written contracts to be retroactive if the contract provides that it will become effective “as of” an earlier date, the contract is “retroactive to the earlier date” *Viacom Intern. Inc. v. Tandem Productions, Inc.*, 368 F.Supp. 1264, 1270 (S.D.N.Y. 1974).

<sup>72</sup> Under New York law, “[t]he fundamental, neutral precept of contract interpretation is that agreements are construed in accord with the parties’ intent.” *Anita Babikian, Inc. v. TMA Realty, LLC*, 78 A.D.3d 1088 (N.Y. App. Div. 2010).

<sup>73</sup> *See Buffalo Police Benev. Ass’n v. City of Buffalo*, 453 N.Y.S.2d 314, 317 (N.Y. Sup. Ct. 1982) (permitting retroactivity of the collective bargaining agreement to cover the period between the new contract execution date and the expiration of the old contract). *See also Local Union 1567, Intern. Broth. of Elec. Workers, AFL-CIO v. Orange & Rockland Utilities, Inc.*, 478 N.Y.S.2d 937, 938 (N.Y. App. Div. 1984) (permitting retroactivity); *Matthews v. Jeremiah Burns, Inc.*, 129 N.Y.S.2d 841, 847 (N.Y. Sup. Ct. 1954) (permitting the amended agreement to be retroactive to the date of the original amendment).

<sup>74</sup> This is consistent with the district court finding that “[g]iven this retroactive effect, the [Intellectual Property Assignment Agreement] would then operate to transfer title from [AZ-UK] to Abraxis as of that date as well” for the omitted patents that were later assigned. *See Abraxis BioScience, Inc. v. Navinta LLC*, No. CIV.A. 07-1251JAP, 2009 WL 904043, at \*4 (D.N.J. Mar. 30, 2009).

<sup>75</sup> *See generally Euclid Chem. Co. v. Vector Corrosion Technologies, Inc.*, 561 F.3d 1340, 1343 (Fed. Cir. 2009) (“Construction of patent assignment agreement is a matter of state contract law.”).

<sup>76</sup> *See Abraxis Bioscience, Inc. v. Navinta LLC*, 672 F.3d 1239, 1240-41 (Fed. Cir. 2011).

<sup>77</sup> The panel majority approach is in contrary to other decisions rendered by the Federal Circuit on contract interpretation. *See generally Tri-Star Electronics Intern., Inc. v. Preci-Dip Durtal SA*, 619 F.3d 1364, 1367 (Fed. Cir. 2010) (“An assignment of a patent is interpreted in accordance with statutory and common law of contract.”).

commercial sale involved patents, the transaction automatically falls within the purview of the Federal Circuit and that the Federal Circuit Court would apply its own law to construct the patent assignment agreement.<sup>78</sup> Moreover, the Federal Circuit's law erroneously relied on by the panel majority, concerns promise to assign future inventions in employment context, not massive corporate sale of assets involved existing patents.<sup>79</sup> By justifying its decision that the contract matter is of federal law under Federal Circuit precedents, the panel majority has created a patent exception to the general rule of contract interpretation.<sup>80</sup> The panel majority should have known better that the patent exception approach has already been squarely rejected by the Supreme Court in recent years.<sup>81</sup>

The panel majority causes uncertainty to future commercial contracts involving conveyance of patents. Parties to a sale contract, with choice of law provision, expect predictability. They expect courts to apply state law and the contract law of the jurisdiction selected. Though the present case concerns a commercial sale of existing patents, the panel majority arbitrarily ignored the actual commercial transaction, state contract law, and the New York choice of law. Worse, while the parties to the contract had no dispute that transferred assets in a complex transaction of \$350 million did include the pertinent patents on the Closing Date of June 28, 2006, the panel majority injected its judicial preemption to support its conclusion that the transfer occurred on November 2007. The panel majority's decision is contrary to what the parties agreed to in the commercial contract.<sup>82</sup>

The assault on commercial law did not end there, as Abraxis subsequently petitioned the Federal Circuit for a hearing en banc, a majority of the court denied the en banc petition and three judges penned a concurrence over the dissent filed by the two other judges. Again, at this juncture, as seen in the concurrence, the Federal Circuit ignored the acquisition of the patent assets by Abraxis as part of the complex assets sale and purchase transaction.<sup>83</sup> The Federal Circuit summarily dismissed the case as a "simple" matter because the Court believed that Abraxis did not own the patents when it filed the patent

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<sup>78</sup> The panel majority erroneously relied on Federal Circuit's cases on promises to assign inventions in future time, as explained in the dissenting opinion. *See* *Abraxis Bioscience, Inc. v. Navinta LLC*, 625 F.3d 1359, 1371 (Fed. Cir. 2010).

<sup>79</sup> *See* *Abraxis*, 625 F.3d at 1365 ("Because the APA is a promise by AZ-UK to assign the relevant patents to Abraxis when AZ-UK obtains legal title, under our 'promise to assign' cases, a subsequent written agreement is necessary to consummate the assignment.").

<sup>80</sup> *See id.* at 1364 ("the question of whether a patent assignment clause creates an automatic assignment or merely an obligation to assign is intimately bound up with the question of standing in patent cases ... [w]e have accordingly treated it as a matter of federal law.").

<sup>81</sup> *See, e.g.,* *eBay Inc. v. MercExchange, LLC*, 547 U.S. 388, 394 (2006) (rejecting a patent exception to the general rule governing injunction); *MedImmune, Inc. v. Genentech, Inc.*, 549 U.S. 118, 132 (2007) (rejecting the rule that declaratory judgment stands only for patent cases).

<sup>82</sup> *See generally* the district court decision and evidence submitted by parties to the contract, *Abraxis Bioscience, Inc. v. Navinta LLC*, No. CIV.A. 07-1251JAP, 2009 WL 904043 (D.N.J. Mar. 30, 2009).

<sup>83</sup> *See* *Abraxis Bioscience, Inc. v. Navinta LLC*, 672 F.3d 1239, 1240 (Fed. Cir. 2011).

infringement action.<sup>84</sup> The concurrence emphasized that the case was correctly decided under the Federal Circuit's precedents on patents.<sup>85</sup>

### *C. The Federal Circuit's New Contract Law for Patents*

A cursory glance at *Abraxis Bioscience v. Navinta* may not mean much to patent scholars and the patent practicing bar, as the case can be viewed myopically as lacking standing under section 261 of the Patent Act to bring infringement suit due to the plaintiff not having ownership of the patents on the filing date. The decision, however, is anything that simple.

Hiding behind patent law, the Federal Circuit has created its own federal contract law to govern commercial sales of assets because the transactions happen to include patents.<sup>86</sup> The Federal Circuit fails to explain why it requires parties to assets transfers involving patents to apply Federal Circuit contract law, in complete disregard of state contract law negotiated and chosen by both the seller and acquirer of the assets.<sup>87</sup>

Specifically, the Federal Circuit in both the panel majority opinion and the subsequent three-judge concurrence opinion in rejecting the petition for *en banc* hearing, did not identify any conflict between federal law or interest and state contract law to justify its imposition. The Federal Circuit provided no justification why it has expressly displaced New York contract law. The court offered no explanation why New York contract law must not be applied to the master Asset Purchase Agreement for the \$350 million sale of assets, including the existing patents owned by the seller and its affiliates at the time of sale, and the ancillary Intellectual Property Assignment Agreement executed by the contracting parties. Under New York contract law, the agreements plainly operated to vest the title in the patents and other assets on "Effective Date", and the contracting parties to the massive sale of corporate assets did not dispute the transaction. In fact, the contracting seller even provided further "belts and suspenders" confirmation of what it had already conveyed under New York law.<sup>88</sup> The court's complete disregard of state contract law on transfer of property ownership is evidence of overreaching its patent hands.

Without identifying any conflict between federal law and state law for displacing New York contract law, the Federal Circuit looked to its own precedents on promises to assign future inventions where the question addressed in those cases centers on "whether a patent assignment clause creates an

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<sup>84</sup> *Id.*

<sup>85</sup> *Id.* at 1241 (quoting *O'Melveny & Myers v. F.D.I.C.*, 512 U.S. 79, 87 (1994) for the well-recognized Supreme Court's teaching that a "significant conflict between some federal policy or interest and the use of state law" must exist "as a precondition for recognition of a federal rule of decision").

<sup>86</sup> *Id.* at 1241 (Gajarsa, J., Linn, J., and Dyk, J., concurring).

<sup>87</sup> *Id.*

<sup>88</sup> *Abraxis*, 672 F.3d at 1247 (O'Malley and Newman, dissenting).

automatic assignment or merely an obligation to assign.”<sup>89</sup> The Federal Circuit’s solution to the question is “intimately bound up with the question of standing in patent cases” and therefore federal law should displace state contract law.<sup>90</sup> The precedents have nothing to do with contracts to sell massive assets inclusive of existing patents. The precedents have nothing to do with corporate sale transactions by contracting parties who have negotiated for each of the contract provisions in exchange for large monetary value in the acquisition of a target company through assets purchase. The precedents have nothing to do with the clear intent of the parties through execution of a set of master sale agreement and ancillary agreements to vest title in the acquirer on an effective date agreed by the parties. The precedents have nothing to do with the body of state contract law that recognizes property that actually has been transferred retroactively on the effective date.<sup>91</sup>

Erroneous wholesale application of the precedents to *Abraxis v. Navinta* creates a new Federal Circuit contract law. Under this new law, contracting parties can no longer rely on state contract law to govern the terms of the contracts. The contracting parties cannot rely on their choice of law as the controlling law for their contract. The contracting parties cannot rely on the typical contractual provisions in a sale and asset purchase agreement. “Effective Date” and “Further Assurances” provisions are now meaningless as contracting parties can’t rely on state law for vesting title retroactively.<sup>92</sup>

Moreover, the new Federal Circuit’s contract law has devastating consequences for commercial law and practices. Complex acquisition of target company through assets sales will be discouraged because for any patent that is not assigned through ancillary agreement by the sellers and its affiliates on the date the parties execute the master Asset Purchase Agreement, the acquirer will have no recourse against a third party for subsequent infringement, regardless of whether or not the seller has already sold and the acquirer has already purchased all of the seller’s and its affiliates’ assets.<sup>93</sup>

A rigid, bright-light rule has been created in the Federal Circuit’s patent vacuum to disrupt contracting parties’ expectation for certainty in their corporate commercial transactions. In any given day in today’s commerce, companies engaging in strategic decision of selling or buying corporate assets that often involve patents now will face a new burden and associated cost. Which companies would want to be in *Abraxis*’ situation? Paying \$350 million for assets from a seller and its affiliates, paying professionals to assist in negotiating

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<sup>89</sup> *Abraxis Bioscience, Inc. v. Navinta LLC*, 625 F.3d 1359, 1364 (Fed. Cir. 2010)

<sup>90</sup> *Abraxis Bioscience, Inc.*, 625 F.3d at 1364 (citing *DDB Technologies, LLC v. MLB Advanced Media, LP*, 517 F.3d 1284, 1290 (Fed. Cir. 2008)); *Speedplay, Inc. v. Bebop, Inc.*, 211 F.3d 1245, 1253 (Fed. Cir. 2000); *Bd. of Trustees of Leland Stanford Junior Univ. v. Roche Molecular Sys., Inc.* 583 F.3d 832, 841-42 (Fed. Cir. 2009); *IP Venture, Inc. v. ProStar Computer, Inc.*, 503 F.3d 1324, 1327 (Fed. Cir. 2007); *Arachnid, Inc. v. Merit Indus., Inc. Inc.*, 939 F.2d 1574, 1580-81 (Fed. Cir. 1991).

