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NOTE

RECOVERING LOST PROFITS: THE RESURRECTION OF SUBSIDIARIES (IS THERE LIFE ON *MARS*?)

BRYCE YOUNG*

I. INTRODUCTION

The business world is an incredibly complex and fast-changing environment. In a capitalist system that thrives on competition, businesses are constantly seeking any advantage over their competitors (e.g., in the products they manufacture, the marketing they employ, the quality of employees they hire and train, etc.). The need for efficiency often dictates the internal structuring of a company, as costs can be greatly allayed by a systematic organization. This is true of all aspects of a company, ranging from its initial election to become a corporation to having a vertical versus horizontal infrastructure to how it handles the intellectual property rights it manages. The internal structuring of a company is vastly important to the company's viability and long-term success.

After making these initial decisions, many businesses have found they cannot handle the manufacturing, marketing, distribution, and selling of their products with their original structure. Some have decided to contract out their products, choosing to share the burden of production with an outside company. Others have opted to simply expand their companies' abilities to handle the increased demand, including the establishment of subsidiaries. Subsidiaries allow businesses to retain internal control of trade secrets and other proprietary information while still realizing many benefits

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of an independent corporate identity.[1] Companies with patents have also taken advantage of these benefits by either assigning the entire patent to a wholly-owned subsidiary or by dividing patent rights among its subsidiaries. These structures allow a company to retain entire control of its patent while still allowing multiple entities to utilize the patent (e.g., one subsidiary will be in charge of distribution while another is in charge of manufacturing).

Unfortunately for companies litigating patent infringement, the Federal Circuit has been slow to allow parent companies and subsidiaries to recover lost profits from infringement litigation. In several cases, the Federal Circuit has held that subsidiaries often do not have enough proprietary interest in the patent to sue for lost profits, even when the patent-holding parent company is joined in the lawsuit.[2] A subsidiary was only allowed to join a lawsuit when it was clearly shown that it had an exclusive license to utilize a patent, which entailed a highly factual determination of the nature of its proprietary interest in the patent.[3] As a result, many companies have not been able to recover lost profits from third parties who infringe on their subsidiaries' licenses and have been forced to resort to taking a royalty or some other form of compensation.

A recent case, however, may have breathed new life into the future of the wholly-owned subsidiary. In *Mars, Inc. v. Coin Acceptors, Inc.*, the court alluded to the possibility of a parent company being able to sue to recover lost profits on behalf of a wholly-owned subsidiary without standing to join the suit on the theory that the wholly-owned subsidiary's profits would "flow inexorably up to the parent."[4] Since the plaintiff did not factually prove that the profits flowed to the parent company, the court was not given a chance to rule expressly on that issue. The court's language, however, invites the question of whether the Federal Circuit was potentially allowing parent companies to realize the benefits of a subsidiary relationship without risking the ability to recover lost profits in patent infringement suits.

I will begin by discussing the potential benefits and advantages to dividing patent rights, specifically to subsidiaries, and why these advantages have caused some companies to risk lost profits from patent infringement litigation. Next, I will discuss the relevant case law on legal standing for subsidiaries and the legal obstacles that have prevented the parent company's recovery of lost profit damages. I will then discuss the possibility

1. Hubert Gatignon & Erin Anderson, *The Multinational Corporation's Degree of Control over Foreign Subsidiaries: An Empirical Test of a Transaction Cost Explanation*, 4 J.L. ECON. & ORG. 305, 305–07 (1988).

2. *E.g.*, Morrow v. Microsoft Corp., 499 F.3d 1332, 1339–40 (Fed. Cir. 2007); Propat Int'l Corp. v. RPost Inc., 473 F.3d 1187, 1194 (Fed. Cir. 2007); Rite-Hite Corp. v. Kelley Co., Inc., 56 F.3d 1538, 1553 (Fed. Cir. 1995).

3. *Morrow*, 499 F.3d at 1339–40.

4. 527 F.3d 1359, 1367 (Fed. Cir. 2008).

that the Federal Circuit is finally allowing businesses that operate as a single entity composed of several separate legal entities to recover for lost profits. Lastly, I will discuss some of the unanswered questions raised by the Federal Circuit's recent jurisprudential shift. Hopefully, if this shift is realized, businesses will be able to capture both the efficiencies and benefits of various organizational forms while not losing the enforcement rights to their patents.

