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In the Name of Patent Stewardship: The Federal Circuit's Overreach into Commercial Law

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IN THE NAME OF PATENT STEWARDSHIP: THE FEDERAL CIRCUIT'S OVERREACH INTO COMMERCIAL LAW

Xuan-Thao Nguyen[*]

Abstract

While the U.S. Court of Appeals for the Federal Circuit has admirably commandeered its stewardship of patent law—Congress bestowed the Federal Circuit with exclusive jurisdiction over patent appeals since 1982—the court has unabashedly extended its reach, unwelcomed, into commercial law. Camouflaged in the name of patent stewardship, the Federal Circuit's foray into commercial law has yielded unexpected and unjustifiable results. This Article argues that, paradoxically, to maintain its stewardship of patent law, the Federal Circuit should not invoke patent law to rationalize its decisions concerning commercial law, which have dramatically altered established commercial law. This encroachment into commercial law, which is within the provenance of state law, destabilizes federalism causing uncertainty in state law. The Federal Circuit must refrain from encroaching into commercial law as it has no authority to inject itself into state law making.

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INTRODUCTION

Consider two scenarios: In the first, your client has exhausted her personal net worth by pumping a total of $10 million in loans into a startup company she founded. Lately, the startup could not obtain funding from outside sources. 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 had 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 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. It faces a hefty judgment in patent litigation that it asserted earlier against a third party, and that third party now levies the patents. Armed with your thorough understanding of secured transaction law and priority rules, you assist your client with foreclosing 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 your client and the third party finds its way, eventually, into the U.S. Court of Appeals for 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 in loans is a fraudulent transfer of the struggling company's assets. In other words, under Federal Circuit law, a grant of security interest in

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patents for preexisting loans is a fraudulent transfer.[1]

The message delivered by the Federal Circuit in the above scenario will send chills down the spines of battle-tested founders of startup companies. It will cause them to think twice before pouring their personal net worth into their own struggling companies.

In the next scenario, your client wants to acquire a target company without assuming 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. Asset purchases often require extensive due diligence, 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 the best practices in the field. You know that mistakes made during due diligence can result in some assets not being properly identified and transferred at closing, and you have, therefore, drafted the master purchase agreement and ancillary agreements with utmost care. You include common provisions in these agreements to retroactively transfer assets that are accidentally left out and subsequently discovered after closing to have the same effective date for transfer as stated in the master purchase agreement. After all, the client is paying $500 million for the target company's assets, and both parties to the transaction agree that your 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 ownership of any transferred assets and assuage the client's concern. The 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. When the client later asserts a patent infringement action against an alleged infringer, it faces a challenge mounted by the defendant. The infringer challenges your client's standing to bring suit in the first place on the basis that your client does not own the patent at issue. In its decision, 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 was not the owner of the patent when the complaint was filed because ownership cannot be made retroactive under the Federal Circuit's contract law for patents![2]

You are speechless. How do you inform the client that their $500

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1. *See* Aptix Corp. v. Quickturn Design Sys., Inc., 148 F. App'x 924, 928–30 (Fed. Cir. 2005).

2. *See* Abraxis Bioscience, Inc. v. Navinta LLC, 672 F.3d 1239, 1240–41 (Fed. Cir. 2011) (en banc) (Gajarsa, J., concurring) (per curiam); Morrow v. Microsoft Corp., 499 F.3d 1332, 1337–38 (Fed. Cir. 2007).

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million acquisition failed to give them ownership of the patent that they paid for? How do you explain to the client that state law is now irrelevant when the Federal Circuit identifies patents in the transaction and insists on the application of the Federal Circuit's own law, displacing state law?

Unfortunately, the above scenarios and others just as surprising are not the imaginary work of an erudite academic. They are the results of the Federal Circuit's extensive overreach into commercial law, including state contract law, secured transaction law, fraudulent conveyance law, and trust law. This Article is part of a broader inquiry into the Federal Circuit's patent exception approach; it is a follow up on a recent article on *Patent Prudential Standing*.[3] In reviewing the Federal Circuit cases on patent prudential standing, this Article observes that while the court has admirably commandeered its stewardship of patent law—Congress first bestowed the court with the exclusive jurisdiction over patent appeals in 1982[4]—the court has extended its reach—unabashedly and without welcome or congressional approval—into state-law areas, disturbing the balance carefully struck under federalism. Often, in the name of patent stewardship, the court's foray into established state law areas yields unexpected and unjustifiable results.

This Article will focus on a number of commercial law cases where the Federal Circuit has overreached its patent jurisdiction. This Article argues that, paradoxically, to steady its stewardship of patent law, the court should not invoke patent law to rationalize its decisions concerning state commercial law that dramatically alters established state law. Encroachment on state law creates uncertainty and destabilizes federalism, therefore the Federal Circuit must restrain itself, particularly as it has no authority to inject itself into state law making.[5] As the U.S. Supreme Court has long instructed, federal courts must not exercise judicial preemption of state law absent explicit federal law or policies justifying the exclusion of state law.[6] It is time for the Federal Circuit to retract its extensive reach

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3. *See generally* Xuan-Thao Nguyen, *Patent Prudential Standing*, 21 GEO. MASON L. REV. 17 (2013) (discussing the Federal Circuit's patent prudential standing rulings and arguing, *inter alia*, that the Federal Circuit's patent prudential doctrine is unnecessary and should be abrogated).

4. Jaskiewicz v. Mossinghoff, 802 F.2d 532, 534 (D.C. Cir. 1986); *see also* Jason Rantanen & Lee Petherbridge, *Disuniformity*, 66 FLA. L. REV. 2007, 2008–09 (2014) (discussing the creation of the Federal Circuit by Congress and its "exclusive jurisdiction over patent appeals").

5. *See, e.g.*, Barry Friedman, *Under the Law of Federal Jurisdiction: Allocating Cases Between Federal and State Courts*, 104 COLUM. L. REV. 1211, 1238 n.66 (2004) (noting that federal courts are increasingly deciding questions of state law "based on federal rather than state court precedent" and arguing that problems of legal certainty due to federal judicial usurpation have returned). 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" (footnotes omitted)).

6. O'Melveny & Myers v. FDIC, 512 U.S. 79, 87 (1994).

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into areas exclusively controlled by state law.[7]

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 Sections in this Part of the Article. The first Section presents the established contract law and best practices in corporate assets transactions. The second Section focuses on a Federal Circuit decision against the backdrop of established contract law and best practices. The last Section offers a critique of the Federal Circuit's decision and judicial preemption of state commercial law, and portrays potential consequences of the court's unfettered reach under the disguise of patent law.

Organized similarly, Part II focuses on the Federal Circuit's overreach in state secured transactions law and fraudulent conveyance law. This Part (1) examines the established secured transactions law and practices in commercial financing; (2) analyzes the Federal Circuit's case on the acceptance of security interest in a patent; and (3) discusses the chilling message emanating 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 a trust formed under a bankruptcy confirmation or liquidation plan. This Part explains how and why a liquidating trust is created in bankruptcy. The Part also examines the relationship between the trust and its beneficiary and how the relationship is in fact for the benefit of the beneficiary. With this background, the Part dissects the Federal Circuit's case in this area and critiques its new trust law.

In Part IV, this Article turns to federalism principles to offer its critique of the Federal Circuit's overreach in commercial law. This 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

This Part analyzes the Federal Circuit's overreach in state contract law. It starts by presenting the state of established contract law and then presents a contrary Federal Circuit decision. It concludes by critiquing this decision and outlining the negative consequences that ensue from it.

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

In the competitive marketplace, companies acquire other target

7. *See id.* at 87–88; Wallis v. Pan Am. Petroleum Corp., 384 U.S. 63, 68 (1966); Wheeldin v. Wheeler, 373 U.S. 647, 651 (1963).

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companies for strategic reasons.[8] There are two common ways a company acquires a target: (1) the company may wish to conduct a stock acquisition of the target, or (2) the company may wish to purchase only the assets from the target.[9] A stock acquisition means the company will assume the target's liability,[10] whereas an asset purchase may permit the company to cherry-pick the desirable assets and therefore avoid liability.[11]

Although the nonliability rule in asset purchases seems attractive,[12] conducting an asset purchase is frequently time-consuming because teams of business and legal advisors often must engage in extensive due diligence prior to the closing of the deal.[13] 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

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8. For a report on technology companies engaged in acquisition activities in 2012, see *2012 Tech 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 $46.9 billion for the targets); *see also* Samuel Wagreich, *Private Tech Company Acquisitions Are up: Report*, INC., http://www.inc.com/samuel-wagreich/private-tech-company-acquisitions-are-up-report.html (last updated Jan. 30, 2013).

9. Another form of acquisition is a 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) ("[A]cquisition agreements take one of three basic forms: stock deals, asset deals, and merger agreements.").

10. FRANKLIN A. GEVURTZ, CORPORATION LAW § 7.2, at 703 (2d ed. 2010); *see* Sharon L. Cloud, Note, *Purchase of Assets and Successor Liability: A Necessarily Arbitrary Limit*, 11 DEL. J. CORP. L. 791, 794 (1986) (discussing stock acquisition and liability).

11. GEVURTZ, *supra* note 10, § 7.2, at 703–04 ("Unlike the sale of assets transaction, the buyer cannot pick and choose which liabilities it will assume and thus eschew the assumption of unknown claims."). 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* Cloud, *supra* note 10, at 796–800 (identifying four different exceptions to the nonliability rule in asset purchases).

12. *See* Cloud, *supra* note 10, at 794 (discussing the general rule of nonliability in asset purchase deals).

13. *See* W. Ashley Hess, *Recent Developments and Trends in Middle-Market M&A Due Diligence Practices*, ASPATORE (Apr. 2013), 2013 WL 2137397, at *2. 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.

Id.

purchase agreements to address, in the post-closing phase, the discovery of inadvertent mistakes made during the due diligence investigation phase.[14]

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.[15] 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 (IP) provisions for the general scope of the purchased IP assets, rights and liabilities, and covenants "governing the parties' conduct relating to the purchased IP . . . assets after signing" relevant contractual agreements and closing the transaction.[16] The APA's IP provisions also typically reference ancillary documents such as IP assignment and license agreements, which contain much greater details that the parties will execute at the closing time of the deal.[17]

Parties to a sale and purchase of assets often anticipate potential problems that may arise in the future after the transaction occurs. Therefore, they routinely draft the IP assignment to "typically include[] a 'further assurances' clause that obligates the seller to work with the buyer" to ensure that the buyer actually obtains all the assets that the seller has sold to the buyer.[18] 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."[19] This means the lawyers will file assignment documents with the appropriate IP registries, whether in the United States or abroad, to update the ownership of the IP assets purchased pursuant to the APA.[20]

The parties also generally contemplate when the closing day will actually be for the transaction and draft the APA with the "effective time" to be the closing date,[21] an earlier date, or a date after the closing date.[22] The effective time is binding on the parties, ensuring that the asset transfer

14. *See* Daniel Glazer, *Intellectual Property: Asset Purchases*, 102 TRADEMARK REP. 1314, 1345–46 (2012) (explaining various post-closing issues).