<sup>91</sup> *See Abraxis*, 672 F.3d at 1241-42.

<sup>92</sup> *Id.* at 1241-46.

<sup>93</sup> *Id.* at 1241.



the deal, conducting due diligence and drafting the contracts, subsequently bringing an infringement litigation against a third party and battling the patent infringement litigation for over three years on the merits that included a full trial on infringement and judicial determination relating to the Hatch-Waxman Act, all of that for a debilitating outcome that the trial and the judgment will be nullified because state contract law has been displaced by the new Federal Circuit contract law dictating that Abraxis had no ownership of the patents and therefore lacking the standing to bring the infringement suit in the first place.<sup>94</sup>

## II. SECURITY INTEREST IN INTELLECTUAL PROPERTY ASSETS AND FRAUDULENT CONVEYANCES

### A. *The Law of Secured Transactions and Fraudulent Conveyances*

Secured transactions are common commercial transactions occurring daily.<sup>95</sup> In a nutshell, when a party is in need of credit, it may attempt to obtain credit from a lender. Typically, the lender does not want to extend a credit line or make a loan to the borrower without any security for the repayment of the loan.<sup>96</sup> That means the lender will demand that in exchange for the loan, the borrower must grant a security interest in its personal, not real, property assets to the lender.<sup>97</sup> If the loan is secured, in the event that the debtor is unable to meet the scheduled repayments, the secured creditor can accelerate the debt and foreclose on the debtor's collateral property.<sup>98</sup> Also, to obtain priority among other creditors of the debtor, the lender wants to place other creditors on notice by perfecting its security interest in the debtor's collateral property through filing the financing

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<sup>94</sup> See generally Paul R. Gugliuzza, *The Federal Circuit as a Federal Court*, 54 WM. & MARY L. REV. 1791, 1820 (2013) ("According to recent opinions by some Federal Circuit judges, the court has improperly leveraged choice-of-law doctrine to expand the scope of federal common law and restrict the scope of state contract law. This dispute over choice of law might be the next doctrinal battle within the Federal Circuit's federalism relationship.").

<sup>95</sup> See, e.g., *Dollar General Seeks \$3.15 Billion to Refinance Secured Debt*, MONEYNEWS (APR. 8, 2013), <http://www.moneynews.com/Companies/Dollar-General-refinance-KKR-debt/2013/04/08/id/498393>; *JCPenney Announces Consummation of \$2.25 Billion Term Loan and Initial Settlement of its Tender Offer and Consent Solicitation*, (May 22, 2013) <http://ir.jcpenny.com/phoenix.zhtml?c=70528&p=irol-newsArticle&ID=1823443&highlight=> (announcing JCPenney has entered into a new five-year \$2.25 billion senior secured term loan credit facility); *Sterling Consolidated Secures \$2.45 Billion Senior Bank Debt* (October 10, 2013), <http://finance.yahoo.com/news/sterling-consolidated-secures-2-45-110000972.html>

<sup>96</sup> See Dana Cimilluca and Sam Schechner, *Alcatel-Lucent Secures \$2.1 Billion Debt Financing*, WSJ (Dec. 14, 2012), <http://online.wsj.com/news/articles/SB10001424127887323981504578177982789220970> (stating that the new loans will mostly be secured by the Paris-based company's U.S. assets, including a "portfolio of patents from the company's storied Bell Labs research arm and at least part of the company's fast-growing data-networking business").

<sup>97</sup> See U.C.C. §9-109 (addressing the scope of secured transactions).

<sup>98</sup> See Part 6 of U.C.C. §9. See also Kathy Cabral and Teresa Wilton Harmon, *Remedies Outside the Box: Enforcing Security Interests Under Article 9 of the Uniform Commercial Code*, BUSINESS LAW TODAY (August 23, 2012) <http://apps.americanbar.org/buslaw/blt/content/2012/08/article-03-cabral.shtml>.

statement with the Secretary of State's Office where the debtor is deemed to locate.<sup>99</sup>

Article 9 of the Uniform Commercial Code ("UCC-9") governs secured transactions, and all states have adopted UCC-9. Secured Transactions law recognizes that the debtor and the secured creditor often enter into an agreement that covers future advances<sup>100</sup> and after-acquired collateral property assets.<sup>101</sup> For example, the secured creditor may make additional loans to the debtor pursuant to the agreement signed by the parties, and the additional loans will be secured by the debtor's existing collateral property.<sup>102</sup> There is no need for the parties to execute additional agreements each time a new loan is issued by the secured creditor to the debtor.<sup>103</sup> Likewise, the parties may enter into an agreement wherein the debtor will acquire new property after the execution date, and the newly acquired property will serve as collateral to secure the original loan.<sup>104</sup> Again, the parties will rely on the original agreement without signing any new agreement to cover the newly acquired collateral property.<sup>105</sup>

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<sup>99</sup> See Part 3 of U.C.C. §9 (addressing methods of perfection of security interests).

<sup>100</sup> See U.C.C. §9-323 (addressing future advances).

<sup>101</sup> See U.C.C. §9-322, Comment 5, Example 4. Specifically, Example 4 states:

On February 1, A makes advances to Debtor under a security agreement covering "all Debtor's machinery, both existing and after-acquired." A promptly files a financing statement. On April 1, B takes a security interest in all Debtor's machinery, existing and after-acquired, to secure an outstanding loan. The following day, B files a financing statement. On May 1, Debtor acquires rights in the new machine, both A and B acquires security interests in the machine simultaneously. Both security interests are perfected simultaneously. However, A has priority because A filed before B.

<sup>102</sup> Example 1 in Official Comment 3 in U.C.C. §9-323 illustrates the common use of having the original security agreement and filed financing statement to cover future advances or loans.

On February 1, A makes an advance secured by machinery in the debtor's possession and files a financing statement. On March 1, B makes an advance secured by the same machinery and files a financing statement. On April 2, A makes a further advance, under the original security agreement, against the same machinery. A was the first to file and so, under the first-to-file-or-perfect rule ..., A's security interest has priority over B's, both as to the February 1 and as to the April 1 advance. It makes no difference whether A know of B's intervening advance when A makes the second advance.

See also *In re Smink*, 276 B.R. 156, 166 (Bankr. N.D. Miss. 2001) ("The future advance clause at issue clearly states that it will secure any future and additional advances on the indebtedness secured by the deed of trust, *as well as, any other debts incurred by the grantors, or any of them, including those represented by, inter alia, subsequent promissory notes.* This particular future advance clause, albeit 'boilerplate language,' is clear and unambiguous.").

<sup>103</sup> See *id.*

<sup>104</sup> See, e.g., *First Bancorp, Inc. v. U.S.*, 945 F. Supp. 2d 802, 811 (W.D. Ky. 2013) (noting that "the UCC shall be liberally construed and applied." Section 355.9-204 sets forth no requirement for particular language in order to create an interest in after-acquired collateral. Therefore, while the traditional "hereafter acquired" language is not present, the language that is present clearly indicates that future assets were intended to be secured."

<sup>105</sup> *Id.*; U.C.C. §9-204 (after-acquired collateral).

Also, secured transactions law allows the lender to receive a security interest in the debtor's collateral property for an antecedent debt. Section 203 of UCC-9 states that a security interest is attached and enforceable between the secured party and the debtor when the secured party has given value to the debtor, the debtor has right in the collateral property, and the debtor has authenticated a security agreement which contains a description of the collateral.<sup>106</sup> The "value" given by the secured party to the debtor means loans or credit extended to the debtor from the secured party<sup>107</sup> or preexisting debt the debtor owed to the secured party.<sup>108</sup> Illustratively, the debtor has borrowed money from the lender and the loan is originally unsecured. Later, the debtor grants the lender a security interest in the debtor's property to secure the debtor's repayments of the loan to the lender.<sup>109</sup> Consequently, the security interest is enforceable between the debtor and the secured lender, as all requirements under section 203 of UCC-9 are met. If the lender then perfects its security interest in the collateral property by filing the financing statement in the correct filing office,<sup>110</sup> the perfected security interest is enforceable against any third party and attains priority over junior secured creditors,<sup>111</sup> bankruptcy trustee and unsecured creditors.<sup>112</sup>

Moreover, a lender's obtaining security interest in the debtor's property for preexisting debt is itself not fraudulent conveyance under state law. Most states have modeled their fraudulent transfer statutes after the Uniform Fraudulent

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<sup>106</sup> See U.C.C. §9-203 provides in pertinent provisions:

(a) [Attachment] A security interest attaches to collateral when it becomes enforceable against the debtor with respect to the collateral, unless an agreement expressly postpones the time of attachment. (b) [Enforceability] Except as otherwise provided in subsections (c) through (i), a security interest is enforceable against the debtor and third parties with respect to the collateral only if : (1) value has been given; (2) the debtor has rights in the collateral or the power to transfer rights in the collateral to a secured party; and (3) one of the following conditions is met: (A) the debtor has authenticated a security agreement that provides a description of the collateral and, if the security interest covers timber to be cut, a description of the land concerned.

