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To hold or not to hold: Considerations in creating an IP holding company

By Bruce Goldner, Esq., and MacKinzie Neal, Esq., ***Skadden, Arps, Slate, Meagher & Flom LLP***

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Companies that own or are in the process of developing a substantial amount of intellectual property ("IP") should consider whether to establish an intellectual property holding company ("IPCo"). An IPCo is a special purpose vehicle whose sole function is to hold and manage a company and its affiliates' IP portfolio.

Typically, an IPCo does not directly use the IP but instead licenses the IP rights to affiliated operating companies ("OPCos") for their use and further sublicense. In the typical IPCo structure, the OPCos transfer all of their present and future IP rights into a wholly-owned affiliate (i.e, the IPCo), which in turn grants a license back to such OPCo affiliates of all IP relevant to the business operations of such OPCos.

Consolidating all of a company's IP assets into one IPCo can provide a number of benefits, including (i) administrative convenience in prosecution, maintenance and enforcement of IP, (ii) more efficient transaction structures, and (iii) potential tax advantages.

> In most instances a reasonable royalty will not fully compensate a corporate group that has lost profits due to a third-party infringement.

Specifically, an IPCo enables a company and its affiliates to centralize all of their respective ownership of IP rights in one entity — this can streamline IP processes for a corporate group as the structure provides certainty with respect to where IP ownership resides and consistency with respect to which corporate entity and officers have the right and standing to take actions with respect to the corporate group's IP.

In addition, the structure can facilitate corporate transactions — for example, in carve-out divestitures an IPCo can reduce the risk of inadvertently divesting key trade secrets or other IP that may also be used in products or services of the retained businesses, as ownership of IP assets cannot be accidentally transferred as result of being inadvertently owned by a divested OPCo.

Finally, an IPCo may create more efficient tax structures by accruing for IP-related profits in a more favorable tax jurisdiction where the IPCo is incorporated, while potentially allowing for the deduction by the OPCos of royalty fees paid to the IPCo for the use of the IP.

Before proceeding with an IPCo structure, however, a company should consider potential risks. By taking a holistic approach to the benefits and burdens of an IPCo structure, a company will be in the best position to determine whether and how to structure an IPCo to better achieve its strategic objectives.

IPCO RISKS AND CONSIDERATIONS

The potential negative consequences of an IPCo structure generally depend on the types of IP that are most material to a corporate group, which we address in turn below.

PATENTS

Where patents are key assets of a corporate group, it is important to consider the potential impact of an IPCo structure on recovery of lost profits when enforcing patents against third parties. The right of a patent owner to seek its lost profits against an infringer can be an important remedy.

But if an IPCo structure is based on non-exclusive licenses from the IPCo to the OPCos, then the corporate group may be foreclosed from recovering lost profits in patent infringement claims.[1]

In this connection, to have standing to recover loss of profits, a patent owner generally must make or sell a product or service that competes with the infringing product or service — otherwise the infringer's conduct cannot cause the patent owner to lose profits on sales, as the patent owner has none.[2]

Accordingly, an IPCo by its very nature as a mere holding company generally cannot recover loss of profits from an infringer. Further, the OPCos (i.e., the corporate group entities that actually make or sell products/services under the patent) cannot bring a patent suit on behalf of the IPCo, as nonexclusive patent licensees generally do not have standing to bring infringement suits.

This potential downside can be remedied by the IPCo granting an exclusive license to each of its OPCos, but as a practical matter this solution may not work where the OPCos' functions and operations overlap with each other, which frequently can be the case with larger or more complex corporate groups.

Further, courts are unlikely to infer exclusivity based on corporate proximity between the OPCos and the IPCo. In *Poly-America*

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LP v. GSE Lining Tech. Inc., 383 F.3d 1303 (Fed. Cir. 2004), the Federal Circuit denied the recovery of lost profits where the IPCo was a sister entity of the OPCo.

As the court explained, two corporations "may not enjoy the advantages of their separate corporate structure and, at the same time, avoid the consequential limitations of that structure — in this case, the inability of the patent holder to claim the lost profits of its non-exclusive licensee."[3]

Note that the exclusive license should be one where the licensee has an express exclusionary right against everyone.