15. For sample APAs, see *Asset Purchase Agreement*, ONECLE, http://contracts.onecle.com/type/19.shtml (last visited Dec. 12, 2014).

16. Glazer, *supra* note 14, at 1333.

17. *Id.* at 1343–45.

18. *Id.* at 1345.

19. *Id.*

20. *Id.* at 1345–46.

21. *See, e.g.*, 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 date); Marathon Projects Ltd. v. Creative Designs Int'l., Ltd., No. 10 CV 2396(RPP), 2011 WL 1002424, at *2 (S.D.N.Y. Mar. 16, 2011) (stating that in the APA the "Effective Time is defined as 11:59 p.m. on the Closing Date" (internal quotations omitted)); Marzoll v. Marine Harvest US, Inc., No. 08-261-B-S, 2009 WL 4456321, at *29 (D. Me. Nov. 29, 2009) (noting that the "Effective Time" is the closing date).

22. *See* VisionChina Media Inc. v. S'holder Representative Servs., LLC, 967 N.Y.S.2d 338, 340–41 (App. Div. 2013) (noting that the closing date was two months before the "Effective Date").

contractually occurs between the parties.[23] 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 has occurred is still within the zone of protection.[24]

To encourage corporate commercial transactions such as asset transfers, courts routinely treat these transactions simply as contractual transfers of property governed by state law.[25] Contract law of the jurisdiction selected by the parties to the asset transfer agreement governs claims and disputes arising from the contract.[26] Courts recognize that the primary rule of

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23. For example, in *Old T.B.R., Inc. v. Billing Res., LLC* (*In re* Old T.B.R., Inc.), Ch. 11 Case No. 07-52890-ASW, Adv. No. 09-5074, 2011 WL 5402506 (Bankr. N.D. Cal. Oct. 31, 2011), the APA provided:

> 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 . . . .

Id. at *12 (alterations in original).

24. For example, in *VisionChina Media Inc.*, the buyer brought action against the seller, alleging that the buyer's claims against the seller were within the one-year period from the effective time as negotiated by the parties to the APA. 967 N.Y.S.2d at 343. The court determined that "[a]lthough the buyers offer several reasons why the contractual one-year limitation period should be ignored . . . , none are persuasive." *Id.*

25. Sales of assets or acquisitions are today's modern corporate contracts. *See* GRT, Inc. v. Marathon GTF Tech., Ltd., No. 5571-CS, 2011 WL 2682898, at *12 & n.65 (Del. Ch. July 11, 2011) (emphasizing the contractual nature of the transaction); *In re* Fitch, 174 B.R. 96, 101 (Bankr. S.D. Ill. 1994) ("Determination of the significance of the remaining obligations [of a contract] is made by looking to state law, as state law controls with regard to property rights in assets of a debtor's estate." (citing Mitchell v. Streets (*In re* Streets & Beard P'ship), 882 F.2d 233, 235 (7th Cir. 1989))).

26. *See* Bremen v. Zapata Off-Shore Co., 407 U.S. 1, 11–12 (1972) (according presumptive validity to choice-of-law provisions in the contract); Postlewaite v. McGraw-Hill, Inc., 411 F.3d 63, 67 (2d Cir. 2005) (applying New York law where "[t]he parties do not dispute that New York law applies" pursuant to 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 Chem. Co. v. Vector Corrosion Techs., Inc., No. 1:05CV080, 2007 WL 4460628, at *3 (N.D. Ohio Dec. 14, 2007) (applying Ohio law to determine the meaning of a patent assignment contract), *vacated*, 561 F.3d 1340, 1343 (Fed. Cir. 2009) (providing still that "[c]onstruction of patent assignment contracts is a matter of state contract law" (quoting Mars, Inc. v. Coin Acceptors, Inc., 527 F.3d 1359, 1370 (Fed. Cir. 2008) (internal quotation marks omitted)).

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contract law is that when the parties express their intent in clear terms,[27] courts "will not resort to construction."[28] 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.[29]

Indeed, courts look at the plain language of the contract and hold that the transfer is deemed to occur at the effective time.[30] *VisionChina Media Inc. v. Shareholder Representative Services, L.L.C.* is an example of how the court looks to effective time for the calculation of the critical period during which buyers can assert claims against the sellers as negotiated by the

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27. 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, 1282 (N.Y. 1978)).

28. Bruhl v. Thul, 134 N.W.2d 571, 574 (Iowa 1965) ("The court will not resort to construction where the intent of the parties is expressed in clear and unambiguous language."); 2 SAMUEL WILLISTON & RICHARD A. LORD, A TREATY ON THE LAW OF CONTRACTS § 6:61, at 894 (4th ed. 2007) ("[I]t 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."); *see, e.g.*, Am. Cyanamid Co. v. Ring, 286 S.E.2d 1, 3 (Ga. 1982) ("[T]he 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."); 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." (quoting Mt. Hawley Ins. Co. v. Azia Contractors, Inc., 886 S.W.2d 640, 642 (Mo. Ct. App. 1994)); *Mt. Hawley Ins. Co.*, 886 S.W.2d at 642 ("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."); *see also* 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.").

29. Viacom Int'l Inc. v. Tandem Prods., 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."), *aff'd*, 526 F.2d 593 (2d Cir. 1975). Some courts go further: "The 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 396. 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.

30. *See* VisionChina Media Inc. v. S'holder Representative Servs., LLC, 967 N.Y.S.2d 338, 340–41 (App. Div. 2013).

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parties.[31] In that case, the buyers purchased assets from the sellers pursuant to a merger agreement, which contained a number of representations and warranties.[32] The contractual provisions provided that the buyers could 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.[33] The buyers 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 [i]ndisputably 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.[34]

The *VisionChina Media* court looked to state contract law to resolve the dispute relating to assets transferred pursuant to the agreement. Likewise, if a sale and purchase transaction includes the transfer of IP assets, courts recognize that "[b]ecause patents have the attributes of personal property, the transfer of patents and property rights . . . in patents are governed by state law."[35] Thus, transfer and ownership of patents are matters governed by state contract law.[36] Indeed, courts must apply state law when determining the "contractual obligations and transfers of property rights,

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31. *See id.* at 344.
32. *Id.* at 340–41.
33. *Id.* at 341, 343.
34. *Id.* at 344.
35. St. John's Univ., N.Y. v. Bolton, 757 F. Supp. 2d 144, 190 (E.D.N.Y. 2010) (citation omitted) (citing Bd. of Trs. of Leland Stanford Junior Univ. v. Roche Molecular Sys., Inc., 583 F.3d 832, 841 (Fed. Cir. 2009)).
36. *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 Techs. LLC v. SAP AG, 576 F.3d 1374, 1379 (Fed. Cir. 2009), *cert. denied*, 130 S. Ct. 2343 (2010).

Similarly, when federal bankruptcy law intersects with contract law, courts look to state law to govern contractual issues. *See, e.g.*, River Prod., Co. v. Webb (*In re* Topco, Inc.), 894 F.2d 727, 738 (5th Cir. 1990) ("Even in bankruptcy proceedings, courts of appeals look to state law to decide contract issues."). Indeed, the Supreme Court has "long recognized that the basic federal rule in bankruptcy is that the state law governs the substance of claims, Congress having generally left the determination of property rights in the assets of bankrupt's estate to state law." Travelers Cas. & Surety Co. of Am. v. Pac. Gas & Elec. Co., 549 U.S. 443, 451 (2006) (internal quotation marks omitted). Therefore, "when the Bankruptcy Code uses the word 'claim' . . . it is usually referring to a right to payment recognized under state law." *Id.*

including those relating to patents."[37] For example, according to state contract law, in a case where the patentee has already assigned its invention to the assignee within the scope of the assignment, the former patentee cannot later claim ownership of the transferred invention that has subsequently been granted a patent.[38] 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.[39] Similarly, "actions . . . vindicat[ing] property rights in patents are subject to state statutes of limitations, and state law doctrines [that] determin[e] when a limitations period may be tolled."[40]

B. Abraxis Bioscience, Inc. v. Navinta LLC

Contrary to established state contract law governing sales and purchases of assets, the Federal Circuit has developed its own approach. The Federal Circuit has recently ignored the contracting parties' choice-of-law provision in the contract, creating its own contract law in disregard of long-standing choice-of-law rules, which accord significant weight to a choice-of-law provision in a contract.[41] *Abraxis Bioscience, Inc. v. Navinta LLC*[42] is a glaring example of the Federal Circuit's expansive overreach into state contract law for commercial sale and purchase transactions involving patent property under the disguise of exclusive jurisdiction over patents.

Abraxis centered on a commercial transaction involving the sale and purchase of assets.[43] Here, the transaction was between two pharmaceutical

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37. Regents of Univ. of N.M. v. Knight, 321 F.3d 1111, 1118 (Fed. Cir. 2003).

38. *See* Reid v. Gen. Motors Corp., 489 F. Supp. 2d 614, 617, 621 (E.D. Tex. 2007) ("[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" (citation omitted)).

39. *See Sky Techs. LLC*, 576 F.3d at 1376–79 (holding that the chain of title in the purchased patents was not broken from the defaulted debtor to the secured creditor and then to the subsequent purchaser of the foreclosed patents).

40. *See St. John's Univ.*, 757 F. Supp. at 191 ("Because Defendants invoke constructive notice of the Liquisolid 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 Liquisolid 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 Liquisolid Patents' existence to Plaintiff.").

41. *See, e.g.*, Advani Enters., Inc. v. Underwriters at Lloyds, 140 F.3d 157, 162–63 (2d Cir. 1998) (noting that federal choice-of-law rules accord considerable 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 *1–2, *15 (N.C. Super. Ct. May 2, 2011) (noting that "[t]he 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 holding that the remaining claims should be resolved pursuant to New York law because the "consensual choice of law clause in the purchase contract dictates the application of New York law to the contract claims").

42. 625 F.3d 1359 (Fed. Cir. 2010), *cert. denied*, 132 S. Ct. 115 (2011).