<sup>107</sup> See *In re Metric Metals Intern., Inc.*, 20 B.R. 633, 637-38 (S.D.N.Y. 1981) (finding the security interest has attached because the "debtor signed a security agreement describing the collateral, the bank gave value to the debtor in the form of loans and the debtor had property rights in the claims for tax refunds").

<sup>108</sup> See *Farmers & Merchants State Bank v. Teveldal*, 524 N.W.2d 874, 878 n.4 (S.D. 1994) (stating "preexisting debt may supply 'value' for attachment of a security interest").

<sup>109</sup> See *First Nat. Bank of Seminole v. Hooper*, 104 S.W.3d 83 (Tex 2003); *Wyzard v. Goller*, 23 Cal. App. 4th 1183 (Cal. Ct. App. 1994)..

<sup>110</sup> In addition to filing the financing statement, the secured party can utilize other methods of perfection of security interest, depending on the types of collateral. See U.C.C. §9-312 (addressing perfection by taking possession of the collateral); U.C.C. §9-304 (addressing perfection by taking control of deposit accounts); U.C.C. §9-305 (addressing perfection by taking control of investment property); U.C.C. §9-306 (addressing perfection by taking control of letter-of-credit rights).

<sup>111</sup> See U.C.C. §9-322 (addressing priority among conflicting security interests and agricultural liens in the same collateral is determined according to the following rules: (1) conflicting perfected security interests and agricultural liens rank according to priority in time of filing or perfection. Priority dates from the earlier of the time a filing covering the collateral is first made ..., if there is no period thereafter when there is neither filing nor perfection.)

<sup>112</sup> See U.C.C. §917 (stating that an unsecured security interest is subordinate to creditors who have filed the financing statement or perfected the security interest). U.C.C. §917 also provides that a security interest that is perfected before lien creditor will have priority.

Transfer Act.<sup>113</sup> Also, all fifty states have adopted Article 9 of the Uniform Commercial Law.<sup>114</sup> For examples, Texas and California are among the states that have adopted both sets of law.<sup>115</sup> Specifically, both Texas Fraudulent Transfer Act and California Fraudulent Transfer Law are virtually identical.<sup>116</sup>

For example, the Texas Supreme Court in *First Nat. Bank of Seminole v. Hooper* held that the insolvent debtor's conveyance of its property to the bank to further secure preexisting debt was not fraudulent transfer.<sup>117</sup> On January 4, 1990, the Bank originally loaned Ernest Thornton \$300,000 and Thornton granted the bank security interest in the debtor's accounts, gas contracts, chattel paper, general intangibles and equipment. Over the next two years, the Bank made an additional loan of \$100,000 to the debtor. In early 1993, Thornton was already insolvent. On March 30, 1993, Hooper & Sons Investment Company obtained a judgment against Thornton for an amount of \$950,000 from a dispute between the two parties. Two weeks later, while still insolvent and in disregard of Hoopers' judgment, Thornton granted to the bank a security interest in additional collateral, namely conveyance of a particular deed of trust in the Owego system, to secure the preexisting debts. Soon thereafter, the bank proceeded to foreclose on the collateral. Hoopers then sued the bank, alleging that Thornton's conveyance of the Owego property to secure antecedent debts while insolvent was fraudulent, and sought damages from the bank. Applying Texas Uniform Fraudulent Transfer Act which was modeled after the Uniform Fraudulent Transfer Act,<sup>118</sup> the jury found that Thornton defrauded the Hoopers

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<sup>113</sup> Uniform Business and Financial Laws Locator,

<http://www.law.cornell.edu/uniform/vol7.html#frcon>.

<sup>114</sup> *Changes to UCC Article 9 Effective July 1, 2013*, CREDIT TODAY (July 2012)

<http://www.credittoday.net/public/Changes-to-UCC-Article-9-Effective-July-1-2013.cfm> (noting that all fifty states have adopted the 2001 version of U.C.C. Article 9).

<sup>115</sup> *Id.*; Uniform Business and Financial Laws Locator,

<http://www.law.cornell.edu/uniform/vol7.html#frcon> (listing California and Texas among the states that adopted the Uniform Fraudulent Transfer Act). *See also* *Wyzard v. Goller*, 23 Cal. App. 4<sup>th</sup> 1183, 1187-88 (Cal. Ct. App. 1994) (describing the history of the Uniform Fraudulent Act and California's adoption of the model law).

<sup>116</sup> *See* CAL. CIV. CODE §§3439.04(a) and (b); [TEX. BUS. & COMM. CODE §§24.005\(a\) and \(b\)](#)

<sup>117</sup> *See* *First Nat. Bank of Seminole v. Hooper*, 104 S.W.3d 83 (Tex. 2003). *See also* J. Richard White and Jeffrey T. Arnold, *Real Property Law Survey*, 57 SMU L. REV. 1157, 1167 (2004).

<sup>118</sup> *See* *First Nat. Bank of Seminole*, 104 S.W.3d at 85. A pertinent provision of the Fraudulent Transfer Act provides:

- (a) A transfer made or obligation incurred by a debtor is fraudulent as to a creditor, whether the creditor's claim arose before or within a reasonable time after the transfer was made or the obligation was incurred, if the debtor made the transfer or incurred the obligation:
  - (1) with actual intent to hinder, delay, or defraud any creditor of the debtor;
  - or
  - (2) without receiving a reasonably equivalent value in exchange for the transfer or obligation, and the debtor:
    - (A) was engaged or was about to engage in a business or a transaction for which the remaining assets of the debtor were unreasonably small in relation to the business or transaction; or

when he conveyed the Owego property to secure the preexisting debt to the bank, Thornton was indeed insolvent when he transferred the property to the bank, and the property was not exchanged for reasonably equivalent value.<sup>119</sup> The jury awarded the Hoopers \$700,000.

The case was eventually appealed to the Texas Supreme Court. The bank did not challenge the jury's findings that Thornton was insolvent and intended to defraud the Hoopers when he transferred the security interest in the additional property.<sup>120</sup> The bank, instead, asserted "because the transfer was made to secure a valid antecedent debt, reasonably equivalent value was given as a matter of law."<sup>121</sup> The Court recognized that in a secured transaction, from the debtor's perspective "the value of the interest in the collateral transferred to the creditor can never be more than the amount of the debt. The value of the collateral is therefore irrelevant to the ultimate question because the excess over the debt is not lost to the debtor or other creditors."<sup>122</sup> Consequently, the Court found that in the present case, the value of the Owego collateral that Thornton had conveyed to the bank "could not have been more than the amount of Thornton's debt to the

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(B) intended to incur, or believed or reasonably should have believed that the debtor would incur, debts beyond the debtor's ability to pay as they became due.

(b) In determining actual intent under Subsection (a)(1) of this section, consideration may be given, among other factors, to whether:

- (1) the transfer or obligation was to an insider;
- (2) the debtor retained possession or control of the property transferred after the transfer;
- (3) the transfer or obligation was concealed;
- (4) before the transfer was made or obligation was incurred, the debtor had been sued or threatened with suit;
- (5) the transfer was of substantially all the debtor's assets;
- (6) the debtor absconded;
- (7) the debtor removed or concealed assets;
- (8) the value of the consideration received by the debtor was reasonably equivalent to the value of the asset transferred or the amount of the obligation incurred;
- (9) the debtor was insolvent or became insolvent shortly after the transfer was made or the obligation was incurred;
- (10) the transfer occurred shortly before or shortly after a substantial debt was incurred; and
- (11) the debtor transferred the essential assets of the business to a lienor who transferred the assets to an insider of the debtor

<sup>119</sup> Under the Texas Uniform Fraudulent Transfer Act, a transfer is fraudulent if the debtor makes it intending to defraud a creditor, or, irrespective of the debtor's intent, the debtor receives less than the asset's reasonably equivalent value in return: (a) a transfer made or obligation incurred by a debtor is fraudulent as to a creditor, whether the creditor's claim arose within a reasonable time before or after the transfer was made or the obligation was incurred, if the debtor made the obligation: (1) with actual intent to hinder, delay, or defraud any creditor of the debtor; or (2) without receiving a reasonably equivalent value in exchange for the transfer or obligation. V.T.C.A., Bus. & C. §24.006(a).

<sup>120</sup> See *First Nat. Bank of Seminole*, 104 S.W.3d at 85.

<sup>121</sup> *Id.*

<sup>122</sup> *Id.* at 86, *In re Anand*, 210 B.R. 456, 459 (Bankr. N.D. Ill. 1997) (citing *Unisys Fin. Corp. v. Resolution Trust Corp.*, 979 F.2d 609, 611 (7th Cir. 1992)).

Bank.”<sup>123</sup> Accordingly, the Bank gave reasonably equivalent value for the deed of trust lien and the jury judgment for the Hoopers therefore cannot be sustained.<sup>124</sup> In addition, the Court noted that there was no evidence that the bank intended to assist Thornton in evading his creditors. In conclusion, the Court held that there was no fraudulent transfer as a matter of law because “the value of the interest in an asset transferred for security is reasonably equivalent” to the amount of preexisting debt that it secures.<sup>125</sup>

The above decision illustrates that state courts in interpreting the conveyance of security interest in debtor’s property to satisfy an antecedent debt, hold that the conveyance does not amount to fraudulent conveyance.<sup>126</sup> This type of transactions is prevalent. Even in cases where the debtor is both in insolvency *and* in defrauding other creditors, the debtor’s grant of security interest to secure an antecedent debt is not fraudulent if the transfer has been exchanged for reasonable equivalent value and in absence of evidence of the secured party’s aiding the debtor to commit fraud.<sup>127</sup>

#### B. *Aptix Corporation v. Quickturn Design Systems, Inc.*

This case is another commercial law decision involving patents opined by the Federal Circuit.<sup>128</sup> The focus is security interest in patents. Mr. Mohsen was the founder of Aptix, a hardware-logic-emulation technology company. Mohsen personally made numerous loans to Aptix, totaling more than nine million dollars in order to keep the company in operation, to pay employees and other creditors.<sup>129</sup> In exchange for the loans, Aptix granted Mohsen a security interest in Aptix’s patents in July 2000.<sup>130</sup> Mohsen perfected the security interest in the

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<sup>123</sup> First Nat. Bank of Seminole v. Hooper, 104 S.W.3d 83, 87 (Tex. 2003).