There are a few exceptions in which an OPCo may potentially recover lost profits where the license between the IPCo and the OPCo is nonexclusive, namely

- where the OPCo is the subsidiary of the IPCo parent, a court may permit arguments that profits from the subsidiary/nonexclusive licensee "flow inexorably up to the parent";[4] and
- where the OPCo is a sole licensee, in which case the OPCo may have standing to join if it has been directly damaged by an infringer and there has been a clearly defined nexus between the OPCo and the IPCo.[5]

But these particular instances are not the norm in an IPCo structure where there are a number of OPCos that use the IP held by the IPCo, and such positions in any event may not prevail.

In the absence of an ability to recover for lost profits, an IPCo can seek a reasonable royaly.[6] But in most instances a reasonable royalty will not fully compensate a corporate group that has lost profits due to a third-party infringement.

This is true even in instances where courts consider the impact of the infringing activity on all of the OPCos for purposes of reasonable royalty damages,[7] as a royalty by definition generally is just a percentage of the OPCos' overall profits or net revenues.

Accordingly, IPCo structures with nonexclusive licenses may be unable to recover damages commensurate with the corporate group's losses.

Finally, in addition to monetary relief, the right to obtain an injunction against infringers can also be a critical remedy to stop current or deter future infringing activity. Here too, however, this equitable remedy may be more elusive in an IPCo structure featuring nonexclusive licenses.

To obtain a permanent injunction, a patent owner generally must satisfy a four-factor test that requires, among other things, proof of irreparable harm in the absence of a court granting an injunction.[8]

Where a patent owner cannot show that the continued infringing activity of a third party will directly impact the business of the patent owner, courts are more likely to deny injunctive relief,[9] and courts accordingly are sometimes reluctant to find that an IPCo has suffered irreparable harm from infringing activity.[10]

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IPCo structures present risks with respect to copyrights that are akin to those posed to patents. Specifically, a non-exclusive licensee of copyrights typically lacks standing to bring a lawsuit against infringement of the copyrights.[11]

Under the Copyright Act, the owner of an exclusive right in the copyright has standing to sue for infringement.[12] This is true even if an entity is assigned the rights to bring a claim for copyright infringement but has no exclusive rights in the underlying copyright itself.[13]

IPCo structures may present fewer risks with respect to trade secrets. Under the 2016 Defend Trade Secrets Act, an "owner" of a trade secret may bring a lawsuit to enforce its rights.[14] Although companies should consider relevant state law, generally courts have found that "a party has standing to bring a trade secrets claim if it has possession of that trade secret."[15]

In this connection, and in contrast to patent and copyright law, non-exclusive licensees of trade secrets frequently are found to have standing to bring lawsuits against misappropriation of the trade secret.[16]

TRADEMARKS

Although a non-exclusive trademark licensee will have standing to sue for certain, but not all, types of trademark infringement claims,[17] trademarks present additional potential risks within an IPCo structure. Trademark law requires the owner-licensor of a mark to demonstrate control of the quality of goods and services associated with its mark.[18]

When the owner of the mark is the principal user of the mark, quality control is exercised automatically as the trademark owner de facto has control over its own business and activities. However, an IPCo generally does not use the trademarks itself, but rather holds the trademarks for purposes of licensing use to its affiliate OPCos.[19]

Although there are a number of obvious bases to find a proper exercise of quality control by an IPCo over its affiliates (including that the IPCo de facto is well aware of and has implicitly consented to its corporate group's trademark use and quality standards), there is at least one case where the court invalidated a trademark owned by a parent holding company on the basis that it was neither operating a business under the trademark nor sufficiently controlling its affiliate's use of the trademark.[20]

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RECOMMENDATIONS

Given the potential importance of an IPCo structure to achieving overall strategic and commercial objectives of a business group, the question from an IP perspective generally should not be "whether" to implement such structure, but rather "how" best to do so.

For starters, when considering an IPCo structure, strong consideration should be given to establishing an exclusive license between the IPCo and the OPCo where practicable. An exclusive license generally will allow either or both the IPCo and OPCo to be plaintiffs in an infringement suit and will open up the availability of lost profits recovery for patent infringement.