43. *Id.* at 1361.

companies, seller AstraZeneca (AZ) and buyer Abraxis.[44] According to the press release about the important sale, the transaction included eight anesthetic and analgesic drug products and their patents,[45] as part of a larger $350 million assets sale.[46]

The transaction unfolded in a typical fashion that commercial lawyers are intimately familiar with.[47] The parties entered into an APA dated April 26, 2006, and selected New York law to govern the contract.[48] Under the APA, AZ "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 patent assets.[49] Among various ancillary documents executed as part of the assets' acquisition by Abraxis, on June 28, 2006, the parties signed an IP Assignment Agreement, which referred back to the APA and stated that the "provisions of this instrument are subject to the terms and conditions of the Purchase Agreement."[50] The IP Assignment Agreement also included a "Further Assurances" clause affirming that the seller, AZ, 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, sell, convey, assign, transfer, set over to or vest in Buyer any of the Transferred Intellectual Property."[51]

The IP Assignment Agreement listed the transferred patents, including patent numbers 4,870,086 ('086), 5,670,524 ('524), and 5,834,489 ('489), in Schedule A.[52] The transaction, however, was incomplete as AZ subsequently discovered that some of its affiliates had failed to formally assign their patents, including patents '086, '524, and '489 that were part of the assets transferred to Abraxis.[53] To correct their mistakes, these affiliates (transferors) immediately transferred the pertinent patents to AZ (transferee), and AZ then conveyed the patents to Abraxis (the original buyer) in accordance with the "Further Assurances" clause by executing

44. *Id.*

45. AstraZeneca's press release announced that it would receive $350 million from Abraxis for the part of the deal involving anesthetics and analgesic products including, Xylocaine, Polocaine, Naropin, Nesacaine, Sensorcaine, Astramorph, Emla Cream, and Diprivan. *See* Press Release, AstraZeneca, AstraZeneca and Abraxis BioScience to Co-Promote Cancer Therapy ABRAXANE; Abraxis Bioscience to Acquire AstraZeneca's U.S. Anaesthetic and Analgesic Product Portfolio (Apr. 27, 2006), http://www.astrazeneca.com/Media/Press-releases/Article/20060427--AstraZeneca-and-Abraxis-BioScience-to-copromote-canc.

46. *See id.*; Abraxis Bioscience, Inc. v. Navinta LLC, No. 07-1251, 2009 WL 904043, at *1 (D.N.J. Mar. 30, 2009), *rev'd*, *vacated*, *and remanded*, 625 F.3d 1359 (Fed. Cir. 2010).

47. *See* Glazer, *supra* note 14, at 1333, 1343–46 (describing asset purchase transactions and necessary documents).

48. *See Abraxis Bioscience*, 625 F.3d at 1361; *id.* at 1368 (Newman, J., dissenting).

49. *Id.* at 1368–69 (Newman, J., dissenting).

50. *Id.* at 1369.

51. *Id.* (internal quotation marks omitted).

52. *Id.*

53. *Id.*

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additional assignment documents in March 2007.[54] The assignment documents each stated that:

> [T]his instrument is being executed by the parties to enable the Transferee to further convey to Buyer that portion of the Transferred Assets included in the Asset 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.[55]

Subsequently, the original seller, AZ, 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."[56] As noted above, the original APA was executed as part of the asset acquisition on April 26, 2006.[57]

The above transaction was a typical transfer of property by contract within the provenance of state law. Since the contracting parties to the transaction selected New York law to govern the contract, courts should have applied New York law.[58] The transferred patents at issue were subsequently the subject of patent infringement litigation brought by Abraxis against a third party, Navinta, and within the appellate jurisdiction of the Federal Circuit.[59] Navinta challenged Abraxis for lack of standing in bringing the infringement case in the district court.[60] Applying New York contract law on retroactivity, the district court found that Abraxis was the owner of all the transferred assets, including the patents identified in Schedule A that were inadvertently omitted as of the Closing Date, June 28, 2006.[61] When Navinta appealed, instead of applying New York state contract law on the transfer of patents pursuant to the APA, as the district court had correctly done,[62] the Federal Circuit panel majority had a

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54. *Id.* at 1369–70.

55. *Id.* (second and third alterations in original) (internal quotation marks omitted).

56. *Id.*

57. *Id.*

58. *See id.*

59. Abraxis brought its patent infringement litigation against Navinta on March 15, 2007, after Abraxis acquired the assets for $350 million from AZ and affiliates in the April 26, 2006 transaction with the closing date of June 28, 2006. *See* Abraxis Bioscience, Inc. v. Navinta LLC, No. 07-1251, 2009 WL 904043, at *1 (D.N.J. Mar. 30, 2009), *rev'd*, *vacated*, *and remanded*, 625 F.3d 1359 (Fed. Cir. 2010).

60. *Id.* (noting the defendant's lack of standing argument).

61. *See Abraxis Bioscience*, 2009 WL 904043, at *4. This is consistent with the district court finding that "[g]iven this retroactive effect, the IP Agreement would then operate to transfer title from AZ[] to Abraxis as of that date as well" for the omitted patents that were later assigned. *Id.*

62. *See Abraxis Bioscience*, 625 F.3d at 1360; *id.* at 1368 (Newman, J., dissenting) ("The court thus erases the trial, nullifies the judgment, cancels the appeal, and sends the case back so that

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different idea. The panel majority asserted that because the transfer of property in this case involved patents, and because whether there was an assignment of patents would affect the buyer Abraxis's standing to bring an infringement suit against others, the case was "a matter of federal law" and therefore had to be "resolved by Federal Circuit law."[63] Accordingly, the panel majority applied a string of Federal Circuit decisions on patent assignments and promises to assign.[64] These decisions have nothing to do with commercial sales or corporate asset transfers that included patent assets under state contract law.[65]

The panel majority completely ignored New York law on contracts for transfers of property assets, as its opinion neither discussed nor cited to any New York state court decision on the transfer of assets contract.[66] Applying Federal Circuit law on patent assignment of future inventions, the panel majority treated the asset sale and purchase merely as one of many assignments of future invention cases and ruled that under the patent assignment documents, Abraxis did not own the patents until November 12, 2007.[67] Therefore, the panel majority concluded that Abraxis lacked standing to bring the patent infringement suit against Navinta in the complaint filed on March 15, 2007.[68]

If the panel majority had adhered to federalism principles [69] and applied New York contract law on transfers of property assets, as it should have done, the outcome would have been different. 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.[70] This means if the parties select a date to be the effective date for the property conveyance, that date will govern the transaction and be the date the buyer becomes the owner of

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the parties and the district court and this court can do it all again. However, the *court has not shown reversible error* in the district court's ruling on the question of standing, *a ruling based on state contract and commercial transaction law*." (emphasis added)).

63. *Id.* at 1364 (majority opinion) (citing DDB Techs., L.L.C. v. MLB Advanced Media, L.P., 517 F.3d 1284, 1290 (Fed. Cir. 2008)).

64. *Id.* at 1364–65.

65. *Id.* (citing Bd. of Trs. of Leland Stanford Junior Univ. v. Roche Molecular Sys., Inc. 583 F.3d 832, 841 (Fed. Cir. 2009), *aff'd*, 131 S. Ct. 2188 (2011)); *DDB Techs.*, 517 F.3d at 1290; IPVenture, Inc. v. ProStar Computer, Inc., 503 F.3d 1324, 1326–27 (Fed. Cir. 2007); Schreiber Foods, Inc. v. Beatrice Cheese, Inc., 402 F.3d 1198, 1202 (Fed. Cir. 2005); Speedplay, Inc. v. Bebop, Inc., 211 F.3d 1245, 1249 (Fed. Cir. 2000); Arachnid, Inc. v. Merit Indus., Inc., 939 F.2d 1574, 1578 (Fed. Cir. 1991).

66. *See Abraxis Bioscience*, 625 F.3d at 1359 (relying strictly on federal precedent to analyze standing).

67. *Id.* at 1365–66.

68. *Id.* at 1365–66, 1368.

69. *See infra* Part IV.

70. Viacom Int'l Inc. v. Tandem Prods., Inc., 368 F. Supp. 1264, 1270 (S.D.N.Y. 1974), *aff'd*, 526 F.2d 593, 600 (2d Cir. 1975).

the transferred assets.[71] 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 be the date on which the property is conveyed from the seller to the buyer.[72]

Under the parties' reasonable expectations that state contract law would be applied, the sellers and buyers elected to convey the patent property, among other transferred assets, from AZ to Abraxis for $350 million on the closing date. Pursuant to the APA, the closing date was June 28, 2006,[73] and the instrument—the IP Assignment Agreement included as part of the acquisition transaction—was binding on the parties.[74] Accordingly, on June 28, 2006, Abraxis became the (purported, according to the majority) new owner of the transferred assets, including the patents.[75] Both AZ and Abraxis, like many other sophisticated parties in complex commercial sale transactions, understood that inadvertent mistakes are sometimes made and that parties to the transaction generally include provisions like "further assurances" to correct these mistakes in order to effectuate the parties' intent in the original contract.[76]

In this case, the IP Assignment Agreement contained the "Further Assurances" provision under which the seller contractually had to deliver to the buyer all the properties that the seller had already sold to the buyer pursuant to the Master Purchase Agreement.[77] When the mistake—that not all the patents had been conveyed as of the Closing Date—was discovered, the parties corrected the 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.[78]

The "Further Assurances" provision allowed for the patent conveyance to be retroactive.[79] This was consistent with New York law,[80] which allows written contracts to be retroactive if the contract so provides in its relevant

71. *See* Mut. Life Ins. Co. of N.Y. v. Hurni Packing Co., 263 U.S. 167, 175–76 (1923) (applying New York law, the court held that "[i]t 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" and that "[p]lainly[,] their agreement was effective").

72. *See, e.g.*, *Viacom Int'l*, 368 F. Supp. at 1270.

73. *See* Abraxis Bioscience, Inc. v. Navinta LLC, No. 07-1251, 2009 WL 904043, at *1 (D.N.J. Mar. 30, 2009), *rev'd*, *vacated*, *and remanded*, 625 F.3d 1359 (Fed. Cir. 2010).

74. *See Abraxis Bioscience*, 625 F.3d at 1370 (Newman, J., dissenting).

75. *Id.* at 1361 (majority opinion).

76. *See id.* at 1369 (Newman, J., dissenting) (noting that "[i]t is not unusual [for parties] to transfer a complex set of related assets" through a master agreement and ancillary agreements, such as a "Further Assurances" clause).

77. *Id.*

78. *Id.* at 1369–70.

79. *See id.* at 1370.

80. New York law of contracts allows written contracts to be retroactive. Viacom Int'l Inc. v. Tandem Prods., Inc., 368 F. Supp. 1264, 1270 (S.D.N.Y. 1974). If the contract provides that it will become effective "as of" an earlier date, then the contract is "retroactive to the earlier date." *Id.*

provisions.[81] Furthermore, New York law of contracts permits retroactivity to correct unintended omission or mistake in an earlier agreement.[82]

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,[83] the panel majority committed a grave error when it zealously applied Federal Circuit law to a sale contract and disregarded the parties' choice of law contract provision. Sales of patents are simply sales of property, and such property conveyances are governed by state contract law.[84] 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.[85] The panel majority extended its patent jurisdiction too far when it completely abandoned state law in interpreting the sale contract.[86]

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

81. *See id.* 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, 912 N.Y.S.2d 598, 599 (App. Div. 2010) (quoting Greenfield v. Philles Records, Inc., 780 N.E.2d 166, 170 (N.Y. 2002) (internal quotation marks omitted)).