<sup>124</sup> *Id.*

<sup>125</sup> *Id.*. See also Martin v. McEvoy, No. 34254-1-I, 1996 WL 335996, at \*4 (Wash. Ct. App. June 17, 1996) (“To establish constructive fraud ... the evidence must show that the debtor did not receive reasonably equivalent value. Thus, if value was received and that value was reasonably equivalent, constructive fraud cannot be show.”).

<sup>126</sup> See also Mark S. Scarberry, *A Critique of Congressional Proposals to Permit Modification of Home Mortgages in Chapter 13 Bankruptcy*, 37 PEPP. L. REV. 635, 650 n. 57 (2010) (noting that non-bankruptcy law allows “preferences to stand and does not consider them to be fraudulent” and quoting that law provides that “value is given for a transfer or an obligation if, in exchange for the transfer or obligation, property is transferred or an antecedent debt is secured or satisfied” and thus rendering most payments of antecedent debts non-fraudulent); Steven A. Beckelman and Daniel P. D’Alessandro, *Defending Claims of Fraudulent Transfers Against Lenders*, 125 BANKING L.J. 512 (2008) (stating that “where a lender deals with a borrower at arm’s length and receives fair value, in the form of payment or a security interest, for any loan extended to the borrower, securing or satisfaction of an antecedent debt will not constitute a fraudulent transfer under UFTA, as an act to “hinder, delay or defraud any [other] creditor of the debtor.” and concluding that “[t]herefore, as where a lender receives a security interest in an asset of a debtor that exceeds the value of the debt itself, a transaction is not lacking good faith, or seen as an act to hinder, delay or defraud, where the lender is aware that the borrower has other creditors ”); William F. Savino & David S. Widenor, *Commercial Law Survey*, 56 SYRACUSE L. REV. 569, 618-19 (2006) (discussing New York law on the grant of security interest in exchange for an antecedent debt is not a fraudulent transfer).

<sup>127</sup> See First Nat. Bank of Seminole, 104 S.W.3d at 85-87.

<sup>128</sup> See *Aptix Corp. v. Quickturn Design Systems, Inc.*, 148 F. App’x 924 (Fed. Cir. 2005).

<sup>129</sup> *Id.* at 926.

<sup>130</sup> *Id.*

patents by following the filing requirement under California's Article 9 of the Uniform Commercial Code in August 2000.<sup>131</sup>

Aptix brought a patent infringement action against its competitor, Quickturn. The district court dismissed the case in June 2000 and awarded Quickturn four million dollars in attorney's fee and cost.<sup>132</sup> The case was then appealed to the Federal Circuit which subsequently affirmed the district court's ruling and the parties entered into a payment agreement in 2002.<sup>133</sup> Around the same time when Quickturn could not collect the payment of the judgment it levied Aptix's assets, Mohsen foreclosed on Aptix's patent collateral property based on his already perfected security interest back in July 2000.<sup>134</sup> Subsequently, the district court voided Mohsen's security interest in the patents and Mohsen appealed to the Federal Circuit, as the Court has supplemental jurisdiction over the matter.<sup>135</sup>

The panel majority affirmed the district court's ruling. The panel majority voided Mohsen's security interest in the patents because it believed that Mohsen's receipt of the security interest in the patents in exchange for the loans that he had made to Aptix was for the purpose of defrauding the other creditor, Quickturn.<sup>136</sup> The panel majority relied on the fact that Aptix was insolvent when it granted a security interest in the patents to Mohsen and the transfer occurred just before a substantial judgment was to be entered against Aptix.<sup>137</sup> The panel majority concluded that the security interest was fraudulent transfer, ignoring the reality that Mohsen had made numerous antecedent loans to the struggling Aptix in order to keep the company in operation because it could not obtain funding elsewhere to pay employees and other creditors.<sup>138</sup> The panel majority claimed that because Mohsen didn't receive security interest for some of his prior loans to Aptix in the past, the security interest that he received in July 2000 in exchange for loans that he made to Aptix was a badge of fraud.<sup>139</sup>

### *C. The Federal Circuit's New Law on Security Interest and Fraudulent Conveyance*

The Federal Circuit's decision in *Aptix* shows its lack of understanding of secured transaction law and fraudulent conveyance. If the Federal Circuit had better understanding of state laws on secured transactions and fraudulent conveyance as articulated, for illustration purposes, in the Texas Supreme Court's case in *First Nat. Bank of Seminole v. Hooper*, a different outcome is expected. Unfortunately, the Federal Circuit, with its weak grasp of state commercial law fails to notice fundamental concepts in commercial law.

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<sup>131</sup> *Id.*

<sup>132</sup> *Id.*

<sup>133</sup> *Aptix Corp. v. Quickturn Design Systems, Inc.*, 148 F. App'x 924, 926 (Fed. Cir. 2005).

<sup>134</sup> *Id.* at 927.

<sup>135</sup> *Id.*

<sup>136</sup> *Id.* at 928

<sup>137</sup> *Id.* at 928-29.

<sup>138</sup> *Aptix Corp. v. Quickturn Design Systems, Inc.*, 148 F. App'x 924, 929 (Fed. Cir. 2005).

<sup>139</sup> *Id.*

Worse, the Federal Circuit claimed in *Aptix* that it applied California law on secured transactions and fraudulent transfer. The Court, however, missed some pivotal legal principles. First, the Court failed to know that in secured transactions debtors routinely convey security interest to secure or satisfy antecedent debt. Indeed, California's law recognizes the legitimacy of the grant of security interest in property to secure antecedent debt, as reflected in codified statute on fraudulent transfers.<sup>140</sup> That means under California law, *Aptix* is allowed to grant a security interest in property to secure antecedent loans provided to it by Mohsen. Second, California law specifically notes that "a transfer for security is ordinarily for a reasonably equivalent value notwithstanding a discrepancy between the value of the asset transferred and the debt secured, since the amount of the debt is the measure of the value of the interest in the asset that is transferred."<sup>141</sup> It follows that as long as the exchange between *Aptix* and Mohsen is for "a reasonably equivalent value" and the amount of the debt—in this case the total loans were \$9 million—was "the measure of the value of the asset that is transferred", there is no fraudulent transfer. Moreover, there was no dispute that the value of the assets collateral was significantly less than the \$9 million loans. Accordingly, under California law, the grant of the security interest in *Aptix's* property to Mohsen for the security of the preexisting loans of \$9 million was not fraudulent.

In addition, the Federal Circuit failed to observe decisions rendered by bankruptcy courts sitting in California, that routinely address bankruptcy cases wherein debtors are insolvent while they transfer assets to secure antecedent debts or make payments to secured creditors. For example, the *In re First Alliance Mortg. Co.* Court ruled that "[r]epayments of fully secured obligations—where a transfer results in a dollar for dollar reduction in the debtor's liability—do not hinder, delay or defraud creditors [under CAL. CIV. CODE section 3439.04] because the transfers do not put assets otherwise available in a bankruptcy distribution out of their reach, do not result in a

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<sup>140</sup> See Cal. Civ. Code §3439.03 (West) ("Value is given for a transfer or an obligation if, in exchange for the transfer or obligation, property is transferred or an antecedent debt is secured or satisfied."). See also Tex. Uniform Transfer Act § 24.004(a) (West) [hereinafter TUFTA] (providing that "value is given for a transfer or an obligation if, in exchange for the transfer or obligation, property is transferred or an antecedent debt is secured or satisfied...") (emphasis added). Section 24.004(d) of TUFTA defines "reasonably equivalent value" as "includ[ing] without limitation, a transfer or obligation that is within the range of values for which the transferor would have sold the assets in an arm's length transaction." *Id.* § 24.004(d).

<sup>141</sup> See, e.g., *Peoples-Pittsburgh Trust Co. v. Holy Family Polish Nat. Catholic Church, Carnegie.*, 19 A.2d 360 (Pa. 1941). See also Legislative Committee Comments, Paragraph 3 providing:

"The premise of this Act is that when a transfer is for security only, the equity or value of the asset that exceeds the amount of the debt secured remains available to unsecured creditors and thus cannot be regarded as the subject of a fraudulent transfer merely because of the encumbrance resulting from an otherwise valid security transfer. Disproportion between the value of the asset securing the debt and the size of the debt secured does not, in the absence of circumstances indicating a purpose to hinder, delay, or defraud creditors, constitute an impermissible hindrance to the enforcement of other creditors' rights against the debtor-transferor."



diminution of the debtor's estate, and therefore cannot be fraudulent”<sup>142</sup> Likewise, the *In re Walters* court stated that “[a] proportionate reduction in rights or liability constitutes an exchange of reasonably equivalent value for fraudulent transfer purposes under the Bankruptcy Code or California state law”.<sup>143</sup>

Moreover, California law allows Aptix to grant security interest to Mohsen in preference to Quickturn. Indeed, California Code §3432 states that “[a] debtor may pay one creditor in preference to another, or may give to one creditor security for the payment of his demand in preference to another.”<sup>144</sup> In other words, California law does not treat a grant of security interest preference itself a fraudulent transfer. California law clearly established that “it has been the rule for over 400 years, since the Statute of Elizabeth in 1571,” that a transfer which establishes a preference is not thereby fraudulent.<sup>145</sup>

Also, as seen in *Wyzard v. Goller*, a grant of security interest in preference of one creditor to another is not a badge of fraud under California law. In that case, Goller provided legal services to defend Manning and his corporation, Varigon, in a law suit brought by Wyzard.<sup>146</sup> Manning did not pay Goller for the legal services rendered for most of the duration of the litigation.<sup>147</sup> Later, as the litigation was heading to the conclusion of trial and a large judgment was expected to be entered against the corporation, Manning executed a promissory note to Goller, promising to pay the amount he already owed to Goller and granted Goller a security interest in the two properties owned by Manning.<sup>148</sup> As expected, Wyzard received a judgment of \$785,793.46 at the end of the litigation and recorded the abstract of judgment.<sup>149</sup> Manning then filed for bankruptcy and Goller subsequently foreclosed on the two property assets.<sup>150</sup> Wyzard brought an action against Goller, challenging the security interest in the two property assets Goller received from Manning.<sup>151</sup>

The court in *Wyzard v. Goller*, in rejecting Wyzard’s challenge, noted from the outset that even before 1872, under California law, a debtor may grant security for the payment of his preexisting debt in preference to another creditor.<sup>152</sup> Further, California law had long permitted the insolvent debtor to prefer one creditor over others.<sup>153</sup> The Court also observed that California law,

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<sup>142</sup> *Austin v. Chisick (In re First Alliance Mortg. Co.)*, 298 B.R. 652, 665 (C.D. Cal. 2003) *aff’d* 471 F.3d 977 (9th Cir. 2006).

