ASPEN PUBLISHERS

JANUARY 2009

DEVOTED TO LEADERS IN THE INTELLECTUAL PROPERTY AND ENTERTAINMENT COMMUNITY

VOLUME 29 NUMBER 1

THE Licensing Journal

Edited by the Law Firm of Grimes & Battersby

Wolters Kluwer
Law & Business

The Sky's the Limit: Understanding How Choice of Business Structure Can Impact the Success of Your Patent Licensing Strategy

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At times lately, it has seemed as though the sky is falling on the renowned US economic model. From credit crises to unemployment rates, financial news seems to keep going from bad to worse. As stock markets around the world continue to plummet and widespread economic instability dominates headlines, the significance of maximizing the profitability of intellectual property has never been greater. While the economic downturn has led many companies to cut back on new projects and personnel, intellectual property remains a channel through which businesses can maintain steady revenue streams. By developing and implementing sound licensing strategies that capitalize on intellectual property rights, businesses can put themselves in position to weather the turbulent financial times and maintain growth.

However, development of a great licensing strategy alone is not enough to effectuate such success. Businesses must realize how various business structures can support and maximize the protection and profitability of their intellectual property rights through particular licensing strategies. This focus on understanding the benefits and drawbacks of various business structures, in turn, is what can allow a business to turn an average licensing strategy into a great one. Ultimately, a business must weigh a variety of factors and choose the business structure and licensing strategy that align best with one another and the business' goals. For example, although establishing a holding company to manage licensing revenues might provide certain tax breaks for a company, it might also result in a loss of standing to bring suit or an inability to collect lost profits in the event of an infringement claim. The company, as a result, must weigh the respective options and determine which structure and strategy maximizes both profits and protection of intellectual property rights to the fullest degree. Thus, although there is no magic formula for determining which business structure and licensing strategy combination is optimal, understanding the dynamics of licensing and business structure options is essential to cultivating a successful strategy.

Breaking Down Traditional Business Structures

In order to fully realize how business structures impact intellectual property licensing strategies, it is important to first recognize the primary types of business structures and their characteristics. More specifically, understanding how these structures operate in terms of taxation and liability sheds light on why they might be more or less beneficial for certain licensing strategies. Overall, traditional structures include partnerships, corporations, and sole proprietorships.

A sole proprietorship refers to a one-person business that is not registered with the state. Legally, the business and the owner are one and the same. For these reasons, such businesses tend to be simple and inexpensive to create and operate. The owner reports income and losses on his or her personal tax return and is personally liable for any business-related obligations, such as debts or court judgments.[1]

Partnerships, similarly, also can be simple and inexpensive to create and operate. These organizations tend to fall into one of two categories, either a general partnership or a limited partnership. Under a general partnership, the business is owned by two or more people and is not registered with the state.[2] Partners (owners) share profits or losses and liabilities of the business undertaking with each other. Partnership owners pay taxes on their shares of the business income on their personal tax returns and are each personally liable for the entire amount of any business debts and claims. A limited partnership is similar to a general partnership, except that in addition to one or more general partners (owners), there are one or more limited partners.[3] While general partners are essentially in the same legal position as partners in a conventional partnership, the limited partners do not manage the business and are not liable. Limited partners are not personally liable unless they are active in the management of the business. Business income is reportable on both the general and limited partners' personal income tax returns.[4]

Unlike partnerships, corporations must be registered with the state and are more expensive to create and operate. Corporations are classified as either "S" corporations or "C" corporations based on their number of employees and tax status. "S" corporations cannot have more than one hundred shareholders and must have only one class of stock. Profits and losses must be allocated to shareholders proportionately to each one's interest in the business.[5] Owners have limited personal liability, which is an attractive feature for those seeking to protect and maximize profits from their intellectual property rights in licensing agreements.[6] Further, unlike C corporations, S corporations are not subject to double taxation. This means that the corporation's income or losses are divided among and passed through to its shareholders. The shareholders must then report the income or loss on their own individual income tax returns.[7]

In contrast to S corporations, C corporations do not have a limit on the number of shareholders, domestic or foreign. A board of directors, annual meetings, and annual reporting are required. Most importantly, though, they differ from S corporations in that they are subject to double taxation under Federal tax law.[8] Accordingly, C corporations experience both the taxation of the corporation's income and the separate taxation on their shareholders' respective dividends. Although this tax treatment is less favorable than that of an S corporation, the company, instead of individual owners, carries liability in the case of C corporations.[9]

Understanding How Hybrids Operate

In recent decades, hybrid business structures have been created, as people have sought ways around some of the limitations presented by traditional structures such as corporations. Namely, business desires to minimize tax burdens and maximize profits led to the formation of alternative structures. The primary types of hybrid structures include limited liability companies (LLCs), joint ventures, and holding companies.