82. *See* Int'l Bhd. of Elec. Workers, AFL-CIO v. Orange & Rockland Utils., Inc. (*In re* Local Union 1567), 478 N.Y.S.2d 937, 938 (App. Div. 1984) (permitting retroactive application of arbitration provision despite "the fact that the grievances arose while there was no agreement to arbitrate"); Buffalo Police Benevolent Ass'n v. City of Buffalo, 453 N.Y.S.2d 314, 317 (Sup. Ct. 1982) (permitting retroactivity of a collective bargaining agreement to cover the period between the new contract execution date and the expiration of the old contract); Matthews v. Jeremiah Burns, Inc., 129 N.Y.S.2d 841, 847 (Sup. Ct. 1954) (permitting the amended agreement to be retroactive to the date of the original amendment).

83. Christianson v. Colt Indus. Operating Corp., 486 U.S. 800, 807 (1988).

84. *See* Euclid Chem. Co. v. Vector Corrosion Techs., Inc., 561 F.3d 1340, 1343 (Fed. Cir. 2009) ("Construction of patent assignment agreements is a matter of state contract law." (quoting Mars, Inc. v. Coin Acceptors, Inc., 527 F.3d 1359, 1370 (Fed. Cir. 2008) (internal quotation marks omitted)).

85. The Federal Circuit was divided on this point. *See* Abraxis Bioscience, Inc. v. Navinta LLC, 672 F.3d 1239, 1240–41 (Fed. Cir. 2011) (Gajarsa, J., concurring) (per curiam) (arguing that, "[n]otwithstanding New York [contract] law," the parties could not "retroactively override federal law to revive failed agreements"). *But see id.* at 1241 (O'Malley, J., dissenting) (arguing that preempting state contract law in the instant case neglects clear Supreme Court precedent "restricting preemption of state law" and which precedent "uniformly proscribed the judicial creation of a special federal rule *absent a significant conflict between state law and some federal policy or interest*" (emphasis added) (internal quotation marks omitted)).

86. The panel majority's approach is contrary to other Federal Circuit decisions on contract interpretation. *See generally* Tri-Star Elecs. Int'l, 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 . . . .").

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assignment agreement.[87] Moreover, the Federal Circuit law, on which the panel majority erroneously relied, concerned promises to assign future inventions in an employment context, not massive corporate sale of assets involving existing patents.[88] By justifying its decision that the contract was a matter of federal law under Federal Circuit precedents, the panel majority has created a patent exception to the general rule of contract interpretation.[89] The panel majority should have known that the patent-exception approach has already been squarely rejected by the U.S. Supreme Court in recent years.[90]

The panel majority's decision has caused uncertainty in future commercial contracts involving conveyance of patents. Parties to a sale contract with a choice-of-law provision expect predictability. They expect courts to apply state law and the contract law of the jurisdiction selected. Though *Abraxis Bioscience* concerned 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 provision. Worse, while the parties to the contract did not dispute that the transferred assets in a complex transaction of $350 million did include the pertinent patents on the Closing Date of June 28, 2006,[91] the panel majority injected its judicial preemption to support its conclusion that the transfer occurred in November 2007.[92] The panel majority's decision was contrary to the terms that the parties agreed to in the commercial contract.[93]

The Federal Circuit's assault on commercial law did not end there. Abraxis subsequently petitioned the Federal Circuit for a hearing en banc, and the Federal Circuit, in a per curiam decision, denied the en banc

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87. The panel majority erroneously relied on Federal Circuit 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) (Newman, J., dissenting), *cert. denied*, 132 S. Ct. 115 (2011).

88. *See id.* at 1364–65 (majority opinion) ("Because the APA is a promise by AZ[] to assign the relevant patents to Abraxis when AZ[] obtains legal title, under our 'promise to assign' cases, a subsequent written agreement is necessary to consummate the assignment.").

89. *See id.* at 1364 ("[T]he 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. We have accordingly treated it as a matter of federal law.").

90. *See, e.g.*, MedImmune, Inc. v. Genentech, Inc., 549 U.S. 118, 122, 136 (2007) (rejecting Federal Circuit precedent ruling that "a patent licensee in good standing cannot establish an Article III case or controversy with regard to validity, enforceability, or scope of the patent because the license agreement 'obliterate[s] any reasonable apprehension' that the licensee will be sued for infringement" (alterations in original) (quoting Gen-Probe Inc. v. Vysis, Inc., 359 F.3d 1376 (Fed. Cir. 2004)); eBay Inc. v. MercExchange, L.L.C., 547 U.S. 388, 391–94 (2006) (rejecting the Federal Circuit's application of a general Patent Act exception to a "long tradition of equity practice" and holding that the well-established principles of equity "apply with equal force to disputes *arising under the Patent Act*" (emphasis added) (internal quotation marks omitted)).

91. *See Abraxis Bioscience*, 625 F.3d at 1368 (Newman, J., dissenting).

92. *Id.* at 1372.

93. *See id.*

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petition, with three judges penning a concurrence over the dissent of two other judges.[94] 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 asset sale and purchase transaction.[95] 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 infringement action.[96] The concurrence emphasized that the case was correctly decided under the Federal Circuit's precedents on patents.[97]

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

A cursory glance at *Abraxis Bioscience* may not mean much to patent scholars and the patent bar, as the case can be viewed simply as a matter of lack of standing to bring an infringement suit under § 261 of the Patent Act due to the plaintiff's not having ownership of the patents on the filing date. The decision, however, is anything but simple. By hiding behind patent law, the Federal Circuit has created its own federal common law of contracts to govern commercial sales of assets where the assets happen to include patents.[98] The Federal Circuit failed to explain why it requires parties to asset transfers involving patents to apply Federal Circuit contract law in complete disregard of state contract law provisions negotiated and chosen by both the seller and acquirer of the assets.[99]

Specifically, the Federal Circuit, in both the panel majority opinion and the subsequent three-judge concurrence opinion rejecting the petition for an en banc hearing, did not identify any conflict between federal law or policy and state contract law to justify the imposition of Federal Circuit created contract law.[100] The Federal Circuit provided no justification for why it had expressly displaced New York contract law. The court also offered no explanation for why New York contract law must not be applied to the master APA 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 IP 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 at the "Effective Time," and the contracting parties to the massive sale of corporate assets did not dispute the transaction.[101] In fact, the contracting seller even provided further "belt-

94. *See* Abraxis Bioscience, Inc. v. Navinta LLC, 672 F.3d 1239, 1239 (Fed. Cir. 2011) (per curiam).

95. *See id.* at 1240 (Gajarsa, J., concurring).

96. *Id.*

97. *Id.* at 1240–41.

98. *Id.* at 1241 (O'Malley, J., dissenting).

99. *See id.*

100. *See id.* (noting that the panel majority did not identify a conflict between state law and federal policy or interest).

101. *See supra* notes 79–82, 91–92 and accompanying text.

and-suspenders confirmation" of what it had already conveyed under New York law.[102] The court's complete disregard of state contract law on transfer of property ownership is evidence of the Federal Circuit overextending its patent jurisdiction.

Without identifying any conflict between federal and state law to legitimize displacing New York contract law, the Federal Circuit looked to its own precedents on promises to assign future inventions.[103] The question addressed in those cases centers on "whether a patent assignment clause creates an automatic assignment or merely an obligation to assign."[104] The Federal Circuit's solution to the question is "intimately bound up with the question of standing in patent cases," and therefore it held that federal law should displace state contract law.[105]

This decision was incorrect for a number of reasons. First, the precedents have nothing to do with contracts to sell massive assets inclusive of existing patents. Second, 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 asset purchases. Third, the precedents have nothing to do with the clear intent of the parties through execution of a master sale agreement and ancillary agreements to vest title in the acquirer on an effective date agreed upon by the parties. Finally, the precedents have nothing to do with the body of state contract law recognizing property that actually has been transferred retroactively on the effective date.[106]

Erroneous wholesale application of Federal Circuit precedents to *Abraxis Bioscience* has created a new body of Federal Circuit contract law.[107] 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. They also cannot rely on the typical contractual provisions in a sale and asset purchase agreement. "Effective date" and "further asssurances" provisions are now meaningless as contracting parties cannot rely on state

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102. *Abraxis Bioscience*, 672 F.3d at 1247 (O'Malley, J., dissenting).

103. *Id.* at 1364 (majority opinion).

104. *Id.* (quoting DDB Techs., L.L.C. v. MLB Advanced Media, L.P., 517 F.3d 1284, 1290 (Fed. Cir. 2008)) (internal quotation marks omitted).

105. *Id.* (quoting *DDB Techs.*, 517 F.3d at 1290) (internal quotation marks omitted); *see also, e.g.*, Bd. of Trs. of Leland Stanford Junior Univ. v. Roche Molecular Sys., Inc. 583 F.3d 832, 841 (Fed. Cir. 2009), *aff'd*, 131 S. Ct. 2188 (2011); IPVenture, Inc. v. ProStar Computer, Inc., 503 F.3d 1324, 1327 (Fed. Cir. 2007), *cert. denied*, 553 U.S. 1094 (2008); Arachnid, Inc. v. Merit Indus., Inc., 939 F.2d 1574, 1580–81 (Fed. Cir. 1991).

106. *See Abraxis Bioscience*, 672 F.3d at 1241, 1243–46, 1247 (O'Malley, J., dissenting).

107. *Id.* at 1241 ("The panel majority's creation of federal common law to govern assignments of existing patents conflicts not only with our precedent, but with longstanding Supreme Court precedent restricting judicial preemption of state law.").

law for vesting title retroactively.[108]

Moreover, the new Federal Circuit's contract law has devastating consequences for commercial law and practices. Complex acquisition of a target company through asset 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 APA, the acquirer will have no recourse against a third party for subsequent infringement, regardless of whether the seller has already sold and the acquirer has already purchased all of the seller's and its affiliates' assets.[109]

A rigid, bright-line rule has been created in the Federal Circuit's patent vacuum to disrupt contracting parties' expectation for certainty in their corporate commercial transactions. Companies engaging in strategic decisions to buy or sell corporate assets that include patents now face a new burden and associated cost. What company would want to be in Abraxis' situation: Paying $350 million for assets from a seller and its affiliates; paying professionals to assist in negotiating the deal; conducting due diligence and drafting the contracts; subsequently bringing an infringement litigation against a third party and battling the patent infringement action on the merits for over three years, including a full trial on infringement; and a judicial determination relating to the Hatch–Waxman Act for a debilitating outcome after the district court's judgment was nullified by the new Federal Circuit contract law dictating that Abraxis had no ownership of the patents and therefore lacked the standing to bring the infringement suit in the first place?[110]

II. Security Interest in Intellectual Property Assets and Fraudulent Conveyances

This Part focuses on the Federal Circuit's overreach in state secured transactions law and fraudulent conveyance law. It examines established secured transactions law and practices in commercial financing and a contrary Federal Circuit case. Finally, it discusses the impact of the case on secured transactions.

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

Secured transactions are common commercial transactions that occur daily.[111] In a nutshell, when a party is in need of credit, it may attempt to

108. *See id.* at 1241–46.

109. *See id.* at 1241.

110. *Cf.* Paul R. Gugliuzza, *The Federal Circuit as a Federal Court*, 54 WM. & MARY L. REV. 1791, 1819 (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 . . . might be the next doctrinal battle within the Federal Circuit's federalism relationship." (footnote omitted)).