<sup>143</sup> *Marshack v. Wells Fargo Bank (In re Walters)*, 163 B.R. 575, 581 (Bankr. C.D. Cal. 1994).

<sup>144</sup> *AptixCorp. v. Quickturn Design Systems, Inc.*, 148 F. App’x 924, 931 (Fed. Cir. 2005).

<sup>145</sup> *Wyzard v. Goller*, 23 Cal. Ct. App. 4th 1183, 1190 (Cal. Ct. App. 1994) (citing 13 Eliz., ch. 5 (1571)); Cal. Civ. Code §3432 (West)..

<sup>146</sup> *Wyzard*, 23 Cal. Ct. App. 4th at 1186.

<sup>147</sup> *Id.*

<sup>148</sup> *Id.*

<sup>149</sup> *Id.*

<sup>150</sup> *Id.* at 1187.

<sup>151</sup> *Wyzard*, 23 Cal. Ct. App. 4th at 1187.

<sup>152</sup> *Id.*

<sup>153</sup> *Id.* The court made the observation that even before 1872 it had been recognized that a failing or insolvent debtor could prefer one creditor over another. *See Randall v. Buffington*, 10 Cal. 491, 494 (Cal. 1858) (stating “it is difficult to perceive how the payment of a debt which [is]

past and present, and other states law, all permit a debtor to prefer one creditor over others.<sup>154</sup> Specifically, the Court pointed to a leading case in this area that stated “a transfer made in good faith to secure an antecedent debt is declared to be for fair consideration, and does not amount to an act to ‘hinder, delay or defraud’ an unpreferred creditor.”<sup>155</sup> Moreover, courts “start with the proposition that a preference as such is not a fraudulent conveyance.”<sup>156</sup> Accordingly, Manning’s grant of security interest to Goller to secure the antecedent debt, even though such a transfer is a preference over Wyzard, is not itself a fraudulent conveyance.<sup>157</sup>

The court in *Wyzard v. Goller* next examined whether there was any evidence to support Wyzard’s argument that “the circumstances of the transfer evoke some of the ‘badges of fraud’ from which an intent to defraud may be presumed. The court noted that the noted indicia of fraud are:

(a) Whether the transfer or obligation was to an insider; (b) whether the debtor had retained possession or control of the property transferred after the transfer; (c) whether the transfer or obligation was disclosed or concealed; (d) whether the debtor was sued or threatened with suit before the transfer was made or obligation was incurred; (e) whether the transfer was of substantially all the debtor’s assets; (f) whether the debtor has absconded; (g) whether the debtor had removed or concealed assets; (h) whether the value of the consideration received by the debtor was reasonably equivalent to the value of the asset transferred or the amount of the obligation incurred; (i) whether the debtor was insolvent or became insolvent shortly after the transfer was made or the obligation was incurred; (j) whether the transfer had occurred shortly before or shortly after a substantial debt was incurred; and (k) whether the debtor had transferred the essential assets of the business to a lienor who had transferred the assets to an insider of the debtor.<sup>158</sup>

Applying the above factors to the case, the *Wyzard* court noted that (1) the debtor Manning in this case had been successfully sued by Wyzard before he made the transfer of security interest to Goller, (2) the transfer was of substantially all of Manning’s assets, and (3) the transfer to Goller occurred

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justly owed, and which was past due, can be tortured into an act to hinder, delay, and defraud creditors”); *Wheaton v. Neville*, 19 Cal. 41, 46 (Cal. 1861). Subsequent cases continued the judicial refusal to set aside a preferential transfer solely because it worked a preference. *See McGee v. Allen*, 7 Cal.2d 468, 474 (Cal. 1936); *Bradley v. Buichart*, 217 Cal. 731 (1933).

<sup>154</sup> *Wyzard v. Goller*, 23 Cal. Ct. App. 4th 1183, 1188-89 (Cal. Ct. App. 1994).

<sup>155</sup> *Id.* at 1189 (quoting *Irving Trust Co. v. Kaminsky*, 19 F. Supp. 816 (S.D.N.Y. 1937)).

<sup>156</sup> *Id.* at 1189 (quoting New Jersey Supreme Court opinion in *Smith v. Whitman*, 189 A.2d 15, 18 (N.J. 1963) and citing other cases). *See also Boston Trading Group, Inc. v. Burnazos*, 835 F.2d 1504, 1508 (1st Cir. 1987) (stating that if a hypothetical debtor who owes \$10,000 to A and \$20,000 to B, but has only \$8,000, which he uses to satisfy his debt to A, does not make “fraudulent conveyance” under the Uniform Act because payment satisfies a debt owed to legitimate creditor then “B must find a remedy in bankruptcy, or in some other, law”).

<sup>157</sup> *See Wyzard*, 23 Cal. Ct. App. 4th at 1189.

<sup>158</sup> *Id.* at 1190. These indicia of fraud were contained in the Uniform Act, § 4, subd. (b) which California later adopted as subsection (b) to section 3439.04 in 2004. *See Aptix Corp. v. Quickturn Design Systems, Inc.*, 148 F. App’x 924, 928 (Fed. Cir. 2005).

before Wyzard obtained the judgment against Manning. These three factors, however, did not change the undisputed facts that Manning owed Goller a substantial sum for the legal services and the unpaid fees were secured by the two property collateral. Therefore, the court concluded that “the transfer to Mr. Goller, in payment for his legal services, while a preference, is not for that reason a transfer made to ‘hinder, delay or defraud’ Mr. Wyzard.”<sup>159</sup>

The facts in *Wyzard v. Goller* are similar to *Aptix v. Quickturn*. Yet, as explained above, the Federal Circuit failed to understand state law on secured transactions, preference and fraudulent transfer under California statutes and case law. The Federal Circuit, contrary to long established California law, has created new Federal Circuit law that a grant of security interest for preexisting debt is a badge of fraud of property conveyance. Specifically, the Federal Circuit held that just because Mohsen received the security interest from the debtor for the antecedent loans before the debtor faced a judgment in favor of Quickturn, the transfer to Mohsen was fraudulent. In reaching its decision, the Federal Circuit ignored the fact that Aptix, the company itself, could not obtain funding from any other sources. No one, except Mohsen, had stepped up to provide the loans desperately needed by Aptix to pay its employees and essential creditors in order to continue to operate its struggling business. Voiding Mohsen’s security interest, as the Federal Circuit did, sends a chilling message to individuals who use their personal resources in funding struggling companies in exchange for security interest in these companies’ patents. Under the Federal Circuit security interest law, these individuals will stop providing such funding because their acceptance of security interest in patents for the loans will be immediately viewed as a badge of fraud and subject to the Federal Circuit’s scrutiny that is in disregard of well-established state law on secured transactions and fraudulent transfers.<sup>160</sup>

### III. INTELLECTUAL PROPERTY ASSETS IN BANKRUPTCY AND THE FEDERAL CIRCUIT’S NEW TRUST LAW

#### A. *The Role of Liquidating Trust Created in Bankruptcy*

In Chapter 11 reorganization under bankruptcy law, the creation of liquidating trust has become common.<sup>161</sup> The liquidating trust is generally

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<sup>159</sup> *Wyzard v. Goller*, 23 Cal. Ct. App. 4th 1183, 1190 (Cal. Ct. App. 1994).

<sup>160</sup> See generally Paul R. Gugliuzza, *The Federal Circuit as a Federal Court*, 54 WM. & MARY L. REV. 1791, 1820 (2013) (“According to recent opinions by some Federal Circuit judges, the court has improperly leveraged choice-of-law doctrine to expand the scope of federal common law and restrict the scope of state contract law. This dispute over choice of law might be the next doctrinal battle within the Federal Circuit’s federalism relationship.”).

<sup>161</sup> See Chad A. Pugatch, *et al.*, *The Lost Art of Chapter 11 Reorganization*, 19 U. FLA. J.L. & PUB. POL’Y 39, 61-62 (2008) [hereinafter Chad A. Pugatch] (tracing the “widespread phenomenon” of liquidating trusts in bankruptcy reorganization). In fact, liquidating trusts are so common that bankruptcy courts have observed certain characteristics of legal advisors of the trusts. See *In re USN Communications, Inc.*, 280 B.R. 573, 600, (Bankr. D. Del. 2002) (noting the common practice regarding liquidating trust and that the attorneys who had represented unsecured creditors’ committee are often the same attorneys to represent liquidating trustee post-confirmation, in order to reduce cost).

created to pursue cause of actions for its beneficiaries, to oversee various litigation and tax matters, to prosecute avoidance actions, and/or to complete distributions to unsecured creditors.<sup>162</sup> In other words, liquidating trust, as some critics have noted, is where bankruptcy trustee has expanded its power from the limited role of litigating claims belonged to the bankruptcy estate, to litigating claims of the creditors in post-confirmation plan against third parties.<sup>163</sup>

To be classified as a liquidating trust for tax purposes, an entity must meet certain conditions set forth by the IRS Revenue Procedure.<sup>164</sup> For instance, the trust must be created pursuant to a confirmed plan under Chapter 11 of the Bankruptcy Code. The primary purpose of the liquidating trust is to liquidate the assets that have been transferred to the trust.<sup>165</sup> The trust is typically funded with some of the bankruptcy sales proceeds and “vested with” the bankruptcy estate’s litigation claims that would then be prosecuted for potential cash to be subsequently distributed by the trustee to the beneficiaries.<sup>166</sup> The liquidation trust, by law, has a duration of not more than five years from creation date. Any extension of the trust’s existence beyond the statutory term must be approved by the bankruptcy court with jurisdiction over the trust.<sup>167</sup>

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<sup>162</sup> See *In re HNRC Dissolution Co.*, No. Civ.A.04-158HRW, 2005 WL 1972592, at \*8 (E.D. Ky. 2005) (stating that the Liquidating Trust in the present case was “created to pursue causes of action for its beneficiaries, the holders of allowed unsecured claims against the Debtor’s estates, and the Liquidating Trustee has filed over 600 avoidance action complaints against third parties. . . . As the only tasks remaining are for the Liquidating Trust to oversee various litigation and tax matters, prosecute avoidance actions on behalf of the remaining creditors, complete these appeals, and complete any distributions to the unsecured creditors . . .”).