A limited liability company is a hybrid business entity that possesses characteristics of both a corporation and a partnership.[10] It often is more flexible than a corporation, whereby owners have limited liability for the business' actions and debts. Further, owners have limited personal liability for business debts even if they participate in management. Unlike in conventional corporations or partnerships, profits and losses can be allocated differently than ownership interests, and IRS rules allow LLCs to choose between being taxed as a partnership or a corporation.[11]

Joint ventures, in contrast, represent legal organizations that take the form of short term partnerships in which the persons jointly undertake a transaction for mutual profit. Joint ventures are used widely by companies to gain entrance into foreign countries because the companies can complement their skill sets and acquire a geographic presence in a foreign market. For Federal income tax purposes, joint ventures are treated like partnerships and are not subject to double taxation. Thus, they represent a flexible and cost-effective way to establish broader market presence for businesses.

Similarly, holding companies offer an innovative and often favorable tax strategy for those engaged in licensing intellectual property. For example, many large, multinational companies will set up patent holding companies in tax favorable states and countries and then sell, transfer, or assign all of the patent rights for the company to that patent holding company. The subsidiary holding company then grants a license to the parent company or third parties in exchange for royalty payments.

Holding companies are particularly popular among those licensing intellectual property because they offer significant administrative and tax advantages over more traditional business structures. Concerning tax advantages, a parent company generally can deduct the royalty payment as a deductible expense. In turn, this reduces the parent company's income/franchise tax liability. Furthermore, intellectual property holding companies can make tax-free dividend distributions or loans to the parent company. Depending on which

jurisdiction the holding company is organized in, royalties obtained through these arrangements also can be tax-free.

The potential administrative benefits associated with establishing a holding company also are significant. First, a holding company provides centralized management of an intellectual property portfolio. Ultimately, by organizing intellectual property assets in a holding company, it becomes much easier to effectively coordinate and manage an intellectual property licensing strategy. Second, holding companies provide greater asset protection for intellectual property owners. By placing the intellectual property in a non-trading entity that does not have a contractual or other relationship with customers, it becomes less likely that a customer or other third party can bring a claim against the owner of the intellectual property.

Examining the Dynamics of Patent Licensing

In order to more fully realize the relationship between types of business structures and licensing strategy, it is important to understand the dynamics of patent licensing in full. The concepts of scope and standing lie at the heart of such analysis. Scope simply references the scope of a grant of rights in a licensing agreement, while standing refers to a party's ability to bring suit.

The scope of a grant of rights under a patent typically will take one of four basic forms: (1) assignment, (2) exclusive license, (3) sole license, and (4) nonexclusive license.[12] The scope of the grant is important because it plays a large role in determining whether standing to bring suit exists for parties involved in a licensing agreement, and with that the right to possibly collect lost profits. With an assignment, the licensor transfers the right, title, and interest in the patent (the ownership interest) to the assignee.[13] Unlike an assignment, a sole license is established when a licensor grants the licensee all of its rights in the patent, but reserves the right to practice the patent.[14] An exclusive license occurs when the licensor grants the licensee all of its rights in the patent, including the right to practice and to license it to others, but retains title to the patent.[15] In contrast, a nonexclusive license involves a licensor granting the licensee freedom to operate under the patent, whereby it promises not to sue the licensee for infringement (*i.e.*, a covenant not to sue).[16]

This concept of exclusivity, in turn, plays the key role in determining whether or not a licensor or licensee possesses standing to sue in light of the terms in the licensing agreement in question. The statutory basis for standing in patent matters comes from 35 U.S.C.S. § 281, which states that "a patentee shall have remedy by civil action for infringement of his patent."[17] This authority is clarified further by 35 U.S.C.S. § 100(d), which states that "the word 'patentee' includes not only the patentee to whom the patent was issued but also the successors in title to the patent."[18] Consequently, any agreement that involves the granting of title to the patent also passes along standing to sue. Any assignment, therefore, of a patent also would include a transfer of standing to sue because the grant would involve the transfer of title.[19]

The general flexibility that parties to a license have in defining the scope of the granted rights does not extend easily to the right to sue for infringement. An express grant to the licensee of the right to sue will be ineffective if the licensee does not otherwise have standing to bring suit.[20] The Supreme Court laid down the basic rule for determining standing of patent assignees and licensees in 1891 in *Waterman v. Mackenzie*.[21] There, the Court held that the assignment of all of the rights in a patent or all of the rights in the patent for a specified territory vest assignee with title in the patent with the right to sue for infringement, in the first case by itself, in the second, jointly with the assignor.[22] In recent times, the right of a true assignee, *i.e.*, one who has received all right, title, and interest in the patent, to sue in its own name without joining the assignor, has not been the source of much debate. Similarly, there has been little debate on the other end of the spectrum, whereby it is well established that a nonexclusive licensee cannot sue in its own name even by joining the patentee.[23]