II. Reasons for Subsidiary Business Organizations

The face of business is constantly changing. One idea can transform a business run out of a person's garage into a 38,000-employee, multi-national corporation in a relatively short time.[5] Other businesses may have a less dramatic experience as they slowly and methodically expand their market share and their companies' size. However the expansion occurs, business executives have much to consider when discussing how best to accommodate the increased needs for research, production, marketing, and distribution of their products and services. Much of the decision involves a calculated determination of the desired level of control over the expansion process, transaction costs of working with a new business, and the optimal protection for intellectual property.[6] These factors will determine the course a business chooses from the plethora of available options (for example, joint ventures, contracts with outside companies, subsidiaries) to pursue when expanding.

Businesses have shown a growing trend to expand via establishing subsidiary companies, either through buying already-existing companies or establishing new businesses.[7] A subsidiary company, by definition, is controlled by another company, a parent company, which has controlling interest in the subsidiary company. Accordingly, businesses are using subsidiary companies as they used divisions and departments in previous eras. This structure has netted greater efficiency for businesses and has become a lucrative option for expanding businesses. Consequently, the trend for subsidiaries is fairly easy to understand given the many advantages associated with this type of organizational structure.

The primary benefit to having a subsidiary is the level of control retained by the parent company. The parent company, as majority stockholder, can direct the subsidiary's actions in every regard, subject to

5. *See generally Our Story*, Medtronic, http://www.medtronic.com/about-medtronic/our-story/index.htm (last updated Sept. 22, 2010). Earl Bakken founded a medical equipment repair shop in his garage in 1949. A few years later, he created the first battery-powered pacemaker, and his business exploded. His company, Medtronic, Inc., is now the leader in the pacemaker industry, as well as being globally competitive in other medical devices, such as spinal fusion technology, stints, insulin pumps, and neurological stimulators.

6. *See* Gatignon & Anderson, *supra* note 1, at 305.

7. Melvin Aron Eisenberg, *Megasubsidiaries: The Effect of Corporate Structure on Corporate Control*, 84 Harv. L. Rev. 1577, 1577 (1971).

fiduciary duties owed to the subsidiary itself and third-parties.[8] This close relationship allows direct oversight of the subsidiary with minimal transaction costs and guarantees that the interests of the parent company will always be respected and pursued by the subsidiary.[9] Furthermore, the close business relationship better safeguards proprietary information such as trade secrets. This is especially true of wholly-owned subsidiaries, which are completely owned and controlled by the parent company. The flow of information between parent and subsidiary is, for all intents and purposes, internal company communication, minimizing the risk of exposure inherent in providing proprietary trade secret information to outside companies.

The subsidiary approach also has several corporate income tax advantages.[10] Many companies with intellectual property assets set up intellectual property holding companies (IPHCs), which are often wholly-owned subsidiaries of the parent companies.[11] These IPHCs then receive the intellectual property rights from the parent company and license them back to the parent for its own use.[12] This structure allows a parent to set up an IPHC in a jurisdiction with no income tax, so the "royalties received by the IPHC are generally tax-free."[13] Plus, the parent can deduct the royalties it pays to the IPHC as a business expense, reducing its overall income for taxation purposes.[14] Finally, the parent company can utilize any tax savings accrued by way of creatively distributing profits and losses amongst the parent and its subsidiaries.[15]

Beyond tax savings and management decisions, subsidiaries are often used to shield the parent company from liability. In a products liability context, a parent company will be held liable in tort litigation for its subsidiary's actions only when that parent has dominated the subsidiary's decisions and actions to such an extent that the subsidiary is a "mere agent" or conduit "through which the parent conducts its business."[16] This protection also extends to discrimination claims and other claims against the subsidiaries—all claims against the subsidiary are personal to that entity unless

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8. Stefan J. Padfield, *In Search of a Higher Standard: Rethinking Fiduciary Duties of Directors of Wholly-Owned Subsidiaries*, 10 FORDHAM J. CORP. & FIN. L. 79, 80–82, 115 (2004).

9. Gatignon & Anderson, s*upra* note 1, at 305.

10. Lanning Bryer & Matthew Asbell, *Combining Trademarks in a Jointly Owned IP Holding Company*, 98 TRADEMARK REP. 834, 837, 860–61 (2008).

11. *Id.* at 837.

12. *Id.*

13. Kara K. Fairbairn, *Intellectual Property Holding Companies Can Create Significant Tax Savings and Protect Valuable Assets*, FREDRIKSON & BYRON ARTICLES (Apr. 2003), http://www.fredlaw.com/articles/ip/inte_0304_kks.html.