<sup>163</sup> See generally Andrew J. Morris, *Clarifying the Authority of Litigation Trusts: Why Post-Confirmation Trustees Cannot Assert Creditors’ Claims Against Third Parties*, 20 AM. BANKR. INST. L. REV. 589 (2012) [hereinafter Andrew J. Morris] (offering a critique of the expansion of liquidating/litigation trusts).

<sup>164</sup> See *A Solid Overview of Liquidating Trusts*, KPMG, <http://www.kpmg.com/US/en/IssuesAndInsights/ArticlesPublications/taxnewsflash/Documents/us-sep24-liquidating-trusts.pdf>

<sup>165</sup> See Rev. Proc. 94-45, July 11, 1994 (“A ruling generally will be issued that an entity is classified as a liquidating trust if the following conditions are met: . . . The trust is or will be created pursuant to a confirmed plan under Chapter 11 of the Bankruptcy Code for the primary purpose, as stated in its governing instrument, of liquidating the assets transferred to it with no objective to continue or engage in the conduct of a trade or business, except to the extent reasonably necessary to, and consistent with, the liquidating purpose of the trust.”).

<sup>166</sup> Chad A. Pugatch, *supra* note 157, at 63 (“a liquidating trust is funded with some or all of the [bankruptcy] sale proceeds, and is vested with the estate’s litigation claims, which are then prosecuted, and hopefully liquidated to cash, by the liquidating trustee for” the beneficiary creditors).

<sup>167</sup> The trust instrument must contain a fixed or determinable termination date that is generally not more than 5 years from the date of creation of the trust and that is reasonable based on all the facts and circumstances. If warranted by the facts and circumstances, provided for in the plan and trust instrument, and subject to the approval of the bankruptcy court with jurisdiction over the case upon a finding that the extension is necessary to the liquidating purpose of the trust, the term of the trust may be extended for a finite term based on its particular facts and circumstances. The trust instrument must require that each extension be approved by the court within 6 months of the beginning of the extended term.

A liquidating trust is a state law trust that has become a useful tool for Chapter 11 reorganization plan that the Third Circuit in *In re Insilco Techs.* provides the following observations:

While we typically think of Chapter 11 as the “reorganization” section of the Bankruptcy Code (as opposed to Chapter 7, the “liquidation” section), it is not uncommon for debtors to use the Chapter 11 process to liquidate. This is because Chapter 11 provides more flexibility and control in determining how to go about selling off the various aspects of the debtor’s business and distributing the proceeds. A typical mechanism for effecting a Chapter 11 liquidation is the creation of a “liquidating trust”- a *state-law trust managed by a group of creditors that succeeds to the debtor’s assets and administers the liquidation and distribution process* (emphasis added).<sup>168</sup>

For example, in *Holloway v. Dane*, the court observed that in the related Chapter 11 bankruptcy case, the Consolidated FGH Liquidating Trust was formed for the “purpose of recovering, administering and distributing estate assets for the benefit of unsecured creditors.”<sup>169</sup> The Liquidating Trust in that case commenced various adversary proceedings against numerous defendants for their alleged corporate misdeeds.<sup>170</sup>

Similarly, in *WRT Creditors Liquidation Trust v. C.I.B.C. Oppenheimer Corp.*,<sup>171</sup> under the confirmed reorganization plan, the Plan and the Liquidating Trust Agreement approved by the bankruptcy court that the debtor’s present and future litigation claims, rights of action, suits or proceedings were transferred to the WRT Trust for the benefit of the unsecured creditors.<sup>172</sup> The WRT Trust also received the right to solely coordinate the prosecution and settlement of the litigations on behalf of and for the benefit of the beneficiaries, and to distribute the proceeds to the beneficiaries.<sup>173</sup> Thereafter, the WRT Trust brought at least nineteen adversary proceedings against different defendants, asserting causes of action under state law and Bankruptcy Code.<sup>174</sup>

Most importantly, as seen in the trust examples above, the liquidating trusts are created for the beneficiaries. Indeed, to be classified as a liquidating trust, the confirmed plan and any separate trust documents “must provide that the beneficiaries of the trust” will be treated as “the grantors” and “deemed owners

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<sup>168</sup> *In re Insilco Technologies, Inc.*, 480 F.3d 212, 214 n.1 (3d Cir. 2007).

<sup>169</sup> *See Holloway v. Dane*, 316 B.R. 876, 878 (S.D. Miss. 2004)

<sup>170</sup> *See id.* at 878-79.

<sup>171</sup> *See WRT Creditors Liquidation Trust v. C.I.B.C. Oppenheimer Corp.*, 75 F.Supp.2d 596, 600-01 (S.D. Tex. 1999).

<sup>172</sup> *Id.* at 600 (noting that the Plan assigned all the debtor’s “Causes of Action” to the WRT Trust, defining that term as “[a]ny and all causes of action, claims, rights of action, suits or proceedings, whether in law or equity, whether known or unknown, which have been or could be asserted, by the Debtor”).

<sup>173</sup> *Id.*

<sup>174</sup> *Id.* at 601.

of the trust”.<sup>175</sup> Structurally, the liquidating trust is administered by a liquidating trustee who must adhere to the duty described in the trust agreement and the duty of loyalty and good faith in operating the trust for the benefit of the beneficiaries.<sup>176</sup>

Who are the beneficiaries of a liquidating trust? The beneficiaries of the liquidating trust are typically the creditors of the bankruptcy estate who “trade their creditor status” for the new status in the trust,<sup>177</sup> and are generally identified in the confirmed plan and trust documents. The beneficiaries of a trust are therefore the deemed “owners of the trust” res.<sup>178</sup> Trustee is typically appointed to oversee the liquidating trust in bringing claims belonged to creditors against third parties in post-confirmation plan.<sup>179</sup>

A question arises as to whether the beneficiaries as owners of the liquidating trust have standing to bring litigation against third party in cases involving the property held by the trust.

#### B. *Morrow v. Microsoft Corporation*

This case centers on a bankruptcy asset, namely, a patent, held by a liquidation trust for the beneficiary creditors, is another decision rendered by the Federal Circuit. Specifically, the At Home Corporation (“AHC”) was in bankruptcy and the bankruptcy court ordered a plan wherein several trusts were formed as successors to AHC to orderly liquidate the assets in September 2002.<sup>180</sup> The liquidation plan created a two-tiered trust system wherein GUCLT was established to function as trustee to various creditors and AHLT trustee to GUCLT to facilitate intellectual property infringement litigation on GUCLT’s behalf.<sup>181</sup> That means AHLT is the trustee and GUCLT is the beneficiary. In other words, AHLT holds only bare title to the assets and GUCLT possesses all the proprietary interest or ownership rights to the assets. That also means pursuant to the liquidation plan, the patent asset is owned by GUCLT and merely held by AHLT in trust and for the benefit of GUCLT.<sup>182</sup>

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<sup>175</sup> *Id.* (“The plan, disclosure statement, and any separate trust instrument must provide that the beneficiaries of the trust will be treated as the grantors and deemed owners of the trust.”).

<sup>176</sup> *Recent Developments in Business Bankruptcy* – 2010 CAL BANKR. J. 665, 684 (2010) (noting that a bankruptcy court in a case found that the liquidating trustee “breached (1) his duty of loyalty and good faith, (2) the trust agreement, (3) his duty to keep and render accounts, (4) his duty to preserve trust assets and pursue claims of the trust, and (5) his duty to keep trust assets separate. The court also denied the liquidating trustee’s request for indemnification.”). *See also* In re Fruehauf Trailer Corp., 431 B.R. 838 (Bankr. C.D. Cal. 2010).

<sup>177</sup> Chad A. Pugatch, *supra* note 157, at 61 (stating “the creditors of the estate trade their creditor status for a beneficiary interest in the trust res”).

<sup>178</sup> *WRT Creditors Liquidation Trust v. C.I.B.C. Oppenheimer Corp.*, 75 F.Supp.2d 596, 601 (S.D. Tex. 1999).

<sup>179</sup> *See* Andrew J. Morris, *supra* note 159 at 595-97 (explaining why trustees want to assert claims of creditors and why creditors allow trustees to bring claims on behalf of creditors against third parties).

<sup>180</sup> *See* *Morrow v. Microsoft*, 499 F.3d 1332, 1335 (Fed. Cir. 2007).

<sup>181</sup> *See* Petition for Panel Rehearing and Rehearing En Banc of Plaintiff at \*2-3, *Morrow v. Microsoft Corp.*, 2007 WL 3992497, (Fed. Cir. 2007).

<sup>182</sup> *Id.*

Subsequently, GUCLT brought a patent infringement action against Microsoft. Microsoft challenged GUCLT's standing to bring the patent suit and the district court found that GUCLT had standing to sue under bankruptcy law principles and "based on its trust beneficiary status."<sup>183</sup> Three years later, in 2006, upon completion of the discovery process in the litigation, the parties cross-moved for summary judgment on invalidity and infringement issues. The district court ruled for Microsoft on invalidity and non-infringement.<sup>184</sup> Thereafter, the parties appealed to the Federal Circuit.

The Federal Circuit decided to focus on whether GUCLT had standing to sue Microsoft for the patent infringement. The panel majority framed the question "as to how bankruptcy or trust law relationships affect the standing analysis in a patent infringement case" and noted that the issue "is a question of first impression in this court."<sup>185</sup> The panel majority held that GUCLT's rights under the liquidation plan failed to situate GUCLT in one of the two Federal Circuit's categories where it could sue in its own name or where it could maintain a co-plaintiff status in the infringement suit.<sup>186</sup> Specifically, the panel majority held that GUCLT had no standing to sue Microsoft for patent infringement under patent law, even though AHLT had been added as a co-plaintiff.<sup>187</sup> The majority vacated the infringement judgment below and reversed the district court's decision on standing.<sup>188</sup>

Consequently, after three years of costly litigating the patent infringement case and after the district court made its findings on the merit, the Federal Circuit brushed everything aside to focus on standing. By ruling that GUCLT lacked standing, the district court's findings on invalidity and infringement became eviscerated due to the Federal Circuit's vacating order. That means the only choice GUCLT and AHLT plaintiffs have is to restart the case all over in the district court. Most troublesome of all, under the panel majority's ruling, GUCLT cannot be a plaintiff in the new patent infringement case. Likewise, both GUCLT and AHLT together also cannot be plaintiffs in the new patent infringement suit, if the suit is subsequently initiated in the district court!