A closer issue has been the standing of an exclusive licensee to sue for infringement. Courts have recognized that although denominated an exclusive license, an agreement may nonetheless convey all of the substantial rights in a patent, *i.e.*, exclusivity, the right to transfer and the right to sue infringers, such that it is in substance an assignment thereby giving the licensee standing to sue.[24] That result may be obtained even when the licensor retains inconsequential rights, such as the right to be notified of any suit brought by the licensee, a right to obtain patents on the invention in other countries or a reversionary right to the patent in the event of bankruptcy.[25]

When the exclusive license is not in substance the equivalent of an assignment, the licensee nonetheless has constitutional standing to sue in its own name because it has a legally protected interest in the patent. However, because of the possibility of multiple infringement suits against a single infringer, *i.e.*, one by the patentee and one by the licensee, the exclusive licensee does not have prudential standing to sue by itself and must join the patentee as a party to maintain

a suit for infringement.[26] An exclusive licensor holds title to the patent in trust for the exclusive licensee and must allow use of its name as plaintiff in the exclusive licensee's suit against an infringer.[27]

Although the subject of very little decisional law, a sole license has been treated as an exclusive license for the purposes of standing; *i.e.*, it can sue in its own name, but must join the patentee (or show that the patentee was notified of the action, but refused to join).[28]

Understanding How Different Business Structures Impact Exclusivity

A recently decided Federal Circuit case, *International Gamco, Inc. v. Multimedia Games, Inc.*, highlighted how exclusivity impacts standing and, thus, a party's ability to enforce its patent.[29] In the case, Gamco sued the defendant alleging that the gaming company violated one of its patents regarding a coin collection system in a gaming machine. The primary issue addressed by the Court was whether an exclusive licensee for a field of use under a patent could sue in its own name, as can an exclusive licensee for a geographically restricted area.[30]

The Court held that an exclusive licensee for field of use under a patent must join the patentee to have standing to sue.[31] In reaching this conclusion, the Court reasoned that granting standing to sue without joining the patentee would give rise to the risk of multiple suits being brought against the same infringer for the same act of infringement.[32] Further, in contrast to field of use, an exclusive territorial license does not give rise to the same concerns because a single act of infringement would be likely to give rise to only one suit in the jurisdiction where the infringement occurred.[33] This holding demonstrates that the labeling of a license as "exclusive" is not conclusive on the issue of whether a licensee is in fact exclusive or not. Instead, as evidenced by the holding, courts look to the agreement in its entirety to determine whether the licensee has actually received exclusive patent rights. Ultimately, in order to determine whether such exclusivity was conveyed in the transfer, courts will look at whether all substantial rights in the patent were transferred. As employed by the Court here, the "all substantial rights" test has become the standard for determining whether a party has sufficient exclusivity and, in turn, standing to sue. This interpretation of exclusivity is made to serve a policy that enables greater judicial efficiency and efficacy. By effecting such policy, the goal is to allow an alleged infringer to respond in one action to all claims of infringement for his act, and thus either defeat all the claims in one action, or by satisfying one adverse decree to bar all subsequent actions.

Given the role of exclusivity, though, how does the all substantial rights standard apply to various business structures? For closely held companies, a shareholder's ability to enforce a patent was outlined by the Federal Circuit in *Lans v. Digital Equip. Corp*.[34] The Court in *Lans* rejected the Plaintiff inventor's argument that, even though he had assigned his patent to a non-party corporation, of which he was the sole shareholder, he could not rely on the corporation's legal distinctness when it was a tax advantage to him and ignore it when it would provide adverse consequences. Concerning this ruling, the Court reasoned that "[T]he law does not allow for 'reverse piercing' of the corporate veil when it suits the corporation's owner."[35] In the case, the Court ultimately held that "a person who has voluntarily adopted the corporate form to engage in business is precluded from asking courts to disregard that form merely because the person is disadvantaged by its use."[36]

Given these limitations on a shareholder's ability to enforce a patent, what about a non-exclusive licensee's ability to enforce a patent? How does business structure impact a party's standing and ability to collect damages under such circumstances? This issue was addressed in *Blumenthal v. Barber-Colman Holding Corp.*[37] In the case, Furnace Control was a company wholly owned and controlled by Blumenthal and Melville, the patentees bringing suit. Furnace Control held a non-exclusive worldwide license under the patent-in-suit and was the only vehicle by which the patentees developed and produced the patented technology.[38] There were no other licensees. The Defendants argued that Furnace Control only possessed a "bare" license that conveyed no legally ascertainable patent interest and, therefore, had no right to join in the cause of action.[39] Ultimately, the Court agreed with this argument and dismissed Furnace Control as a Plaintiff for lack of standing because the furnace company's rights were expressly stated to be non-exclusive and because the licensors had retained the right to terminate the license unilaterally without cause.[40]