14. *Id.*

15. 18A AM. JUR. 2D *Corporations* § 679 (2010).

16. 63 AM. JUR. 2D *Products Liability* § 113 (2010). This principle follows very closely with the test for the reverse piercing of the corporate shield for liability.

a plaintiff can prove that the parent is truly manipulating the subsidiary completely.[17]

Subsidiaries offer much of the protection of contracting with outside companies without giving up vital control. Subsidiaries do come at a cost, however, as establishing subsidiaries often involves huge asset expenditures since the parent company has to purchase controlling shares of the subsidiary's stock.[18] Furthermore, establishing and running a subsidiary often does not capture the economies of learning that may exist with outside contractors who have specialized in the field.[19] The business must decide if the loss of liquidity is worth the advantages of establishing a subsidiary. Many large companies have realized the benefits, especially the hefty tax advantages, of establishing subsidiaries to handle the expansion of their companies.

Subsidiaries, however, have one specifically problematic disadvantage when it comes to defending intellectual property rights—a seeming inability to recover lost profits from an infringing party. In order for a subsidiary to actually use a patented item without itself infringing on the patent, the parent company, as the patent-holding entity, must grant some of the patent's power and rights to the subsidiaries. In this effort, businesses have divided their patent rights among the subsidiaries, allowing one subsidiary to function in one way with the patent rights and another subsidiary to function in a different way with the patent rights. The practice of dividing patent rights has created a barrier to recovering lost profits from a party infringing on the patent—with the patent rights divided, courts have found that the parent company and the subsidiary may lack standing to sue for lost profits from the infringement because neither company owns enough of the patent rights to have direct damages from the infringement. Accordingly, neither the parent nor the subsidiary company can recover the full extent of the lost profits. The next part of this article focuses on the development of this dilemma and the recent case law that may bring long-needed relief.

III. Case Law on Subsidiary Prudential Standing

Many businesses have adopted the parent/subsidiary organization for their expansion process. This structure means many corporations actually consist of a multitude of independent entities working together for their common good. The modern corporation often has a primary headquarters that oversees operations and logistics, while distribution, manufacturing, marketing, and customer services are handled by different legal entities under the supervision and direction of headquarters.

17. N. Stevenson Jennette III, *Providing Safety Services to Subsidiaries*: *A Liability Trap for Parent Corporations*, 1990 Det. C.L. Rev. 713, 713 (2009).

18. Gatignon & Anderson, s*upra* note 1, at 305–07.

19. *Id.* at 307.

Over the past two decades, many companies have tried to assert their patent rights against infringers. These companies, unfortunately, have run into significant legal resistance in recognizing the right of the subsidiary to sue for lost profits. An analysis of the rationale denying relief provides perspective on the unpredictability businesses face when choosing to employ subsidiaries and the need for change within the judicial system to allow the company's full recovery after infringement.

A. *Overview of Standing*

The United States Constitution defines the parameters of the judiciary. Under Article III, Section 2, courts shall have jurisdiction over "cases" and "controversies."[20] In the Supreme Court's jurisprudence, this limitation has meant that the courts can only hear cases involving, at the very least, an alleged "personal injury fairly traceable to the defendant's allegedly unlawful conduct" and that the injury will likely be "redressed by the requested relief."[21] This subject matter is the purview of the judiciary. Constitutional standing is relatively broad and often is not an issue in patent law cases. Since patents are a statutory and not a constitutional right, however, the courts must look to the statutes for authority.[22]

By creating enforceable patent property rights, Congress granted the creator of a patentable invention the rights to exclude others from making, using, selling, or offering to sell the patented invention in the United States.[23] To enforce this statutory right to exclude others, Congress authorized patentees, a group consisting of the original issuer as well as any successors in title,[24] to seek remedies for patent infringement in civil courts.[25] Congress allows the patentee to be awarded "damages adequate to compensate for the infringement, but in no event less than a reasonable royalty for the use made of the invention by the infringer, together with interest and costs as fixed by the court."[26] In order to seek money damages for patent infringement, however, a party must show that it held legal title to the patent at the time of the infringement.[27] Because 35 U.S.C. § 100(d) recognizes successors in interest as patentees, an original patentee may assign some or all of its proprietary interest to another and pass along the statutory protection to that interest.[28] If the party did not actually hold legal or proprietary interest in the patent, then the party did not suffer an injury in fact and