Who then can be the proper plaintiff? It seems from the Federal Circuit's decision that AHLT is the proper plaintiff because it owns the patent. But the liquidation plan endorsed by the bankruptcy court doesn't allow AHLT the right to bring patent infringement litigation, and that means AHLT cannot be the plaintiff. Moreover, the Federal Circuit ignored the fact that AHLT had already been added as a plaintiff in the patent litigation when the Circuit vacated the entire judgment on the merit of invalidity and non-infringement. What good did it or would it accomplish when the "proper" plaintiff AHLT had already been overlooked by the Circuit? Most costly, of course, is to begin the entire litigation

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<sup>183</sup> *Morrow*, 499 F.3d at 1335.

<sup>184</sup> *Id.* at 1336.

<sup>185</sup> *Id.*

<sup>186</sup> *Id.* at 1339-44.

<sup>187</sup> *Id.* at 1344.

<sup>188</sup> *Morrow v. Microsoft*, 499 F.3d 1332, 1334 (Fed. Cir. 2007).

again with AHLT alone as the plaintiff so the district court will reach the same results on the merit of invalidity and non-infringement again, and the parties will waste precious resources again to litigate the case at the district court level again, and to appeal the case to the Federal Circuit again? Surely, precious financial and judicial resources will be wasted because GUCLT cannot be even a co-plaintiff pursuant to the Federal Circuit's decision. While the Federal Circuit denied GUCLT the right to be a co-plaintiff in the patent infringement litigation, the liquidation plan approved by the bankruptcy court vested GUCLT with such right. Needless to say, the Federal Circuit has created chaos in the name of patent stewardship.

### C. *The Federal Circuit's New Trust Law*

How did the Federal Circuit cause this disarray? In reaching its decision, the majority had its own view of the fact and understanding of trust law, particularly liquidating trusts created in post-confirmation in bankruptcy proceedings. The panel majority superficially believed that the liquidation plan merely created GUCLT and AHLT as trusts for purposes of distributing the assets and rights among the trusts.<sup>189</sup> Mechanically, the majority recounted that GUCLT received the rights to bring various causes of action for the estate, including infringement of intellectual property. AHLT was "in charge of conducting the administrative wind-down of the company's business" and was given the ownership right in the intellectual property by default and therefore, AHLT "received legal title to the ... patent... though it did not have the right to sue third parties for infringement of the patent."<sup>190</sup> The majority mentioned that "AHLT's assets were to be managed for the benefit of the bondholders and the general creditors of ... GUCLT."<sup>191</sup> What the majority ignored or misunderstood was the relationship between GUCLT and AHLT.

The relationship between the litigation trust GUCLT and liquidating trust AHLT is itself also a trust wherein AHLT is the trustee and GUCLT the beneficiary. A careful examination of the liquidation plan reveals that the plan created a two-tiered trust system. The first tier is where GUCLT functioned as a trustee to the general creditors. The second tier is where AHLT functioned as a trustee to GUCLT; AHLT was the liquidation plan agent facilitating patent infringement litigation for the benefit of the beneficiary GUCLT. As a trustee to the beneficiary GUCLT, AHLT holds the property only in bare title. More precisely, AHLT holds the patent only in bare title and that is why the liquidation plan approved by the bankruptcy court dictates that while AHLT holds the bare title, it has no power to initiate patent infringement litigation.<sup>192</sup> That is how the liquidation plan empowers GUCLT with the right to bring patent infringement suit. GUCLT, as the beneficiary, ultimately has all the benefits and proprietary interest or ownership rights to the patent. In other words, from the liquidation

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<sup>189</sup> *Id.* at 1335 ("The liquidation plan distributed certain assets and rights among the trusts.").

<sup>190</sup> *Id.*

<sup>191</sup> *Id.*

<sup>192</sup> See Petition for Panel Rehearing and Rehearing En Banc of Plaintiff at \*2-3, *Morrow v. Microsoft Corp.*, 2007 WL 3992497, (Fed. Cir. 2007).



plan approved by the bankruptcy court, for the trust relationship to work as created under the plan, the patent is truly owned by the beneficiary GUCLT and merely held by AHLT in trust and for the benefit of the beneficiary GUCLT.<sup>193</sup> Therefore, either GUCLT by itself, or GUCLT and AHLT together, should be permitted to bring patent infringement action against third party infringers, as they were created and approved by the bankruptcy court to liquidate the property assets per confirmation plan.<sup>194</sup> The majority ignored the trust relationship and viewed it strictly through patent law that GUCLT and AHLT could not maintain the patent suit, as they could not be squarely categorized as co-plaintiffs for standing purposes.<sup>195</sup>

Additionally, the majority had its own understanding of patent law and forced the trust relationship between GUCLT and AHLT into its rigid categories. The majority created three categories of plaintiffs in analyzing constitutional standing issue in patent infringement.<sup>196</sup> The majority centered its division of the categories and “constitutional injury in fact” on whether the plaintiff possesses “exclusionary rights”.<sup>197</sup> The “exclusionary rights” identified by the majority are the “legal right to exclude others from making, using, selling, or offering to sell the patented invention ... or importing the invention.”<sup>198</sup> Specifically, the first category includes patentee who holds “all the exclusionary rights” and “suffers constitutional injury in fact” from patent infringement and therefore can bring infringement suits in its own name.<sup>199</sup> Under the first category, GUCLT obviously would not have standing to bring patent infringement action against Microsoft in its own name as it is not the patentee.

The second category of plaintiff, the majority asserted, “hold exclusionary rights,” but “not all substantial rights” to the patent. The majority failed to explain the meaning of a plaintiff with all exclusionary rights, but without all substantial rights. Did the majority mean “exclusionary rights” are “substantial rights”? Do exclusionary rights cover substantial rights? The majority merely stated that the plaintiff in the second category are the exclusive licensees who suffers injury caused by any party that “makes, uses, sells, offers to sell, or imports the patented invention.”<sup>200</sup> The majority announced that the second

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<sup>193</sup> *See id.*

<sup>194</sup> *See Spacone v. Microsoft Corp.*, C 03-4739 CW, 2006 WL 1600675 (N.D. Cal. June 7, 2006) rev'd and vacated sub nom. *Morrow v. Microsoft Corp.*, 499 F.3d 1332 (Fed. Cir. 2007); *Spacone ex rel. Gen. Unsecured Creditor's Liquidating Trust of At Home Corp. v. Microsoft Corp.*, C 03-4739 CW, 2006 WL 648740 (N.D. Cal. Mar. 10, 2006) decision clarified on denial of reconsideration sub nom.

<sup>195</sup> *Morrow v. Microsoft*, 499 F.3d 1332, 1344 (Fed. Cir. 2007).

<sup>196</sup> *Id.* at 1339.

<sup>197</sup> *Id.* (“The party holding the exclusionary rights to the patent suffers legal injury in fact under the [patent] statute.”).

<sup>198</sup> *Id.*

<sup>199</sup> *Id.*

<sup>200</sup> *Morrow v. Microsoft*, 499 F.3d 1332, 1340 (Fed. Cir. 2007) (“As the grantee of exclusionary rights, this plaintiff is injured by any party that makes, uses, sells, offers to sell, or imports the patented invention. Parties that hold the exclusionary rights are often identified as exclusive licensees, because the grant of an exclusive license to make, use, or sell the patented invention carries with it the right to prevent others from practicing the invention.”).

category of plaintiff cannot bring patent infringement suits in its own name, but must include the patentee as a co-plaintiff “to satisfy prudential standing concerns.”<sup>201</sup> Did the majority mean that the second category of plaintiff fulfills the constitutional standing on its own term and that including the patentee as a co-plaintiff has nothing to do with constitutional standing, but prudential standing? Did the majority mean that the second category of plaintiff must satisfy both constitutional standing and prudential standing, and by adding the patentee AHLT as co-plaintiff both standings now met?

Peculiarly, under the second category, the majority denied GUCLT standing to maintain the patent infringement litigation against Microsoft, even after GUCLT added AHLT as co-plaintiff to the suit. The majority categorically did not give *both* GUCLT and AHLT the right to maintain patent infringement litigation for lack of standing. Specifically, the majority asserted that there was a lack of constitutional standing, not prudential standing. In other words, it is unclear what the majority really meant!

Consequently, without a good understanding of trust law and the relationship between a trust and its beneficiaries as owners of the property held by the trust, the Federal Circuit thrust GUCLT, the owners of the patents held by AHLT, into one of its rigid categories. It denied both GUCLT and AHLT the rights to prosecute their patents against the infringer, as they could not fit in any of the categories. Both GUCLT and AHLT are liquidating trusts in post-confirmation plan in bankruptcy, and that means they are temporal in scope for the purpose of liquidating the property on behalf of the creditors. These liquidating trusts suffer a harsh consequence from the Federal Circuit’s decision; they will not be able to defend or prosecute the property that they have been specifically created to serve. Under the Federal Circuit’s new trust law, liquidating trusts should never be created because they will never be allowed to bring patent infringement suit against third party. Alleged infringers will have the upper hand and enjoy the alleged infringing activities because the liquidating trusts are powerless without standing to maintain suit. Confirmation plans in bankruptcy proceedings will now be reluctant to create liquidating trusts involving patent assets for fear of the Federal Circuit’s overreaching patent hand that prohibits liquidating trusts to bring patent infringement litigation against alleged infringers. What good will the Federal Circuit’s new trust law do to state trusts? Hardly any exists, except to reinforce the banner of patent exceptionalism in the name of patent stewardship.<sup>202</sup>

#### IV. RESPECTING FEDERALISM PRINCIPLES IN STEWARDSHIP OF PATENT LAW

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<sup>201</sup> *Id.* (stating “these exclusionary rights must be enforced through or in the name of the owner of the patent, and the patentee who transferred these exclusionary interests is usually joined to satisfy prudential standing concerns”).