As a result of this dismissal, Blumenthal's potential damages were limited significantly because it could not claim damages incurred by Furnace Control. Given the Plaintiffs' contention that Furnace Control was the only vehicle by which the patentees had developed and commercialized the technology protected by the patents-in-suit, the Plaintiffs' potential collection of significant damages was contingent on Furnace Control remaining a Co-Plaintiff. Once Furnace Control was dismissed from the suit, the Plaintiffs

were effectively left with no possibility to collect such damages. Further, because of the dismissal, Blumenthal and Melville, as individuals, were directly exposed to counter-claims and the cost of suit. In turn, this dismissal demonstrated the significance of exclusivity for shareholders when establishing licensing agreements in terms of standing to sue, ability to collect lost profits, and exposure to counter-claims, and attorney fees. Above all, this case affirms that shareholders must establish exclusive licensing agreements with licensees if they wish to be able to preserve standing to sue and ensure the ability to potentially collect lost profits for infringement suffered by their licensees. Of course, the counterpoint to leaving the patent in the name of individuals is that there is no risk of loss of the patent if the company enters Chapter 7 of the Bankruptcy Code. Taxes also are an issue regarding who should retain ownership and whether the deal should be structured as a sale to qualify for capital gains treatment, as discussed below.

The importance of such exclusivity relative to a licensee's ability to bring suit was further evidenced in *Speedplay, Inc. v. Bebop, Inc.*[41] In this case, an inventor provided an exclusive worldwide, royalty-free right and license to Speedplay for a patent regarding bike pedals. The Court explained the requirement of exclusivity to establish standing by stating:

> [a] party may bring an action for patent infringement only if it is the "patentee," *i.e.*, if it owns the patent, either by issuance or by assignment. 35 U.S.C.S. §§ 100(d), 261, 281. A party that has been granted all substantial rights under the patent is considered the owner regardless of how the parties characterize the transaction that conveyed those rights. The proper focus is on the substance of what was granted. The grantee of an exclusive license can sue in its own name without joining the grantor if the license had the effect of conveying all substantial rights in the patent to the licensee.[42]

Here, therefore, the licensee had standing to assert patent rights in its own name because the license agreement in effect granted it all substantial rights in the patent by allowing it to control enforcement, grant sublicenses, and the license was not subject to any prior licenses. Exclusivity of the license, therefore, allowed the licensee to survive a motion to dismiss suit in this case. If parent companies wish to retain standing to sue and the ability to collect lost profits through subsidiary companies, those subsidiaries generally must possess an exclusive license to the patent rights in question.

As evidenced by the case law discussed above, a court's determination of standing largely hinges on the concept of exclusivity. More specifically, the right to exclude others is the essential right conferred by a patent. Without the right to exclude, courts typically conclude that the licensee holds only a nonexclusive license and thus lacks standing to sue and potentially collect lost profits. Moreover, it can possibly leave the parent company or individual inventor directly liable for any infringement claims. The best business structure for protecting intellectual property rights and maximizing profits, therefore, involves the establishment of exclusive licensing agreements that minimize personal liability and protect standing to sue and the ability to collect lost profits. Failure to do so could result in a number of negative consequences for the patent owner, including the inability to collect lost profits from a subsidy, as evidenced in the *Blumenthal* case.

The Capital Importance of Understanding Taxation

In addition to standing, exclusivity also determines whether intellectual property owners also are able to take advantage of certain tax benefits. Under Internal Revenue Code § 1235, an intellectual property transfer must be deemed a sale in order to qualify for capital gains tax treatment.[43] The overarching purpose of such treatment is to provide an incentive to inventors to contribute to the welfare of the nation by providing statutory assurance that certain patent holders will be afforded favorable tax treatment. As a general rule, a licensing transfer will be treated as a sale if all substantial rights in the property are transferred.[44] Much as with exclusivity and standing to sue, a transfer of all substantial rights must include a transfer of the entire right to exclude everyone from making, using, and selling the invention. The ability to exclude is the key here. If the transaction does not qualify as such a sale, it is classified as a "mere" license or "non-sale" license, and the proceeds are taxable at higher rates as ordinary income.[45]