Note that the exclusive license should be one where the licensee has an express exclusionary right against everyone (even as against other affiliates of the IPCo/OPCo), as an implied license where there is an "understanding" that the IPCo has granted an exclusive license may not suffice.[21]

Also, companies wishing to place trademark ownership into an IPCo — particularly where the trademark is highly valuable — may want to consider including provisions in the intercompany agreement whereby actual quality control is exercised by the IPCo, and implement procedures to periodically ensure that such provisions are complied with.[22]

Finally, to the extent that foreign operations of the corporate group are material, a company should consult with local counsel in material jurisdictions to ensure that the objectives of IP ownership, registration, enforcement and recovery of damages inherent in planning an IPCo structure are optimized globally.

Notes

[1] *WiAV Solutions LLC v. Motorola Inc.*, 631 F.3d 1257 (Fed. Cir. 2010).

[2] *Rite-Hite Corp. v. Kelley Co.*, 56 F.3d 1538, 1548 (Fed. Cir. 1995).

[3] 383 F.3d at 1311 (Fed. Cir. 2004).

[4] *Kowalski v. Mommy Gina Tuna Res.*, 574 F. Supp. 2d 1160, 1163 (D. Haw. 2008); *Fujitsu Ltd. v. Tellabs Inc.*, No. 09-cv-4530, 2013 WL 2285794 (N.D. Ill. May 23, 2013).

[5] *Kalman v. Berlyn Corp.*, 914 F.2d 1473, 1482 (Fed. Cir. 1990).

[6] *Supra* note 2 at 1553.

[7] *Union Carbide Chemicals & Plastics Tech. Corp. v. Shell Oil Co.*, 425 F.3d 1366, 1378 (Fed. Cir. 2005).

[8] *eBay Inc. v. MercExchange LLC*, 547 U.S. 388, 391 (2006).

[9] *Advanced Cardiovascular Sys. Inc. v. Medtronic Vascular Inc.*, 579 F. Supp. 2d 554, 561 (D. Del. 2008).

[10] *See Sundance Inc. v. DeMonte Fabricating Ltd.*, No. 02-cv-73543, 2007 WL 37742 (E.D. Mich. 2007), and *z4 Techs Inc. v. Microsoft Corp.*, 434 F. Supp. 2d 437 (E.D. Tex. 2006).

[11] *Saregama India Ltd. v. Mosley*, 635 F.3d 1284, 1297 (11th Cir. 2011).

[12] 17 U.S.C.A. § 501(b). *See also DRK Photo v. McGraw-Hill Glob. Educ. Holdings LLC*, 870 F.3d 978 (9th Cir. 2017) (stating that only the legal or beneficial owner of an exclusive right conferred by the Copyright Act has standing to sue).

[13] *Id*.

[14] 18 U.S.C.A. § 1836(b)(1).

[15] *BladeRoom Grp. Ltd. v. Facebook Inc.*, 219 F. Supp. 3d 984, 990 (N.D. Cal. 2017)(citing *Williams-Sonoma Direct Inc. v. Arhaus LLC*, 304 F.R.D. 520, 527 (W.D. Tenn. 2015)).

[16] *See Id.*

[17] *Quabaug Rubber Co. v. Fabiano Shoe Co.*, 567 F.2d 154, 160 (1st Cir. 1977).

[18] *Kentucky Fried Chicken Corp. v. Diversified Packaging Corp.*, 549 F.2d 368, 387 (5th Cir. 1977).

[19] 15 U.S.C.A. § 1127 (1994); 15 U.S.C.A. § 1055 (1994).

[20] *CNA Financial Corp. v. Brown*, 922 F. Supp. 567 (M.D. Fla. 1996).

[21] *See Spine Solutions Inc. v. Medtronic Sofamor Danek USA Inc.*, 620 F.3d 1305, 1318 (Fed. Cir. 2010).

[22] One of the measurements of control required by the USPTO to avoid naked licensing occurs if the licensee is a wholly owned subsidiary of the owner and is subject to the owner's control over the nature and quality of the trademark. Trademark Manual of Examining Procedure § 1201.03(b) and (c).

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ABOUT THE AUTHORS

Bruce Goldner (L) is head of **Skadden**'s New York office and its Diversity Committee and co-head of the firm's Intellectual Property and Technology Group. He can be reached at bruce.goldner@skadden.com. **MacKinzie Neal** (R) is an Intellectual Property and Technology law clerk in Skadden's New York office. She can be reached at mackinzie.neal@skadden.com.

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