20. U.S. CONST. art. 3, § 2, cl. 1.
21. Allen v. Wright, 468 U.S. 737, 751 (1984).
22. Arachnid, Inc. v. Merit Indus., Inc., 939 F.2d 1574, 1578 (Fed. Cir. 1991).
23. *See* 35 U.S.C. § 154 (2006); 35 U.S.C. § 271(a) (2006); *Arachnid*, 939 F.2d at 1578.
24. 35 U.S.C. § 100(d) (2006).
25. 35 U.S.C. § 281 (2006).
26. 35 U.S.C. § 284 (2006).
27. *See* Crown Die & Tool Co. v. Nye Tool & Machine Works, 261 U.S. 24, 40–42 (1923).
28. Rite-Hite Corp. v. Kelley Co., Inc., 56 F.3d 1538, 1551 (Fed. Cir. 1995).

does not have prudential standing to seek monetary damages for infringement.[29]

The Supreme Court has a long-standing jurisprudence about the assignment of patent rights and what actions are necessary to convey a legal title to the patent. A patentee may assign either "(1) the whole patent, comprising the exclusive right to make, use, and vend the invention throughout the United States; or (2) an undivided part or share of that exclusive right; or (3) the exclusive right under the patent within and throughout a specified part of the United States."[30] However, only the entire transfer of a patent, either for the entire United States or in a specific geographic part, grants the new party enough of the legal title to sue for infringement of their own accord.[31] Assigning a part or a share of the exclusive right requires joining the patent holder to the claim to satisfy standing requirements.[32] This assignment creates an "exclusive license," as the licensee has an express or implied promise from the patent holder that others will be excluded from practicing that right within that territory.[33] An assignment that does not rise to these levels is merely a license and does not grant the licensee a right to sue for infringement, even when joined by the original patentee.[34] Finally, the court looks only to the legal effects of the conveyance's provisions to determine standing, not the title given to the entities by the parties in the document.[35] The next section will outline in greater detail the various rights necessary for a conveyance to rise to the level of legal title to a patent.

The emerging issue in patent law has been the ability of a parent company, either with or through a subsidiary company, to sue for infringement and to seek lost profits. The issue of standing is frequently implicated in the transfer of the patent to the IPHC, or of the rights to the subsidiaries for production or distribution, due to the lack of a conveyance of a legal interest in the patent. In those situations, the parent company is often deemed to still hold the equitable title to the patent; however, the parent company can recover only its own damages, not that of the subsidiary.[36] Since the parent company did not create or sell the infringed product but only oversaw the process, the parent company cannot claim lost profits directly. The parent can only pursue a reasonable royalty of the value of the infringement—which is often less than the lost profits from the subsidiaries and less than the value gained by the infringing company.[37]

29. Morrow v. Microsoft Corp., 499 F.3d 1332, 1339 (Fed. Cir. 2007).
30. Waterman v. Mackenzie, 138 U.S. 252, 255 (1891).
31. *Id.*
32. *Id.*
33. *See* Indep. Wireless Tel. Co. v. Radio Corp. of Am., 269 U.S. 459, 468–69 (1926).
34. *Waterman*, 138 U.S. at 255.
35. *Id.*
36. Morrow v. Microsoft Corp., 499 F.3d 1332, 1340–41 (Fed. Cir. 2007).
37. 35 U.S.C. § 284 (2006).

B. Case Law on Subsidiary Standing—Exclusive Licenses

For a subsidiary to have standing to sue for lost profit damages, the company must either have a proprietary interest in the patent itself or have been granted an exclusive license from the patentee.[38] If a patentee holds all of the legal rights to a patent, it clearly has standing and can recover lost profits.[39] Cases where plaintiffs hold some, but not all, of the exclusionary rights to a patent, however, are more difficult to determine; in these cases, the court must determine if the plaintiff holds enough exclusionary powers to warrant standing.[40] In making this determination, the Federal Circuit employs a case-by-case, factually intensive inquiry to determine if a license given to a subsidiary company is exclusive enough to grant standing to the party.[41] While there is much case law on this analysis, the court has never established a clear, bright-line standard for exclusivity, as the analysis is too case-specific to extrapolate general rules. Consequently, parent companies can never truly be sure of their ability to recover lost profits through suits brought by their subsidiaries—they can only interpret the case law and hope their subsidiaries will be deemed to be more like an exclusive licensee than not.