In addition to the transfer of all substantial rights, the duration of the intellectual property holding also is important in determining whether favorable tax treatment is possible. Concerning potential tax breaks, capital gains tax is broken down into two categories: (1) short-term, and (2) long-term capital gains. Short-term capital gains involve capital assets that are held less than a year. Such gains are currently subject to short-term capital gains tax at a maximum rate of 35 percent depending on the licensee's tax bracket.[46] In

contrast, capital assets held more than one year are designated as long-term for federal tax treatment and are only taxed at a maximum of 15 percent depending on the licensee's tax bracket.[47] Thus, in order for licensees to receive favorable tax treatment on their intellectual property holdings, all substantial rights in the property must have been transferred in the licensing agreement and the capital assets must have been held for more than a year. The question of when the one year grace period starts conception, filing or issuance, is not addressed here.

However, what about instances in which practical commercial considerations do not always permit the total disposition of all interests in a patent? For example, there may not be a potential transferee capable of efficiently exploiting the value of the property in the entire geographic area, or in all industries or applications. In such cases, geographic or field-of-use license limitations may be commercially appropriate. In response to these interests, the IRS and courts have accommodated such business concerns and have treated intellectual property as divisible, under certain circumstances, into separate rights capable of transfer. As a result of such divisibility, an owner of intellectual property may structure a license that is non-exclusive as a result of one of these divisions and yet still achieve capital gains tax treatment.

More specifically, under established patent law principles, a sale can result even though the purchaser is granted the exclusive right to use intellectual property only within a specified industry or particular geographic area. This concept was affirmed in *United States v. Carruthers*,[48] in which the court held that a transfer of patent rights limited to the tuna industry qualified as a sale rather than a license of those rights for tax purposes. The court reasoned that although the transfer of patent rights was limited to the tuna industry, there was in fact a transfer of whole patent rights within that field-of-use. As a result, the court found that the transfer constituted proceeds from a sale within the meaning of I.R.C. § 117, and could properly be classified as capital gains rather than ordinary income.[49]

However, unlike certain geographic or field-of-use limitations, limitations regarding the duration of the transfer are more frequently treated as non-sale licenses by courts. More specifically, a transfer of intellectual property rights will be treated as a license and not a sale if the rights transferred expire before the end of the property's useful or legal life.[50] If a new patent with a lifetime of 20 years from the filing date is transferred to a licensee for a period less than that 20 year mark, this would qualify the transfer as a license and not a sale for tax purposes. Similarly, according to courts, a transfer of all substantial rights to a patent does not include a grant of patent rights under an agreement when the transferor possesses the right to terminate the agreement at will before the patent expires.[51] Thus, any limitations regarding duration of rights under the transfer render the transfer a license for tax purposes.

These principles regarding the sale/license distinction for capital gains tax treatment apply in generally the same fashion for sole proprietors, partnerships, and corporations. For example, with an S corporation, if an intellectual property transfer involves the transfer of all substantial rights in a patent, then it will most likely qualify for capital gains tax treatment if held for more than a year. The corporation will, as a result, receive the favorable tax treatment associated with such a classification. The classification hinges on the structure of the licensing agreement itself, and is not contingent necessarily on the structure of the businesses involved in the transfer. Thus, the tax benefits and drawbacks associated with business structures themselves still apply, whereby, for example, a C corporation is subject to double taxation.

Among the various business structures, holding companies particularly have been popular recently because of the potential tax advantages they can offer. Many large, multinational companies have set up parent holding companies in tax-favorable states or countries and have then sold, transferred, or assigned all of the patent rights for the company as a whole to that patent holding company. The subsidiary holding companies, in turn, then grant licenses to the parent company or third parties in exchange for royalty payments. While this holding company strategy has previously offered parent companies an opportunity to deduct royalty payments as deductible expenses and benefit from reduced tax liabilities, states and countries have begun shutting down such possibilities.

With increased budget deficits, some states have started to challenge intellectual property holding company structures. These states typically attempt to tax some of the revenue earned by corporations incorporated outside the state that do no business in the state under an affiliated tax nexus theory. Such states have contended that intellectual property holding companies have sufficient contacts with the parent corporation state so that the state has jurisdiction to impose a corporate tax directly on the holding company.[52] Other states have attempted to indirectly tax the holding company by denying the parent corporation's deduction for royalties paid to its holding

company. However, with the right planning, a parent corporation can help insulate its holding company structure from such attacks. The most important step is to make sure that the holding company engages in significant business activity apart from merely licensing intellectual property back to the parent company. As a general rule, holding companies with real business purpose and with continuous business activity are more likely to withstand a challenge by the IRS or a state's taxing authority.