111. *See, e.g.*, *Dollar General Seeks $3.15 Billion to Refinance Secured Debt*, MONEYNEWS (Apr. 8, 2013, 3:10 PM), http://www.moneynews.com/Companies/Dollar-General-refinance-KKR-

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.[112] This 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.[113] 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[114] and foreclose on the debtor's collateral property.[115] 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 a financing statement with the Secretary of State's Office where the debtor is deemed to be located.[116]

Article 9 of the Uniform Commercial Code (UCC-9) governs secured transactions, and all states have adopted UCC-9.[117] Secured transactions law recognizes that the debtor and the secured creditor often enter into an agreement that covers future advances[118] and after-acquired collateral

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debt/2013/04/08/id/498393; *Sterling Consolidated Secures $2.45 Million Senior Bank Debt*, REUTERS (Oct. 10, 2013, 7:00 AM), http://www.reuters.com/article/2013/10/10/idUSnGNX4 TNZFK+1df+GNW20131010; *JCPenney Announces Consummation of $2.25 Billion Term Loan and Initial Settlement of Its Tender Offer and Consent Solicitation*, JCPENNEY (May 22, 2013), http://ir.jcpenney.com/phoenix.zhtml?c=70528&p=irol-newsArticle&ID=1823443 (announcing that JCPenney entered into a new five-year $2.25 billion senior secured term loan credit facility).

112. WILLIAM H. LAWRENCE ET AL., UNDERSTANDING SECURED TRANSACTIONS 2 (5th ed. 2012); *see* Dana Cimilluca & Sam Schechner, *Alcatel-Lucent Secures $2.1 Billion Debt Financing*, WALL ST. J. (Dec. 14, 2012, 9:47 AM), http://online.wsj.com/news/articles/SB1000142412788732398 1504578177982789220970 (subscription required) ("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.").

113. *See* U.C.C. § 9-109 (2010) (addressing the scope of secured transactions).

114. *See* JAMES J. WHITE & ROBERT S. SUMMERS, UNIFORM COMMERCIAL CODE: SECURED TRANSACTIONS § 25-3, at 887 (2000) (discussing the prevalence of acceleration as an option to secured parties).

115. *See, e.g.*, U.C.C. § 9-601(a) (permitting the secured party, upon the debtor's default, to "reduce a claim to judgment, foreclose, or otherwise enforce the claim"); *id.* § 9-607 (addressing collections and enforcements by a secured party); Kathy Cabral & Teresa Wilton Harmon, *Remedies Outside the Box: Enforcing Security Interests Under Article 9 of the Uniform Commercial Code*, BUS. L. TODAY (Aug. 23, 2012), http://www.americanbar.org/publications/blt/2012/08/03_ cabral.html (discussing remedies available to secured parties upon default of the debtor).

116. *See* U.C.C. § 9-310(a) ("Except as otherwise provided . . . a financing statement must be filed to perfect all security interests and agricultural liens."); WHITE & SUMMERS, *supra* note 114, § 22-10, at 779 (describing perfection by filing as "the most common method of performing a security interest under Article 9").

117. James W. Bowers, *Some Economic Insights into Application of Payments Doctrine: Walker-Thomas Revisited*, 89 CHI.-KENT L. REV. 229, 245 (2014).

118. *See* U.C.C. § 9-323 (addressing future advances).

property assets.[119] 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.[120] There is no need for the parties to execute additional agreements each time the secured creditor issues a new loan to the debtor.[121] 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.[122] Again, the parties will rely on the original agreement without signing any new agreement to cover the newly acquired collateral property.[123]

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

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119. *See id*. § 9-322 (discussing conflicting security interests and priority therein). Specifically, comment 5, 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 a new machine. When Debtor acquires rights in the new machine, both A and B acquire security interests in the machine simultaneously. Both security interests are perfected simultaneously. However, A has priority because A filed before B.

Id. § 9-322 cmt. 5, ex. 4.

120. Example 1 in Official Comment 3 of U.C.C. § 9-323 illustrates the common practice of having the original security agreement and filed financing statement 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 1, 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 knows of B's intervening advance when A makes the second advance.

Id. § 9-323 cmt. 3 ex. 1; *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.").

121. *See In re Smink*, 276 B.R. at 166.

122. *See, e.g.*, First Bancorp, Inc. v. United States, 945 F. Supp. 2d 802, 811 (W.D. Ky. 2013) ("[T]he 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.").

123. *Id.*; U.C.C. § 9-204(a) ("Except as otherwise provided . . . a security agreement may create or provide for a security interest in after-acquired collateral.").

between the secured party and the debtor when the secured party has given value to the debtor, the debtor has a right to the collateral property, and the debtor has authenticated a security agreement which contains a description of the collateral.[124] The "value" given by the secured party to the debtor can be loans or credit extended to the debtor from the secured party[125] or preexisting debt the debtor owed to the secured party.[126] To illustrate this, assume a debtor has borrowed money from a 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.[127] Consequently, the security interest is enforceable between the debtor and the secured lender, as all requirements under § 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,[128] the perfected security interest is enforceable against any third party and attains priority over junior secured creditors,[129] bankruptcy trustees, and unsecured creditors.[130]

Moreover, a lender obtaining security interest in the debtor's property for preexisting debt is itself not a fraudulent conveyance under state law. Most states have modeled their fraudulent transfer statutes after the Uniform Fraudulent Transfer Act (UFTA).[131] Also, as noted previously, all fifty states have adopted UCC-9.[132] Texas and California, for example, are

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124. *See* U.C.C. § 9-203.

125. *See* Sterling Nat'l Bank & Trust Co. of N.Y. v. Bornstein (*In re* Metric Metals Int'l, Inc.), 20 B.R. 633, 637–38 (S.D.N.Y. 1981) (finding the security interest had attached because "[t]he "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").

126. *See, e.g.*, Farmers & Merchs. State Bank v. Teveldal, 524 N.W.2d 874, 878 n.4 (S.D. 1994) ("[P]reexisting debt may supply 'value' for attachment of a security interest.").

127. *See, e.g.*, First Nat'l Bank of Seminole v. Hooper, 104 S.W.3d 83, 84 (Tex. 2003); Wyzard v. Goller, 28 Cal. Rptr. 608, 609 (Ct. App. 1994).

128. 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(b) (addressing perfection by taking possession of the collateral); *id.* § 9-304 (addressing perfection by taking control of deposit accounts); *id.* § 9-305 (addressing perfection by taking control of investment property); *id.* § 9-306 (addressing perfection by taking control of letter-of-credit rights).

129. *See id.* § 9-322 (addressing priority among conflicting security interests and agricultural liens in the same collateral and setting forth rules for determining that priority).

130. *See id.* § 9-317 (stating that an unsecured security interest is subordinate to creditors who have filed the financing statement or perfected the security interest). U.C.C. § 9-317 also provides that a security interest that is perfected prior to a lien creditor's interest perfection will have priority. *See id.* § 9-317(a)(2) (providing that a security interest is subordinate to the rights of "a person that becomes a lien creditor *before* the earlier of that time" (emphasis added)).

131. *See* CORNELL U. L. SCH., *Uniform Business and Financial Laws Locator*, LLI, http://www.law.cornell.edu/uniform/vol7.html#frcon (last visited Dec. 12, 2014).

132. *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 UCC-9); *see also* Bowers, *supra* note 117, at 245 (providing that "all states" have adopted the latest version of UCC-9).

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among the states that have adopted both UFTA and UCC-9.[133] The Texas Uniform Fraudulent Transfer Act (TUFTA) and the California Fraudulent Transfer Law are virtually identical.[134]

For example, the Texas Supreme Court in *First National Bank of Seminole v. Hooper*[135] held that the insolvent debtor's conveyance of its property to the bank to further secure preexisting debt was not a fraudulent transfer.[136] On January 4, 1990, the bank originally loaned Ernest Thornton $300,000, and Thornton granted the bank a security interest in the debtor's accounts, gas contracts, chattel paper, general intangibles, and equipment.[137] Over the next two years, the bank made an additional loan of $100,000 to the debtor.[138] In early 1993, Thornton was already insolvent.[139] On March 30, 1993, Hooper & Sons Investment Company obtained a $950,000 judgment against Thornton arising from a dispute between the two parties.[140] Two weeks later, while still insolvent and in disregard of the 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.[141] Soon thereafter, the bank proceeded to foreclose on the collateral.[142] The Hoopers then sued seeking damages from the bank, alleging that Thornton's conveyance of the Owego property to secure antecedent debts while insolvent was fraudulent.[143] Applying TUFTA, which was modeled after UFTA,[144] the jury found that Thornton defrauded the Hoopers when he conveyed the Owego property to secure the preexisting debt to the bank. The jury found that Thornton was indeed insolvent when he transferred the property to the bank,[145]and the property was not exchanged for reasonably equivalent value.[146] Thus, the jury awarded the Hoopers $700,000.[147]

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133. CREDIT TODAY, *supra* note 132; CORNELL U. L. SCH., *supra* note 131 (listing California and Texas among the states that adopted the UFTA); *see also* Wyzard v. Goller, 28 Cal. Rptr. 608, 610–11 (Ct. App. 1994) (describing the history of the Uniform Fraudulent Act and California's adoption of the model law).

134. *Compare* CAL. CIV. CODE § 3439.04(a)–(b) (West 2014), *with* TEX. BUS. & COM. CODE ANN. § 24.005(a)–(b) (West 2014).

135. 104 S.W.3d 83 (Tex. 2003).

136. *See id.* at 84; *see also* J. Richard White & Jeffrey T. Arnold, *Real Property*, 57 SMU L. REV. 1157, 1167–68 (2004).

137. *First Nat'l Bank of Seminole*, 104 S.W.3d at 84.

138. *Id.*

139. *Id.*

140. *Id.*

141. *See id.*

142. *Id.*

143. *Id.*

144. *See id.* at 86 ("Our interpretation of the asset to be valued in this context comports with the Uniform Fraudulent Transfer Act, *upon which TUFTA was modeled*." (emphasis added)).

145. *Id.* at 84–85.

146. *Id.* at 85. Under TUFTA, a transfer is fraudulent if the debtor makes the transfer intending to hinder, delay, or defraud a creditor. *See* TEX. BUS. & COM. CODE ANN. § 24.005(a)(1) (West

The bank eventually appealed the case to the Texas Supreme Court. "[T]he bank [did] not challenge the jury's findings that Thornton was insolvent and intended to defraud the Hoopers" when Thornton transferred the security interest in the additional property.[148] The bank instead asserted that "because the transfer was made to secure a valid antecedent debt, reasonably equivalent value was given as a matter of law."[149] 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."[150] 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 Bank."[151] Accordingly, "the Bank gave reasonably equivalent value for the deed of trust lien," and the jury judgment for the Hoopers therefore could not be sustained.[152] In addition, the court noted that there was no evidence that the bank intended to assist Thornton in evading his creditors. 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 the [preexisting] debt that it secures."[153]

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 transfer does not amount to fraudulent conveyance.[154]

2014). Additionally, a transfer is also fraudulent—irrespective of the debtor's intent—if the debtor receives less than the asset's reasonably equivalent value in exchange for the transfer, 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 (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.

