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# The pitfalls of structuring patent ownership between affiliated entities

**By: Bret A. Hrivnak, Esq. and Jason R. Strobel, Patent Agent**

Corporations and other entities are often faced with the issue of whether they should transfer or license their ownership interest in a patent to an affiliated or subsidiary entity, which may be a holding company. In some cases, an entity may decide to assign or transfer all or a portion of its patent rights to an affiliate or subsidiary entity. In other instances, the patent-owning entity may decide to retain ownership, and merely license certain patent rights to the affiliate or subsidiary entity. In the latter instance, it is important to properly consider a variety of issues when structuring the license, including whether the licensee should have the right to sue an alleged patent infringer. In such cases, it must also be determined what damages the licensee may be able to obtain for any resulting infringing activity. In *Mars, Inc. v. Coin Acceptors, Inc.*, the Federal Circuit identified potential pitfalls regarding these issues. The court's analysis serves as a timely reminder that the structuring of patent rights amongst patent owners and licensees demands careful consideration and preparation.

In this case, Mars, Inc. (Mars) originally brought suit in 1990 against defendant Coin Acceptors, Inc. (Coin Acceptors), alleging that certain vending machine products manufactured and sold by Coin Acceptors infringed two patents owned by Mars. While Mars owned two patents concerning vending machine technologies, it did not manufacture or sell any products covered by its patents. Instead, Mars granted a license on its patents to Mars Electronics International, Inc. (MEI), under which MEI manufactured and sold such coin-changing products.

Between 1990 and 1996, MEI had a royalty agreement with Mars, under which MEI paid royalties to Mars even if it did not make a profit. In 1996, Mars entered into a set of agreements with MEI and another Mars subsidiary in the United Kingdom, which was also called Mars Electronics International (MEI-UK). Under this agreement, Mars transferred its entire interest in the patents-in-suit to MEI. In exchange, MEI-UK agreed to pay royalties to Mars through 2004.

In 2005, the found that Coin Acceptors *did* infringe Mars' patents. In a separate proceeding, the district court was to determine the resulting damages owed to Mars. It is well established that a patent owner may recover lost profits as damages for infringing activity, if proven, but, at the very least, the patent owner may recover no less than a reasonable royalty.  Coin Acceptors acknowledged that Mars was due a reasonable royalty for damages arising prior to 1996. Coin Acceptors did, however, challenge Mars' claim for lost profits, as well as its claim for all damages arising after Mars' transfer of the patents-in-suit to MEI in 1996, since Mars no longer owned the patents-in-suit. In response, Mars attempted to join MEI to the suit for the purpose of recovering the damages in dispute. The district , however, agreed that Mars was not entitled to lost profit damages, while also denying Mars' request to join MEI on the basis that MEI did not have standing to sue Coin Acceptors, since MEI was not an owner of the patent or an exclusive licensee (only an exclusive licensee may have the ability to sue an alleged infringer). Subsequent to the district court's decision, and in response to a motion for reconsideration, the  court suggested that Mars' lack of standing could be cured by having MEI transfer the rights back to Mars before final judgment. In 2006, Mars and MEI executed an agreement confirming that Mars retained the rights to sue for past infringements. Accordingly, the district court found that Mars was now entitled to sue and recover damages for the period during which MEI owned the patents. Ultimately, the district court awarded a reasonable royalty, which both parties appealed to the Court of Appeals for the Federal Circuit (CAFC).

On appeal, the CAFC addressed four issues: (1) whether Mars was entitled to lost profits; (2) whether MEI had standing to recover damages incurred prior to 1996: (3) whether Mars had standing to recover damages incurred from 1996 to 2003; and (4) whether the erred by imposing a 7% royalty rate.

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In addressing whether Mars was entitled to lost profits, the CAFC affirmed the district court's holding that Mars was not so entitled. Mars claimed that it inherently lost profits when MEI lost profits because of the parent-subsidiary relationship between the two companies. The CAFC noted that the license agreement between Mars and MEI required MEI to pay a royalty to Mars whether MEI made a profit or not, and that Mars was unable to identify that it ever received or recognized any form of profit or revenue from MEI apart from the royalty payments. As Mars was unable to prove that MEI's profits inexorably flowed to Mars, the CAFC ultimately determined that lost profits were not an appropriate remedy.

Regarding MEI's standing to sue for infringement prior to 1996, the CAFC relied on the fact that MEI was not an *exclusive* licensee in holding that MEI lacked constitutional standing to sue on the patents-in-suit during that time period. To be an exclusive licensee for standing purposes, a party must have received not only the right to practice the invention within a given territory, but also the patentee's express or implied promise that others are excluded from practicing the invention within that territory as well. Prior to 1996, MEI-UK, a separate corporate entity from both Mars and MEI, was entitled to manufacture and export to the United States products covered by the patents-in-suit. Therefore, because MEI held only a "bare license" prior to 1996, it was not entitled to collect lost profit damages for any losses it incurred due to infringement.

The CAFC next addressed Mars' standing to recover damages between 1996 and 2003 by evaluating a 2006 agreement between Mars and MEI which purported to transfer all of MEI's rights in the patents, including title to the patents, to Mars. The passage in issue from the 2006 agreement stated:

> Mars and the Buyer [MEI] do hereby <u>acknowledge</u> that Mars owns and retains the right to sue for past infringement of the Litigation Patents. To the extent that MEI may have or claims <u>any rights in or to any past infringement of the Litigation Patents or any recovery therefore</u>, upon the terms and subject to the conditions of the Purchase Agreement, MEI hereby does irrevocably assign all such rights to Mars.

Here, the CAFC found that MEI only assigned to Mars the right to sue for past infringement, not the title to the patents-in-suit. The CAFC noted that the 1996 agreements between Mars and MEI made clear that both parties knew how to transfer title when they intended to do so, but that the 2006 failed to transfer title. Therefore, Mars had no standing to recover damages between 1996 and 2003 because it did not hold title to the patents-in-suit.

Lastly, the CAFC addressed the 7% reasonable royalty calculated by the district court. Coin Acceptors challenged the rate, claiming the district court erred by awarding a royalty rate higher than the cost of implementing a non-infringing alternative. Coin Acceptors also alleged the rate was improper because Mars had licensed the patents to MEI-UK for a 4% royalty. Finally, Coin Acceptors claimed the district court erred by relying on Coin Acceptors' incremental profit, rather than its operating profit, to calculate the reasonable royalty.

Addressing each argument in turn, the CAFC first held that an infringer may be liable for damages, including reasonable royalty damages, that exceed the amount that the infringer could have paid to avoid infringement. Second, the CAFC held that it was not error for the district court to impose a higher royalty rate on Coin Acceptors than on an affiliate. The CAFC reasoned that Mars' negotiation with MEI-UK was not an "arm's length transaction" and certainly was not a license between competitors, as the negotiation between Mars and Coin Acceptors would be. Finally, the CAFC held that the district court did not err in selecting incremental profits over operating profits in calculating the reasonable royalty. The appropriate method of profit accounting in the circumstances is properly left to the broad discretion of the court – the

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Federal Circuit has never held that any one profit accounting methodology is appropriate for all industries, for all companies, in all cases. Thus, the district court's calculation of the 7% reasonable royalty rate was not in error.

In conclusion, the structure of an assignment or licensing agreement may determine who, if at all, has standing to sue a potential patent infringer, as well as who may recover damages if infringement is found. Before assigning rights in or licensing your patent, consult an attorney familiar with these issues to ensure that your interests in potential litigation align with your goals for the assignment or license.