Available Remedies—Proving Lost Profits

After determining whether standing exists to bring suit and assessing possible tax implications of licensing strategies, the next relevant question relating to licensing strategy concerns available remedies for patent damages. If there should happen to be a finding of infringement, how does a company's business structure enhance or inhibit its ability to collect damages? Does the established licensing agreement allow the licensee to pursue and collect lost profits? What about the patentee and licensor?

In terms of statutory authority, 35 U.S.C.S. § 284 outlines patent damages by stating that "upon finding for the claimant the court shall award the claimant damages adequate to compensate for the infringement but in no event less than a reasonable royalty."[53] This provision sets the statutory floor for damages. In many cases, given that an award of a reasonable royalty is guaranteed upon a finding of infringement, a claimant will pursue its lost profits in an effort to obtain greater damages. Understanding what is required to prove lost profits, in turn, is central to understanding how licensing arrangements influence a party's abilities to collect damages.

In order for a party to prove lost profits, it must affirmatively establish four elements:[54]

1. It must show that there exists a demand for the patented product;[55]
2. The party must prove that there is an absence of acceptable non-infringing substitutes;[56]
3. That party must prove that it possesses the manufacturing and marketing capability required to exploit the demonstrated demand;[57] and
4. The claimant must demonstrate the amount the patentee would have made if the infringement had not occurred.[58]

If all four of these elements have been satisfied, then a court may award lost profits to the injured party.

But does the party requesting lost profits have to have actually produced or sold the patented product? The Federal Circuit addressed this question in *Rite-Hite Corp. v. Kelley Co, Inc.*[59] In the case, Rite-Hite sought lost profits for two types of vehicle restraints that it made and sold. These restraints included the "Manual Dok-Lok" (MDL-55), which incorporated the patent-in-suit, and the "Automatic Dok-Lok" (ADL-100), which was not covered by the patent-in-suit. Kelley, in turn, marketed a "Truk Stop" restraint that was designed to compete primarily with Rite-Hite's ADL-100. On appeal before the Federal Circuit, Kelley argued that the patent statute did not provide for damages based on Rite-Hite's ADL-100 because the ADL-100s were not covered by the patent-in-suit and the patented dock levelers were not attributable to demand for the patented invention and, therefore, are not recoverable losses.

In deciding the case, the Federal Circuit's decision hinged on its interpretation of the four-part test set forth in *Panduit* for determining lost profits. The Court here ultimately found that the *Panduit* test turns on "reasonable, objective foreseeability" of lost sales that may be suffered by an infringed patent holder.[60] Therefore, according to the Federal Circuit:

> being responsible for lost sales of a competitive product is surely foreseeable; such losses constitute the full compensation set forth by Congress, as interpreted by the Supreme Court, while staying well within the traditional meaning of proximate cause. Such lost sales should therefore be clearly compensable … [even] though recovery for lost sales of a device not covered … by the patent-in-suit is not of course expressly provided for by the patent statute.[61]

Applying this reasoning to the case, the Court held that the ADL-100 was not an "acceptable, non-infringing substitute" within the meaning of the *Panduit* test because, being patented by Rite-Hite, it was not available to customers except Rite-Hite. As a result, Rite-Hite would not have lost sales to a third party. Thus, this decision established that a patent holder does not have to necessarily produce or sell the patented product, but must show a "reasonable, objective forseeability" of lost sales in order to collect lost profits.

With the lost profits test established, though, what about when two companies have a common parent corporation, but are separate corporate entities? When attempting to collect lost profits, can the claimant pursue lost profits that include the lost profits of a sister corporation? The Federal Circuit addressed this

past and potential dilemma in *Poly-America LP v. GSE Lining Technology, Inc.*[62]

In *Poly-America*, Poly-America owned a patent and non-exclusively licensed it to its sister corporation, Poly-Flex. Poly-Flex, in turn, sold goods that competed with the infringing product. For the purposes of pursuing greater lost profits, Poly-America contended that it operated together with Poly-Flex as a single economic unit for the purposes of production, marketing, and sales of the patented liner.[63] Furthermore, it claimed that the two companies shared a unity of interest that justified treating them as a single economic unit. Under the licensing agreement, Poly-Flex possessed certain substantive rights, including the "right of enforcement for claims for past damages" and the right to sublicense.[64] In support of its argument, Poly-America cited a provision in the licensing agreement stating that Poly-America was entitled to collect damages accruing to Poly-Flex from any infringement of the patents.