See id. § 24.0005(a)(2)(A)–(B).

147. *First Nat'l Bank of Seminole*, 104 S.W.3d at 85.

148. *Id.*

149. *Id.*

150. *Id.* at 86 (quoting Anand v. Nat'l Republic Bank of Chi. (*In re* Anand), 210 B.R. 456, 459 (Bankr. N.D. Ill. 1997)) (internal quotation marks omitted).

151. *Id.* at 86–87.

152. *Id.* at 87.

153. *Id.* at 84; *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[n].").

154. *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)

This type of transaction is widely prevalent. Even in cases where the debtor is both insolvent *and* defrauding other creditors, the debtor's grant of a security interest to secure an antecedent debt is not fraudulent if the transfer has been exchanged for reasonable equivalent value and there is no evidence that the secured party is aiding the debtor in committing fraud.[155]

B. Aptix Corp. v. Quickturn Design Systems, Inc.

The Federal Circuit similarly opined on a commercial law decision involving patents in *Aptix Corp. v. Quickturn Design Systems, Inc.*[156] The focus of the litigation was on security interest in patents.[157] Amr Mohsen was the founder of Aptix, a hardware-logic-emulation technology company.[158] In an effort to keep the company operational, Mohsen personally made numerous loans to Aptix—totaling more than $9 million—in order to pay employees and other creditors.[159] In exchange for the loans, Aptix granted Mohsen a security interest in Aptix's patents in July 2000.[160] Mohsen perfected the security interest in the patents by following the filing requirement under California's version of UCC-9 in August 2000.[161]

Next, Aptix brought a patent infringement action against its competitor, Quickturn. The district court dismissed the case in June 2000 and ordered the parties to negotiate attorney's fees resulting in a $4.2 million award for Quickturn.[162] The case was then appealed to the Federal Circuit, which affirmed in part and vacated in part the district court's ruling, and the

(noting that non-bankruptcy law allows "preferences to stand and does not consider them to be fraudulent" and further that the law provides that "'[v]alue 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'" thus "rendering most payments of antecedent debts non-fraudulent" (alteration in original) (quoting UNIF. FRAUDULENT TRANSFER ACT § 3(a) (1984)); Steven A. Beckelman & Daniel P. D'Alessandro, *Defending Claims of Fraudulent Transfers Against Lenders*, 125 BANKING L.J. 512, 514–15 (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" (alteration in original)); William F. Savino & David S. Widenor, *Commercial Law*, 56 SYRACUSE L. REV. 569, 618–19 (2006) (discussing New York law providing that the grant of security interest in exchange for an antecedent debt is not a fraudulent transfer).

155. *See First Nat'l Bank of Seminole*, 104 S.W.3d at 85–87.

156. 148 F. App'x 924, 925 (Fed. Cir. 2005).

157. *Id.*

158. *Id.* at 925–26.

159. *Id.* at 926.

160. *Id.*

161. *See id.*

162. *Id.*

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parties subsequently entered into a payment agreement in 2002.[163] Around the same time, when Quickturn could not collect the payment of the judgment, it levied Aptix's assets. Mohsen then initiated a third party claim to Aptix's patent collateral property based on his already perfected security interest from July 2000.[164] Perceiving Mohsen's third party claim to be a "fraudulent scheme" to prevent recovery of its award against Aptix, Quickturn moved to enforce judgment.[165] The district court conducted an evidentiary hearing and subsequently entered an order voiding Mohsen's security interest in the patents after finding that Aptix granted the security interest to Mohsen with "actual intent . . . to hinder or delay satisfaction of the judgment due" to Quickturn.[166] Mohsen appealed to the Ninth Circuit and eventually had the case transferred to the Federal Circuit.[167]

The Federal Circuit 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.[168] The court 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.[169] The panel majority concluded that the security interest was a fraudulent transfer,[170] 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. The panel majority claimed that because Mohsen did not 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.[171]

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

The Federal Circuit's decision in *Aptix Corp.* shows its lack of understanding of secured transaction law and fraudulent conveyances. If the Federal Circuit had a better understanding of state laws on secured transactions and fraudulent conveyances (as articulated, for illustration purposes, in the Texas Supreme Court's case in *First National Bank of Seminole*) a different outcome would have been expected. Unfortunately, the Federal Circuit, with its weak grasp of

163. *Id.* at 926–27.
164. *See id.* at 927.
165. *Id.*
166. *Id.* (internal quotation marks omitted).
167. *Id.*
168. *Id.* at 927–30.
169. *Id.* at 928.
170. *See id.* at 929.
171. *Id.*

state commercial law, fails to recognize fundamental concepts in commercial law.

Worse, the Federal Circuit claimed in *Aptix Corp.* that it applied California law on secured transactions and fraudulent transfer.[172] The *Aptix Corp.* court, however, missed some pivotal legal principles. First, the court was unaware 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 a security interest in property to secure antecedent debt, as reflected in the codified statutes on fraudulent transfers.[173] This means that under California law, Aptix was 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."[174] It follows that as long as the exchange between Aptix and Mohsen was 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 was no fraudulent transfer. Moreover, there was no dispute that the value of the collateral assets was significantly less than the $9 million loans.[175] 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 California bankruptcy courts that routinely address bankruptcy cases where debtors are insolvent while they transfer assets to secure antecedent debts

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172. *Id.* at 930.

173. *See* CAL. CIV. CODE § 3439.03 (West 2014) ("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. BUS. & COM. CODE ANN. § 24.004(a) (West 2014) ("[V]alue 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 'n arm's length transaction." *Id.* § 24.004(d).

174. CAL. CIV. CODE § 3439.03 cmt. 3; *see also id.* § 3439.04 cmt. 3 ("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."); *see, e.g.*, Peoples-Pittsburgh Trust Co. v. Holy Family Polish Nat'l Catholic Church, Carnegie, 19 A.2d 360, 361 (Pa. 1941).

175. *See Aptix Corp.*, 140 F. App'x at 930.

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or make payments to secured creditors. For example, in *In re First Alliance Mortgage Co.*,[176] the Central District of California ruled that:

> Repayments 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 California Civil 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 diminution of the debtor's estate, and therefore cannot be fraudulent.[177]

Likewise, in *In re Walters*,[178] the U.S. Bankruptcy Court for the Central District of California 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."[179]

Moreover, California law allows Aptix to grant a 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."[180] In other words, California law does not treat a grant of security interest preference itself as a fraudulent transfer. California law clearly establishes that it "has been the rule for over 400 years, since the Statute of Elizabeth in 1571" that a transfer establishing a preference is not thereby fraudulent.[181]

Also, as seen in *Wyzard v. Goller*,[182] the grant of a 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.[183] Manning did not pay Goller for the legal services rendered for most of the duration of the litigation.[184] Later, as the litigation was concluding 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

176. Austin v. Chisick (*In re* First Alliance Mortg. Co.), 298 B.R. 652 (C.D. Cal. 2003), *aff'd*, 471 F.3d 977 (9th Cir. 2006).

177. *Id.* at 665.

178. Marshack v. Wells Fargo Bank (*In re* Walters), 163 B.R. 575 (Bankr. C.D. Cal. 1994).

179. *Id.* at 581.

180. *Aptix Corp.*, 140 F. App'x at 931 (quoting CAL. CIV. CODE § 3432 (West 2014)) (internal quotation marks omitted).

181. Wyzard v. Goller, 28 Cal. Rptr. 608, 609 (Ct. App. 1994) (citing 13 Eliz., ch. 5 (1571)); CAL. CIV. CODE § 3432.

182. *Wyzard*, 28 Cal. Rptr. at 611–12.

183. *Id.* at 609.

184. *Id.*

the two properties owned by Manning.[185] As expected, Wyzard received a judgment of $785,793.46 at the end of the litigation and "presumably" recorded the abstract of judgment.[186] Manning then filed for bankruptcy,[187] and Goller subsequently foreclosed on the two property assets. Wyzard brought an action against Goller, challenging the security interest in the two property assets Goller received from Manning.[188]

The *Wyzard* court, 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.[189] Further, California law has long permitted the insolvent debtor to prefer one creditor over others.[190] The court also observed that California law, past and present, and other states' law, all permit a debtor to prefer one creditor over others.[191] 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."[192] Moreover, courts "start with the proposition that a preference as such is not a fraudulent conveyance."[193] Accordingly, Manning's grant of a 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.[194]

Next, the *Wyzard* court 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."[195] The court stated that the noted indicia of fraud are:

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185. *Id.*

186. *Id.*

187. *Id.* at 609 n.1.

188. *Id.* at 610.

189. *Id.*

190. *Id.* The court observed that even before 1872 it had been recognized that a failing or insolvent debtor could prefer one creditor over another. *Id.* ("[I]t is difficult to perceive how the payment of a debt which [is] justly owed, and which was past due, can be tortured into an act to hinder, delay, and defraud creditors" (alteration in original) (quoting Randall v. Buffington, 10 Cal. 491, 494 (1858)) (citing Wheaton v. Neville, 19 Cal. 41, 46 (1861)). "Subsequent cases continued the judicial refusal to set aside a preferential transfer solely because it worked a preference." *Id.* (citing McGee v. Allen, 7 Cal. 2d 468, 474 (1936), Bradley v. Butchart, 217 Cal. 731, 744 (1933)).

191. *Id.* at 611–12.

192. *Id.* at 611 (quoting Irving Trust Co. v. Kaminsky, 19 F. Supp. 816, 818 (S.D.N.Y. 1937)).

193. *Id.* (quoting Smith v. Whitman, 189 A.2d 15, 18 (N.J. 1963)) (internal quotation marks omitted); *see also* Bos. Trading Grp., 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 $8000, 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").

194. *See Wyzard*, 28 Cal. Rptr. at 612 ("We conclude 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.").

195. *Id.*

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> (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.[196]

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 shortly before Wyzard obtained the judgment against Manning.[197] These three factors, however, did not change the undisputed fact that Manning owed Goller a substantial sum for the legal services and the unpaid fees were secured by the two-property collateral.[198] 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."[199]

The facts in *Wyzard* are similar to *Aptix Corp.* 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 the grant of a 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

196. *Id.* at 612 n.4. In 2004, the California legislature codified these indicia of fraud by adding subsection (b) to § 3439.04 of the California Civil Code. *See* Aptix Corp. v. Quickturn Design Systems, Inc., 148 F. App'x 924, 928 (Fed. Cir. 2005).

197. *Wyzard*, 28 Cal. Rptr. at 612.

198. *See id.* (noting that the arguable application of these factors did not "raise[] a triable issue of material fact").