Over the years, the Federal Circuit has created a jurisprudence of factors that, at most, correlate with the determination of exclusivity for a license. Since the title of the license or the appearance of certain buzz words are not dispositive, the court must determine the exclusivity of a license from its very words as well as the actual manner in which it is implemented.[42] For this determination, the court often looks to the extent of the rights retained by the patentee. The Federal Circuit found that an agency relationship between the parent and the subsidiary makes the subsidiary reliant on the parent for direction with the patent and thus is not an exclusive licensee.[43] Furthermore, even when a parent needs to obtain the subsidiary's consent to grant another license, the Federal Circuit has ruled this is not exclusive enough for standing, as the subsidiary does not have true veto power and the parent actually still possesses the exclusionary power of the

38. *Morrow*, 499 F.3d at 1339–40.

39. *Id.*

40. *Id.* at 1340.

41. *See id.*

42. *See* Intellectual Prop. Dev., Inc. v. TCI Cablevision of Cal., Inc., 248 F.3d 1333, 1344 (Fed. Cir. 2001) ("The title of the agreement at issue, which uses the term 'license' rather than the term 'assignment,' is not determinative of the nature of the rights transferred under the agreement; actual consideration of the rights transferred is the linchpin of such a determination."); Ortho Pharm. Corp. v. Genetics Inst., Inc., 52 F.3d 1026, 1032 (Fed. Cir. 1995)

> ("Thus, a licensee with proprietary rights in the patent is generally called an 'exclusive' licensee. But it is the licensee's beneficial ownership of a right to prevent others from making, using or selling the patented technology that provides that foundation for co-plaintiff standing, not simply that the word 'exclusive' may or may not appear in the license.").

43. Rite-Hite Corp. v. Kelley Co., Inc., 56 F.3d 1538, 1553–54 (Fed. Cir. 1995).

patent.[44] The court has also ruled that a restraint on the subsidiary's ability to transfer its interest in a patent is a strong indicator of non-exclusivity and lack of control over that interest.[45] The fact that a company is, and may have always been, the only licensee has been held to not be dispositive of exclusivity.[46] Even the transfer of the unilateral right to sue infringing parties is merely an indicator of exclusivity.[47]

However, the Federal Circuit has ruled that a license can be exclusive even though the parent company still retains (1) a reversionary interest in the patent in the event of bankruptcy, (2) the ability to obtain patents in other countries, (3) the ability to veto sublicenses, (4) the right to receive infringement damages, and (5) the right to be informed of all lawsuits.[48] Furthermore, multiple entities can be granted exclusive licenses, so long as the licenses are restricted to separate geographical territories.[49]

This survey of the case law of the Federal Circuit only begins to reveal the complexity of the balancing tests employed to determine exclusivity. Many of these factors will weigh against each other with no clear hierarchy emerging as to which is more persuasive. With so many factors in play, all with countervailing merits on exclusivity, district courts seem to have wide discretion in granting status as an exclusive licensee—one factor can easily influence the equation and shift the balance. Under these conditions, businesses are gambling as to how much power they may retain in the parent companies while maintaining an effective transfer of an exclusive license. Businesses would like to be able to decrease the unpredictability of this risk so they can better calculate their business allocations and operations. To that end, businesses desire that their subsidiaries at least have a more calculated chance to be considered an exclusive licensee, especially given their close relationship with the parent company.

C. Emerging Recognition of Close Business Relationships

The previous section's discussion of case law and the quagmire of rights necessary to trigger standing for a subsidiary appears daunting. Companies are still employing this subsidiary approach to manage patents but are losing millions of dollars in lost profits from infringements. The Federal Circuit seems slow, if not openly resistant, to adapt its jurisprudence to the reality that companies are becoming more complex and multi-faceted. The current reality is that businesses exist as multiple, smaller subsidiaries act-

44. Propat Int'l Corp. v. RPost Inc., 473 F.3d 1187, 1194 (Fed. Cir. 2007); *Morrow*, 499 F.3d at 1343.

45. *Propat Int'l Corp.*, 473 F.3d at 1194; *Morrow*, 499 F.3d at 1342–43.

46. Bicon, Inc. v. Straumann Co., 441 F.3d 945, 956 (Fed. Cir. 2006).

47. Rite-Hite Corp. v. Kelley Co., Inc., 56 F.3d 1538, 1553 (Fed. Cir. 1995); *Propat Int'l Corp.*, 473 F.3d at 1194.

48. Vaupel Textilmashinen KG v. Meccanica Euro Italia SPA, 944 F.2d 870, 875–76 (Fed. Cir. 1991).

49. Weinar v. Rollform, Inc., 744 F.2d 797, 806–07 (Fed. Cir. 1984).

ing somewhat independently but overall for the betterment of the whole umbrella corporation. The patent laws seem antiquated; assigning patent rights to separate legal entities acting in specific capacities (such as production, distribution, marketing, etc.) for the patent holder seems to be a forbidden, but extremely close, corollary to the permissive dividing of patent rights between departmental lines within a single company. This distinction prevents companies from fully recovering from infringement and may even be allowing the infringing company to keep some of the benefit from its infringing behavior.