<sup>202</sup> *Id.* at 1337 (stating “the patent statutes have long been recognized as the law that governs who has the right to bring suit for patent infringement, even when patent rights have been transferred as a result of bankruptcy or proceedings in equity”). The panel majority’s ruling has its own critics as seen in the vigorous dissenting opinion penned by Judge Prost. *See id.* at 1344-48.

Federalism is the bedrock of governance in the United States.<sup>203</sup> Matters of state law must be left to the sovereignty of state, as dictated by the Constitution.<sup>204</sup> Commercial laws, including laws governing contracts, property transfers, secured transactions, fraudulent conveyances, and trusts, are strictly within the boundaries of state.<sup>205</sup> No federal court has the authority to unilaterally extend its reach into matters belonging to state law.<sup>206</sup> Under Supreme Court's teaching, federal courts must exercise with utmost care in imposing judicial preemption of state law, displacing state law with federal law, in cases when there is a "significant conflict" between state law and federal policy or interest.<sup>207</sup>

The Supreme Court has long instructed courts to restrict judicial preemption of state law.<sup>208</sup> Under Supreme Court's precedents, judicial preemption is justified only in cases where there is a significant conflict between federal law and state law.<sup>209</sup> The requirement of the existence of such a conflict as a

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<sup>203</sup> See, e.g., Robert J. Pushaw, Jr., *A Neo-Federalist Analysis of Federal Question Jurisdiction*, 95 CAL. L. REV. 1515, 1512 (2007) (stating that federal courts must "implement a bedrock tenet of judicial federalism: they have primary responsibility over federal law, whereas state tribunals control state law"); Jessica L. Hannah and Kevan P. McLaughlin, *On Certiorari to the Ninth Circuit Court of Appeal: The Supreme Court's Review of Ninth Circuit Cases During the October 2006 Term*, 38 GOLDEN GATE U. L. REV. 409, 422 (2008) ("One of the bedrock concepts of American government is the delineation of powers between the federal government and the states, i.e., the legal relationship called federalism."); *Pacific Co. v. Johnson*, 285 U.S. 480, 493 (1932) ("Thus, in our dual system of government, action of the one government in the proper exercise of its sovereign powers, regarded as innocuous and permissible notwithstanding its incidental effects on the other, may become offensive and be deemed forbidden if it discriminates against the other.").

<sup>204</sup> For example, "police matters within the states" are left to the states, "in light of the bedrock principle of federalism". Thomas H. Lee, *The Safe-Conduct Theory of the Alien Tort Statute*, 106 COLUM. L. REV. 830, 888 (2006). See also Elizabeth B. Wydra, *Constitutional Problems with Judicial Takings Doctrine and the Supreme Court's Decision in Stop the Beach Renourishment*, 29 UCLA J. ENVTL. L. & POL'Y 109, 120 (observing that because states' "development of property law relies in many ways on the interaction between background common law principles and legislation", federal judicial takings "threatens to violate bedrock principles of federalism and disturb the incremental development of state property law by state and local policy makers and state courts.").

<sup>205</sup> See, e.g., Viva R. Moffat, *Super-Copyright: Contracts, Preemption, and the Structure of Copyright Policy Making*, 41 U.C. DAVIS L. REV. 45, 97 (2007) (noting that "contract law has been a matter of state law, and there are many good reasons for this: basic principles of federalism and the desire to create laboratories of law, for example"); Robert J. Pushaw, Jr., *Bridging the Enforcement Gap in Constitutional Law: A Critique of the Supreme Court's Theory that Self-Restraint Promotes Federalism*, 46 WM. & MARY L. REV. 1289, 1324 (2005) (noting that the Supreme Court settled in early precedents that "state courts have general jurisdiction, which includes final authority over their states' laws and concurrent jurisdiction over cases involving federal law."); Lawrence M. Friedman, *AMERICAN LAW OF THE 20TH CENTURY* 597 (2002) ("Federalism is thus in many ways alive and well; state law also still controls most of the law of torts, contracts and commercial law, domestic relations, and criminal law.").

<sup>206</sup> See generally *O'Melveny & Myers v. F.D.I.C.*, 512 U.S. 79, 87 (1994).

<sup>207</sup> *Id.* ("Our cases uniformly require the existence of ... 'significant conflict between some federal policy or interest and the use of state law' ... as a precondition for recognition of a federal rule of decision."). See also *Abraxis Bioscience, Inc. v. Navinta LLC*, 672 F.3d 1239, 1241 (Fed. Cir. 2011) (O'Malley, J. and Newman, J., dissenting).

<sup>208</sup> See *O'Melveny & Myers*, 512 U.S. at 87 (citing cases).

<sup>209</sup> *Id.* at 87 (stating that precedents dictate that cases justifying the "judicial creation of a

precondition is for both the permissibility of judicial preemption “and the scope of judicial displacement of state rules.”<sup>210</sup> Further, even in the patent area where there is federal legislation, courts must still be mindful that “Congress acts against the background of the total *corpus juris* of the states”<sup>211</sup> and therefore where there are no specific statutory provisions on certain matters, courts must view the matters “are presumably left subject to the disposition provided by state law.”<sup>212</sup>

As explained in the critique of *Abraxis Bioscience v. Navinta*, the Federal Circuit provided no justification for its judicial preemption of New York contract law, the choice of law selected by the sellers and acquirers of the complex assets transfer.<sup>213</sup> The Federal Circuit failed to identify any “significant conflict” between federal patent law and New York state contract law, as required by the Supreme Court.<sup>214</sup> The Federal Circuit displaced state contract law with its own precedents of patent assignments.<sup>215</sup> The decision is improper judicial preemption of state contract law.<sup>216</sup> It is a complete disregard of doctrinal federalism. Similarly, in *Aptix v. Quickturn Design Systems*, the Federal Circuit extended its reach in secured transaction and fraudulent conveyances – two areas that are exclusively within the provenance of state law – and ignored long-established state law.<sup>217</sup> The Federal Circuit arrogantly brushed aside state commercial statute for secured transactions, state fraudulent conveyance statute, and state decisional laws interpreting the statutes.<sup>218</sup> Again, the Federal Circuit provided no explanation and justification for its judicial preemption.<sup>219</sup> The Federal Circuit continued its assault on doctrinal federalism in *Morrow v. Microsoft* when it reached into state trust law and imposed its misunderstanding of liquidating trust, beneficiaries as true owners the trust res, and the trustee functioning for the benefits of the true owners.<sup>220</sup>

Nothing good can come from the Federal Circuit’s disregard of doctrinal federalism. Business entities, startups, investors, and commercial lawyers face enormous uncertainty when the Federal Circuit extends its reach into areas of well-established state law. The Federal Circuit must heed to the Supreme Court’s teaching in judicial preemption and federalism. In commandeering

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special federal rule” to preempt state law are “few and restricted, limited to situations where there is a significant conflict between some federal policy or interest and the use of state law”). The limitations as imposed by the Supreme Court are due to “federal courts, unlike their state counterparts, are courts of limited jurisdiction that have not been vested with open-ended lawmaking powers.” *Wheeldin v. Wheeler*, 373 U.S. 647, 651 (1963).

<sup>210</sup> *O’Melveny & Myers*, 512 U.S. at 87-88 (“Not only the permissibility but also the scope of judicial displacement of state rules turns upon such a conflict.”).

<sup>211</sup> *Wallis v. Pan Am. Petroleum Corp.*, 384 U.S. 63, 68 (1966).

<sup>212</sup> *O’Melveny & Myers*, 512 U.S. at 86.

<sup>213</sup> *Abraxis Bioscience, Inc. v. Navinta LLC*, 672 F.3d 1239, 1240-41 (Fed. Cir. 2011)

<sup>214</sup> *Id.*

<sup>215</sup> *Id.*

<sup>216</sup> *Id.*

<sup>217</sup> *Aptix Corp. v. Quickturn Design Systems, Inc.*, 148 F. App’x 924, 930-32 (Fed. Cir. 2005).

<sup>218</sup> *See id.*

<sup>219</sup> *Id.*

<sup>220</sup> *See supra* Part III(C).

stewardship of patent law, the Federal Circuit has no authority to exert its power on matters belonged to states. In today's economy, a commercial transaction, be it a sale of assets, a security interest conveyance, or a liquidation trust, will include patents. Just because a commercial transaction includes patents, the transaction does not allow the Federal Circuit to flex its patent hands to exercise judicial preemption. Without articulating any significant conflict between federal and state law or policy, the Federal Circuit must not inject its authority into the state law areas, causing costly results and unwarranted uncertainties. State law is the product of vast experience and wisdom, as businesses have long relied upon it to conduct their commercial transactions. The Federal Circuit, or any other federal court, cannot ignore the benefit which dual sovereignty of doctrinal federalism provides.<sup>221</sup> The destabilization of federalism, as seen in the Federal Circuit's cases, must promptly end in order to foster the richness of existing state law and preserve the vision of governance as dictated by and in the Constitution.<sup>222</sup>

### CONCLUSION

Since 1982 the Federal Circuit has positioned itself as the Patent Court of the United States. Admirably, the Federal Circuit has produced an influential body of patent law with impact beyond national boundaries. However, the Federal Circuit's overreach in commercial law under the guise of patent law is counterproductive. To maintain its stewardship of patent law, the Court should not evoke patent law to rationalize its decisions concerning commercial law that dramatically alters established commercial law. Encroachment of commercial law, which is within the provenance of state law, destabilizes federalism causing uncertainty in state law areas. The Federal Circuit must refrain itself, as it has no authority to inject itself into state law making.

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<sup>221</sup> See e.g., S. Candice Hoke, *Preemption Pathologies and Civic Republican Values*, 71 B.U.L.REV. 685, 765-66 (1991) ("rampant federal preemption forms an ominous threat to the constricted space that remains to local and state").

<sup>222</sup> Margaret Z. Johns, *Should Blackwater and Halliburton Pay for the People They've Killed Or Are Government Contractors Entitled to a Common-law, Combatant Activities Defense?* 80 TENN. L. REV. 347, 353 (2013) (stating that "bedrock constitutional principles dictate that the judicial branch should not recognize a combatant-activities defense that would improperly intrude on state sovereignty in violation of federalism principles").