199. *Id.*

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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 Aptix desperately needed to pay its employees and essential creditors in order to continue to operate as a 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, which disregards well-established state law on secured transactions and fraudulent transfers.[200]

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

This Part discusses the Federal Circuit's overreach in cases concerning liquidating a trust formed under a bankruptcy confirmation or liquidation plan. It examines the relationship between the trust and its beneficiary as well as existing state law in the area. It then presents a contrary Federal Circuit case in this area and critiques the decision.

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

In Chapter 11 Reorganization under bankruptcy law, the creation of a liquidating trust has become common.[201] The liquidating trust is generally created to pursue causes of action for its beneficiaries, to oversee various litigation and tax matters, to prosecute avoidance actions, or to complete distributions to unsecured creditors.[202] In other words, a liquidating trust,

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200. *See* Gugliuzza, *supra* note 110, at 1819 ("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." (footnote omitted)).

201. *See* Chad P. Pugatch et al., *The Lost Art of Chapter 11 Reorganization*, 19 U. FLA. J.L. & PUB. POL'Y 39, 61–62 (2008) (tracing the "widespread phenomenon" of liquidating trusts in bankruptcy reorganization). In fact, liquidating trusts are so common that bankruptcy courts have observed certain common practices of legal advisors to the trusts. *See* Peltz v. Worldnet Corp. (*In re* USN Commc'ns, Inc.), 280 B.R. 573, 600 (Bankr. D. Del. 2002) (noting the common practice regarding liquidating trust and that the attorneys who had represented the unsecured creditors' committee are often the same attorneys to represent the liquidating trustee post-confirmation, in order to reduce cost).

202. *See* United Mine Workers of Am. v. Midwest Coal Corp. (*In re* HNRC Dissolution Co.), No. Civ.A.04-158HRW, 2005 WL 1972592, at *8 (E.D. Ky. Aug. 16, 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. . . . [T]he only tasks remaining

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as some critics have noted, is where a bankruptcy trustee has expanded its power from the limited role of litigating claims belonging to the bankruptcy estate, to litigating claims of the creditors in post-confirmation plan against third parties.[203]

To be classified as a liquidating trust for tax purposes, an entity must meet certain conditions set forth by the IRS Revenue Procedure.[204] For instance, the trust must be created pursuant to a confirmed plan under Chapter 11 of the Bankruptcy Code.[205] The primary purpose of the liquidating trust is to liquidate the assets that have been transferred to the trust.[206] The trust is typically funded with some of the bankruptcy sale's 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.[207] The liquidating trust, by law, has a duration of not more than five years from its creation date.[208] Any extension of the trust's existence beyond the statutory term must be approved by the bankruptcy court that has jurisdiction over the trust.[209]

A liquidating trust is a state law trust that has become a useful tool for Chapter 11 reorganization plans. The Third Circuit provided the following

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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").

203. *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) (offering a critique of the expansion of liquidating/litigation trusts).

204. *See* Paul Kugler et al., *A Solid Overview of Liquidating Trusts*, KPMG (Sept. 24, 2012), http://www.kpmg.com/US/en/IssuesAndInsights/ArticlesPublications/taxnewsflash/Documents/us-sep24-liquidating-trusts.pdf.

205. *Id.*

206. *See* Rev. Proc. 94-45, 1994-2 C.B. 684, 685 ("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.").

207. Pugatch et al., *supra* note 201, 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 benefit of the creditors who, after confirmation, become the beneficiaries of the newly created trust." (footnote omitted)).

208. *See* Rev. Proc. 94-45, 1994-2 C.B. 684, 685.

209. *Id.* ("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.").

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observation regarding Chapter 11 plans in *In re Insilco Technologies*[210]:

> 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*.[211]

For example, in *Holloway v. Dane*,[212] the court observed that in the related Chapter 11 bankruptcy case, the liquidating trust established pursuant to the debtor's reorganization plan was formed "for the purpose of recovering, administering and distributing estate assets for the benefit of unsecured creditors."[213] The liquidating trust in that case commenced an adversary proceeding against numerous corporate defendants for their alleged corporate misdeeds.[214]

Similarly, in *WRT Creditors Liquidation Trust v. C.I.B.C. Oppenheimer Corp.*,[215] under the confirmed reorganization plan, the bankruptcy court approved the Plan and the Liquidating Trust Agreement in which 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.[216] The WRT Trust also received the right to solely coordinate the prosecution and settlement of litigation on behalf of and for the benefit of the beneficiaries and to distribute the proceeds to the beneficiaries.[217] Thereafter, the WRT Trust brought at least nineteen adversarial proceedings against different defendants, asserting causes of action under state law and the Bankruptcy Code.[218]

Importantly, as seen in the trust examples above, liquidating trusts are created for the beneficiaries. Indeed, to be classified as a liquidating trust,

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210. 480 F.3d 212 (3d Cir. 2007).

211. *Id.* at 214 n.1 (emphasis added).

212. 316 B.R. 876 (S.D. Miss. 2004).

213. *Id.* at 878.

214. *See id.* at 878–79.

215. *See* 75 F. Supp. 2d 596 (S.D. Tex. 1999).

216. *Id.* at 600 ("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.'" (alteration in original)).

217. *Id.*

218. *Id.* at 601.

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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 of the trust."[219] 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.[220]

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 a beneficiary interest in the trust"[221] and are generally identified in the confirmed plan and trust documents.[222] The beneficiaries of a trust are therefore the deemed "owners of the trust" res.[223] The trustee is typically appointed to oversee the liquidating trust in bringing claims belonging to creditors against third parties in a post-confirmation plan.[224] A question arises as to whether the beneficiaries, as owners of the liquidating trust, have standing to bring litigation against third parties in cases involving the property held by the trust.

B. Morrow v. Microsoft Corp.

Another decision rendered by the Federal Circuit, *Morrow v. Microsoft Corp.*,[225] centers on a bankruptcy asset, namely, a patent held by a liquidating trust for the beneficiary creditors.[226] 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.[227] The liquidation plan created a two-tiered trust system wherein the General Unsecured Creditors' Liquidating Trust (GUCLT) was established to function as trustee to various creditors, and the At Home Liquidating Trust (AHLT) was established as trustee to

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219. Rev. Proc. 94-45, 1994-2 C.B. 684, 685.

220. *See* Dennis Montali et al., *Recent Developments in Business Bankruptcy—2010*, 31 CAL. BANKR. J. 665, 684 (2011) (providing an example of a liquidating trustee who was found by a bankruptcy court to have "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"); *see also* Harrow v. Street (*In re* Fruehauf Trailer Corp.), 431 B.R. 838, 850–52 (Bankr. C.D. Cal. 2010), *aff'd*, No. CV 10–02312 DDP, 2011 WL 2014672 (C.D. Cal. May 23, 2011).

221. Pugatch et al., *supra* note 201, at 61.

222. Rev. Proc. 94-45, 1994-2 C.B. 684, 685.

223. *Id.*

224. *See* Morris, *supra* note 203, at 600–01 ("Typically, a plan establishes a state-law trust to hold the estate's claims against third parties and appoints the bankruptcy trustee as the post-confirmation trustee who is charged to litigate those claims.").

225. 499 F.3d 1332 (Fed. Cir. 2007).

226. *Id.* at 1335.

227. *Id.*

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GUCLT to facilitate IP infringement litigation on GUCLT's behalf.[228] This meant AHLT was the trustee and GUCLT was the beneficiary. In other words, AHLT held only bare title to the assets, and GUCLT possessed all the proprietary interest and ownership rights to the assets.[229] That also meant that, pursuant to the liquidation plan, the patent asset was owned by GUCLT and merely held by AHLT in trust and for the benefit of GUCLT.[230]

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."[231] 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.[232] The district court ruled for Microsoft on invalidity and noninfringement.[233] Thereafter, the parties appealed to the Federal Circuit.[234]

The Federal Circuit focused on whether GUCLT had standing to sue Microsoft for the patent infringement. The panel majority framed the question as "how [do] bankruptcy or trust law relationships affect the standing analysis in a patent infringement case" and noted that the issue was "a question of first impression in this court."[235] The panel majority held that GUCLT's rights under the liquidation plan failed to situate GUCLT in one of the Federal Circuit's two categories where it could sue in its own name or maintain a co-plaintiff status in the infringement suit.[236] 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.[237] The majority vacated the infringement judgment below and reversed the district court's decision for lack of standing.[238]

Consequently, after three costly years of litigating the patent infringement case and after the district court made its findings on the merits, the Federal Circuit brushed everything aside to focus on standing. By ruling that GUCLT lacked standing, the Federal Circuit eviscerated the district court's findings on invalidity and infringement. This means the

228. *See* Petition for Panel Rehearing and Rehearing En Banc of Plaintiff/Counterclaim Defendant-Appellant Hank M. Spacone at 2, *Morrow*, 499 F.3d 1332.

229. *Id.*

230. *Id.* at 2, 4.

231. *Morrow*, 499 F.3d at 1335.

232. *Id.* at 1336.

233. *Id.*

234. *Id.*

235. *Id.*

236. *Id.* at 1339–44.

237. *See id.* at 1344.

238. *Id.*

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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 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 does not grant AHLT the right to bring patent infringement litigation,[239] 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 court vacated the entire judgment on the merits of invalidity and noninfringement. 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 restart the entire litigation with AHLT as the sole plaintiff so the district court will subsequently reach the same results on the merits of invalidity and noninfringement. The parties will waste precious resources to litigate the case at the district court level, and then to appeal the case to the Federal Circuit again? Surely, precious financial and judicial resources will be wasted because GUCLT cannot even be 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 just that 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 relied on its own view of the facts and understanding of trust law, particularly its own understanding of liquidating trusts created in post-confirmation bankruptcy proceedings. The panel majority naively believed that the liquidation plan merely created GUCLT and AHLT as trusts for purposes of distributing the assets and rights among the trusts.[240] The majority mechanically recounted that GUCLT received the rights to bring various causes of action for the estate, including claims of IP infringement.[241] AHLT was "in charge of conducting the administrative wind-down of the company's business" and was given the ownership right in the IP by default.[242] Therefore, AHLT "received legal title to

239. *Id.* at 1335 (noting that GUCLT "received the rights to *all other causes of action*," including "claims for misappropriation or infringement of AHC's intellectual property rights" (emphasis added)).

240. *See id.* ("The liquidation plan distributed certain assets and rights among the trusts.").

241. *Id.*

242. *Id.*

the . . . patent under the liquidation plan though it did not have the right to sue third parties for infringement of the patent."[243] The majority mentioned that "AHLT's assets were to be managed for the benefit of the bondholders and the general creditors of . . . GUCLT."[244] What the majority ignored or misunderstood was the relationship between GUCLT and AHLT.