Ultimately, the Court did not agree with this argument and highlighted the fact that the companies were actually two separate corporate entities. Concerning Poly-America, the Court noted that "their parent has arranged their corporate identities and functions to suit its own goals and purposes, but it must take the benefits with the burdens."[65] Base on this reasoning, the Court held that while Poly-America may have had the right to sue under its patents, both as an owner and back-licensee, it could only recover its own lost profits, and not Poly-Flex's.[66]

As demonstrated by the *Rite-Hite* and *Poly-America* cases, great care must be taken when allocating the functions of patent ownership and manufacturing/selling among affiliated companies. Although it is not clear how *Poly-America* would impact a straight parent/subsidiary relationship or a holding company/related company relationship, it does effectively highlight the risks associated with establishing a corporate relationship with non-exclusive licenses. Failure to properly structure the business for maximization of profits and patent protection may result in a loss of standing or loss of the right to collect lost profits. This, subsequently, presents the question as to what exactly is the correct corporate structure for collecting lost profits.

Under the most advantageous structure, the company that owns the patent should be the company that sells and/or manufactures the device. Alternatively, the patent owner should exclusively license the patent to one company in the family that sells and/or manufactures the device. Further, the rights granted should include the right to enforce the patent. This would allow the licensee to be joined as a party to the lawsuit and seek lost profits. If offering other licenses is an issue, then the agreement also should allow for the granting of sublicenses.

Is There Any Magic in the Air? Licensing Lessons to Be Applied

As noted earlier, there are no magic rules per se when it comes to developing the best fit possible between business structure and licensing strategy. Ultimately, a business' ownership must weigh the pros and cons associated with different options and make a decision based on personal goals and priorities concerning variables such as business growth, enforcement of patent rights, and liability. However, in spite of this absence of a cardinal formula, there are a number of fundamental precepts that can help a business more effectively manage its intellectual property portfolio and successfully navigate the world's currently choppy economic waters.

Above all, it must be understood that the only parties entitled to commence patent infringement proceedings and recover damages are the relevant patent holder, their exclusive licensee, or any assignee who has been provided with "all substantial rights" in the patent. The word "exclusive" cannot be stressed enough here. In many ways, protection and profitability of patent rights revolve around the concept of exclusivity.

Generally, the greater the licensing agreement's degree of exclusivity, the greater the likelihood that the licensee will enjoy the full rights of that property, including standing, the ability to collect lost profits, and, possibly, preferential capital gains treatment. In turn, setting up a corporate relationship with nonexclusive licenses runs the risk of losing standing and the right to seek lost profits. When examining exclusivity, keep in mind that the labeling of a license as "exclusive" is not conclusive as to whether the license is in fact exclusive. Instead, courts look to the agreement in its entirety to determine whether the licensee has actually received exclusive patent rights.

By taking into account these lessons and recognizing how business structure can impact licensing strategy, businesses can more effectively tailor structures and intellectual property strategies that better align with one another. In turn, this understanding and planning will help businesses to maximize the protection and profitability of their intellectual property rights. With such an understanding in hand, the sky is the limit in terms of realizing stronger economic growth and stability.