The relationship between the litigation trust GUCLT and liquidating trust AHLT was itself also a trust wherein AHLT was the trustee and GUCLT was the beneficiary. A careful examination of the liquidation plan reveals that the plan created a two-tiered trust system. In the first tier, GUCLT functioned as a trustee to the general creditors. In the second tier, AHLT functioned as a trustee to GUCLT and was the liquidation plan agent facilitating patent infringement litigation for the benefit of the beneficiary GUCLT. More precisely, AHLT held the patent only in bare title and that is why the liquidation plan approved by the bankruptcy court dictated that while AHLT held the bare title, it had no power to initiate patent infringement litigation.[245] This system is how the liquidation plan empowered GUCLT with the right to bring a patent infringement suit. GUCLT, as the beneficiary, ultimately had all the benefits and proprietary interest or ownership rights to the patent.[246] In other words, from the liquidation 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.[247] Therefore, either GUCLT by itself, or GUCLT and AHLT together, should have been permitted to bring the patent infringement action against third party infringers, as they were created and approved by the bankruptcy court to liquidate the property assets per the confirmation plan. The majority ignored the trust relationship and viewed it strictly through the lens of patent law, holding that GUCLT and AHLT could not maintain the patent suit, as they could not be squarely categorized as co-plaintiffs for standing purposes.[248]

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 issues in patent infringement.[249] The majority centered its division of the categories and "constitutional injury in fact" on whether the plaintiff possessed "exclusionary rights."[250] The "exclusionary rights"

243. *Id.*

244. *Id.*

245. *See* Petition for Panel Rehearing, *supra* note 228, at 1–3.

246. *Id.* at 4.

247. *See id.* at 2–4.

248. *Morrow*, 499 F.3d at 1343–44.

249. *Id.* at 1339.

250. *Id.* ("The party holding the exclusionary rights to the patent suffers legal injury in fact under the [patent] statute.").

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identified by the majority were the "legal right to exclude others from making, using, selling, or offering to sell the patented invention . . . or importing the invention."[251] Specifically, the first category included a patentee who holds "all the exclusionary rights" and "suffers constitutional injury in fact" from patent infringement and therefore could bring infringement suits in its own name.[252] Under the first category, GUCLT obviously would not have standing to bring the patent infringement action against Microsoft in its own name as it was not the patentee.

The second category of plaintiffs, the majority asserted, "hold exclusionary rights . . . but not all substantial rights to the patent."[253] The majority, however, 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 plaintiffs in the second category were the exclusive licensees who suffered injury caused by any party that "makes, uses, sells, offers to sell, or imports the patented invention."[254] The majority announced that the second category of plaintiffs could bring patent infringement suits in their own name but had to include the patentee as a co-plaintiff "to satisfy prudential standing concerns."[255] Did the majority mean that plaintiffs in the second category fulfill the constitutional standing requirement on their own 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 plaintiffs must satisfy both constitutional standing and prudential standing concerns, and by adding the patentee AHLT as co-plaintiff, both are now met?

Peculiarly, under the second category, the majority denied GUCLT standing to maintain the patent infringement litigation against Microsoft, even after AHLT was brought into the action as a co-plaintiff to the suit.[256] The majority pointedly 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,

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251. *Id.*

252. *Id.* at 1339–40.

253. *Id.* at 1340.

254. *Id.* ("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." (citations omitted)).

255. *Id.* ("[T]hese 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." (quoting Indep. Wireless Tel. Co. v. Radio Corp. of Am., 269 U.S. 459, 467, 469 (1926))).

256. *See id.* at 1344 ("Joining the legal title holder only satisfies prudential standing requirements. It cannot cure constitutional standing deficiencies.").

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not prudential standing.[257] 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 right to prosecute their patents against the infringer since they could not fit in any of the court's categories. Both GUCLT and AHLT were liquidating trusts in the post-confirmation plan phase of bankruptcy, which means they were temporal in scope for the purpose of liquidating the property on behalf of the creditors. These liquidating trusts have suffered a harsh fate as a result of the Federal Circuit's decision; they will not be able to defend or prosecute the property that they were 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 a patent infringement suit against a third party. Alleged infringers will have the upper hand and will be permitted to continue 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 its patent jurisdiction to prohibit them from bringing patent infringement litigation against alleged infringers. What good will the Federal Circuit's new trust law do for state trusts? Hardly any can be identified, except to reinforce the banner of patent exceptionalism in the name of patent stewardship.[258]

IV. RESPECTING FEDERALISM PRINCIPLES IN STEWARDSHIP OF PATENT LAW

Federalism is a bedrock principle of governance in the United States.[259] Matters of state law must be left to the sovereignty of the state, as dictated

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257. *Id.*

258. *See id.* at 1337 ("[T]he 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 Judge Sharon Prost's vigorous dissenting opinion. *See id.* at 1344–48 (Prost, J., dissenting).

259. *See, e.g.*, Jessica L. Hannah & Kevan P. McLaughlin, Comment, "*On Certiorari to the Ninth Circuit Court of Appeals": 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."); Robert J. Pushaw, Jr., *A Neo-Federalist Analysis of Federal Question Jurisdiction*, 95 CALIF. L. REV. 1515, 1517 (2007) ("In exercising this [judicial] discretion, federal courts should implement a bedrock tenet of judicial federalism: They have primary responsibility over federal law, whereas state tribunals control state law."); *see also* Pac. Co. v. Johnson, 285 U.S. 480, 493 (1932) ("[I]n 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.").

by the Constitution.[260] Commercial laws, including laws governing contracts, property transfers, secured transactions, fraudulent conveyances, and trusts, are strictly within the purview of the state.[261] No federal court has the authority, in the absence of a conflicting federal law or policy, to unilaterally extend its reach into matters regulated by state law.[262]

Under the Supreme Court's precedent, federal courts must act with utmost care in imposing judicial preemption of state law.[263] As a result, judicial preemption is justified only where there is conflict between federal law and state law.[264] The requirement of such a conflict as a precondition controls both the permissibility of judicial preemption and "the scope of judicial displacement of state rules."[265] Further, even in the patent area where there is federal legislation, courts must still be mindful that

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260. 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 (2011) ("States' development of property law relies in many ways on the interaction between background common law principles and legislation. The [federal] judicial takings theory 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.").

261. *See, e.g.*, LAWRENCE M. FRIEDMAN, AMERICAN LAW IN 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."); Viva R. Moffat, *Super-Copyright: Contracts, Preemption, and the Structure of Copyright Policymaking*, 41 U.C. DAVIS L. REV. 45, 97 (2007) ("[C]ontract 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."). *Cf.* 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").

262. *See* O'Melveny & Myers v. FDIC, 512 U.S. 79, 87–88 (1994) (noting that the permissibility and scope of the displacement of state rules are predicated on a conflict between federal policy or interest and the use of state law).

263. *Id.* at 87 ("Our cases uniformly require the existence of such a conflict as a precondition for recognition of a federal rule of decision."); *see* Abraxis Bioscience, Inc. v. Navinta LLC, 672 F.3d 1239, 1241 (Fed. Cir. 2011) (O'Malley, J., dissenting) (per curiam).

264. *O'Melveny & Meyers*, 512 U.S. at 87 (stating that precedents dictate that cases justifying the "judicial creation of a 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'" (citations omitted) (quoting Wheeldin v. Wheeler, 373 U.S. 647, 651 (1963) and Wallis v. Pan Am. Petroleum Corp., 384 U.S. 63, 68 (1966))). The limitations as imposed by the Supreme Court are due to the fact that federal courts, "unlike their state counterparts, are courts of limited jurisdiction that have not been vested with open-ended lawmaking powers." *Id.* at 90 (Stevens, J., concurring) (quoting Nw. Airlines, Inc. v. Transp. Workers, 451 U.S. 77, 95 (1981) (internal quotation marks omitted)).

265. *Id.* at 87–88 ("Not only the permissibility but also the scope of judicial displacement of state rules turns upon such a conflict.").

"Congress acts . . . against the background of the total *corpus juris* of the states"[266] and therefore where there are no specific statutory provisions on certain matters, courts must acknowledge that those matters "are presumably left subject to the disposition provided by state law."[267]

As explained in the *Abraxis Bioscience* dissent, the Federal Circuit provided no justification for its judicial preemption of New York contract law, the law selected by the sellers and acquirers in the complex assets transfer.[268] 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.[269] The Federal Circuit displaced state contract law with its own precedents of patent assignments.[270] The decision is improper judicial preemption of state contract law.[271] It is a complete disregard of doctrinal federalism. Similarly, in *Aptix Corp.*, the Federal Circuit extended its reach in secured transactions and fraudulent conveyances—two areas that are exclusively within the provenance of state law—and ignored long-established state law.[272] The Federal Circuit arrogantly brushed aside state commercial statutes for secured transactions, state fraudulent conveyance statutes, and state decisional laws interpreting the statutes.[273] Again, the Federal Circuit provided no explanation and justification for its judicial preemption.[274] The Federal Circuit continued its assault on doctrinal federalism in *Morrow* when it reached into the area of state trust law and imposed its misunderstanding of liquidating trusts, beneficiaries as the true owners of the trust res, and the trustee's function for the benefits of the true owners.[275]

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 the Supreme Court's direction in judicial preemption and federalism. In commandeering stewardship of patent law, the Federal Circuit has no authority to exert its power in matters belonging to states. In today's economy, a commercial transaction—be it a sale of assets, a security interest conveyance, or a liquidation trust—will often include patents. Just because a commercial transaction includes patents does not allow the Federal Circuit to exercise its patent jurisdiction to affect judicial

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266. *Wallis*, 384 U.S. at 68 (internal quotation marks omitted).

267. *O'Melveny & Myers*, 512 U.S. at 85.

268. *Abraxis Bioscience*, 672 F.3d at1241 (O'Malley, J., dissenting).

269. *Id.* (quoting *O'Melveny & Myers*, 512 U.S. at 79) (internal quotation marks omitted).

270. *Id.*

271. *Id.*

272. *See* Aptix Corp. v. Quickturn Design Sys., Inc., 148 F. App'x 924, 931–32 (Fed. Cir. 2005) (Newman, J., dissenting).

273. *See id.*

274. *See id.*

275. *See supra* Section III.C.

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preemption. Without articulating any significant conflict between federal and state law or policy, the Federal Circuit must not inject its authority into state law areas, creating costly results and unwarranted uncertainties. State law is the product of vast experience and wisdom, and businesses have long relied upon it to conduct their commercial transactions. The Federal Circuit, or any other federal court, cannot ignore the benefit that the dual sovereignty of doctrinal federalism provides.[276] The destabilization of federalism, evidenced 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.[277]

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 into commercial law under the disguise of patent law is counterproductive. To maintain its stewardship of patent law, the court should not invoke patent jurisdiction to rationalize its decisions concerning commercial law that dramatically alter established commercial law. Encroachment on commercial law, which is within the provenance of state law, destabilizes federalism causing uncertainty in state law areas. The Federal Circuit must restrain itself, as it has no authority to inject itself into state law making.

276. *See, e.g.*, S. Candice Hoke, *Preemption Pathologies and Civic Republican Values*, 71 B.U. L. REV. 685, 765–66 (1991) ("[R]ampant federal preemption forms an ominous threat to the constricted space that remains to local and state politics.").

277. *Cf.* 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) ("[B]edrock 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.").

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