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8. *Id.*
9. *Id.*
10. *Id.*
11. Bender at 1 Business Organizations with Tax Planning 1.syn.
12. Matthew Bender & Co., Inc., 1-2 Milgrim on Licensing 2.syn (2007), *http://www.lexisnexis.com*.
13. *Id.*
14. *Id.*
15. *Id.*
16. *Id.*
17. *See* 35 U.S.C.S. § 281.
18. *See* 35 U.S.C.S. § 100(d).
19. *See* Waterman v. Mackenzie, 138 U.S. 252 (1891) (holding that the assignment of all rights in a patent or all of the rights in a patent for a specified territory vest assignee with the right to sue for infringement either by itself or jointly with the assignor).
20. *See* Crown Die & Tool Co. v. Nye Tool & Machine Works, 261 U.S. 24 (1923).
21. *Waterman*, 138 U.S. 252.
22. *Id.* at 255.
23. Propat Intl Corp. v. Rpost, Inc., 473 F.3d 1187, 1193, 81 U.S.P.Q.2d 1350 (Fed. Cir. 2007) (holding that a nonexclusive licensee cannot sue in its own name—even by joining the patentee in suit); *see also* Blumenthal v. Barber-Colman Holding Corp., No. 90 C 20365, 1991 WL 353535 (N.D. Ill. Nov. 26, 2001) (dismissing Plaintiff's suit for lack of standing where inventor-plaintiffs were found to have granted a non-exclusive license to their wholly owned and controlled corporation); *see also* Rite-Hite Corp. v. Kelley Co., 56 F.3d 1538, 1558 (Fed. Cir. 1995) (holding that the grant of a bare license to sell an invention in a specified territory, even if it is the only license granted by the patentee, does not provide standing without the grant of a right to exclude others).
24. *See* Enzo Apa & Sons, Inc. v. Geapag A.G., 134 F.3d 1090, 1093 (Fed. Cir. 1998) (holding that an exclusive license for all of the rights under a patent for a specified geographic region will be sufficient to give the assignee standing to sue for infringement in the region).
25. *See* Mentor H/S, Inc. v. Medical Device Alliance, Inc., 240 F.3d 1016, 1017 (Fed. Cir. 2001).
26. *Propat Intl Corp.*, 473 F.3d at 1193.
27. Independent Wireless Tele. Co. v. Radio Corp. of Am., 269 U.S. 459, 469 (1926).
28. *Id.* at 468.
29. Int'l Gamco, Inc. v. Multimedia Games, Inc., 504 F.3d 1273 (Fed. Cir. 2007) (holding that unlike an exclusive license who holds all of the substantial rights in a patent or all of the substantial rights under the patent for a specific territory, an exclusive licensee of a patent whose license was limited to a field of use could not sue in its own name without joining the patentee).
30. *Id.* at 1273.
31. *Id.* at 1274.
32. *Id.* at 1283.
33. *Id.* at 1284.
34. *See* Lans v. Digital Equip. Corp, 252 F.3d 1320 (Fed. Cir. 2001) (holding that if a party lacks title to a patent, that party has no standing to bring an infringement action under that patent).
35. *Id.* at 1325.
36. *Id.*
37. *See* Blumenthal v. Barber-Colman Holding Corp., 1991 U.S. Dist. LEXIS 20531 (N.D. Ill. Nov. 26, 1991).
38. *Id.*
39. *Id.* (holding that a non-exclusive licensee of a patent has no standing to sue for infringement); *citing* Innis, Speiden & Co. v. Food Machinery Corp., 2 F.R.D. 261, 263 (D. Del. 1942) (defining a "bare license" as "a grant of authority to make, use or vend the patented product throughout the United States or in a given part of it with no right of exclusion whatsoever").
40. *Id.*
41. *See* Speedplay, Inc. v. Bebop, Inc., 211 F. 3d 1245 (Fed. Cir. 2000) (holding that the grantee of an exclusive license can sue in its own name without joining the grantor if the license had the effect of conveying all substantial rights in the patent to the licensee).
42. *Int'l Gamco, Inc.*, 504 F.3d at 1252.
43. *See* Internal Revenue Code § 1235.
44. *Id.*
45. Matthew Bender & Co., Inc., 1-6 Taxation of Intellectual Property 6.syn (2007), *http://www.lexisnexis.com*.
46. *Id.*
47. *See id.* The tax rate on long-term gains was reduced in 2003 to 15 percent, or to 5 percent for individuals in the lowest two income brackets. Short-term capital gains, in contrast, are taxed at a higher rate: the ordinary income tax rate. The reduced 15 percent tax rate on capital gains, previously scheduled to expire in 2008, has been extended through 2010 as a result of the Tax Increase Prevention and Reconciliation Act signed into law by President Bush on May 17, 2006 (P.L. 109-222). In 2011, these reduced tax rates will "sunset," or revert to the rates in effect before 2003, which were generally about 20 percent.
48. United States v. Carruthers, 219 F.2d 21 (9th Cir. Or. 1955) (reasoning that in determining whether the transfer of patent interests should be treated as long term capital gains, the decisions consider the nature of the rights involved under a patent, and the interest of the assignor which require that proper effort to promote manufacture and sale of the patented article be provided and enforceable).
49. *Id.*
50. Matthew Bender & Co., Inc., 1-6 Taxation of Intellectual Property § 6.10, *http://www.lexisnexis.com*.
51. *Id.*
52. *Id.*
53. *See* 35 U.S.C.S. § 284.
54. *See* Panduit Corp. v. Stahlin Bros. Fibre Works, Inc., 575 F.2d 1152, 1156 (6th Cir. 1978) (holding that to obtain as damages the profits on sales a patent owner would have made absent the infringement, specifically the sales made by the infringer, a patent owner must prove: demand for the patented product; absence of acceptable non-infringing substitutes; his manufacturing and marketing capability to exploit the demand; and the amount of the profit he would have made).
55. *Id.*
56. *Id.*
57. *Id.*
58. *Id.*
59. *Rite-Hite*, 56 F.3d 1538 (Fed. Cir. 1995).
60. *Id.*
61. *Id.*
62. Poly-America LP v. GSE Lining Technology, Inc., 383 F.3d 1303 (Fed. Cir. 2004) (holding that recovery of lost profits by a patentee is not limited to a situation in which the patentee is selling the patented device; however, the patentee needs to have been selling some item, the profits of which have been lost due to infringing sales, in order to claim damages consisting of lost profits).
63. *Id.*
64. *Id.*
65. *Id.*
66. *Id.*

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