A few cases, however, have recognized the tension between current standing jurisprudence and emerging business trends. In *Ricoh Co., Ltd. v. Nashua Corp.*, the parent company, Ricoh Ltd., and its subsidiaries were allowed standing to sue for lost profits from infringement.[50] Ricoh Ltd. had two subsidiaries, one acting as its distribution arm and one acting as its manufacturing arm.[51] Neither subsidiary was expressly granted an exclusive license to manufacture or distribute.[52] Rather than finding this was only a non-exclusive license granted to a subsidiary, the district court took into account the close business relationship between the subsidiaries and the parent company to determine that there was clearly an implied exclusivity in the license.[53] While implied exclusive licenses were not entirely new, the notion that the close business relationship between the two companies was sufficient to imply exclusivity was a relatively new idea. In *Ricoh*, a court finally realized the truth of these subsidiaries—modern companies establish subsidiaries as a means of dividing their responsibilities and are unlikely to compete against themselves by granting non-exclusive licenses to both their own subsidiaries and their competitors. This precedent, unfortunately, was not in the Federal Circuit and thus had very little traction in the legal world.[54]

In *Aspex Eyewear, Inc. v. Altair Eyewear, Inc.*, an unpublished 2008 opinion, the Federal Circuit also acknowledged that the close business relationship between subsidiaries and their parent organization could be enough, given the correct context, to prove an implied exclusive license.[55] In *Aspex*, the court upheld the district court's refusal to grant summary judgment denying standing to a subsidiary.[56] The district court found that a

50. 947 F. Supp. 21 (D.N.H. 1996).

51. *Id.* at 24.

52. *Id.*

53. *Id.* ("Therefore, while REI is a separate and distinct corporate entity, it is not a mere licensee; rather, it is a wholly-owned subsidiary that functions as plaintiff's manufacturing arm.").

54. The Federal Circuit has exclusive, nationwide jurisdiction over patent claims. While a district court will be persuasive to others, only the precedent of the Federal Circuit and the United States Supreme Court carries binding authority. *About the Court*, The United States Court of Appeals for the Federal Circuit, http://www.cafc.uscourts.gov/the-court/court-jurisdiction.html (last visited Apr. 25, 2011).

55. 288 F. App'x 697 (Fed. Cir. 2008).

56. *Id.* at 706.

genuine issue of material fact existed as to whether the subsidiary had an implied or oral exclusive license due to the presence of a close business relationship with the parent company.[57] The Federal Circuit ruled that the fact that both subsidiaries were "owned by members of the same family and have a close business relationship"[58] could be enough to show, in context, that the parent company meant for the otherwise non-exclusive licenses to be exclusive.[59]

While *Aspex* does not automatically grant subsidiaries standing with the parent company, the Federal Circuit at least appears willing to recognize an argument that the emerging business practice of using subsidiaries can be meshed with the need to adhere to precedent on standing. The court may have been trying to signal that it was establishing a narrow means by which to recognize standing for subsidiaries that function as simple extensions of the parent company, rather than denying them outright as it had done four years earlier in *Poly-America, L.P. v. GSE Technology, Inc.*[60] Aspex does not clearly overrule *Poly-America*, but it seems to be placing an unprecedented amount of importance on a close business relationship, especially when that relationship was given no credence four years earlier.[61] Unfortunately, both its procedural posture (the court was only ruling that a genuine issue of material fact as to standing existed) and its demarcation as an unpublished opinion limit *Aspex*'s precedential value. Nevertheless, this could be perceived as a step toward realizing the need for subsidiaries to recover lost profits for infringement when they function as arms of the parent companies.

This seeming shift in jurisprudence comes at a very interesting time. As the next part examines, the Federal Circuit seems to have also opened the door to allowing parents to prove that profits from their wholly-owned subsidiaries would flow inexorably into the parent's coffers. This possible allowance makes sense as the next logical step in the progression toward recognition of a subsidiary's standing to sue for lost profits due to its close business relationship with its parent company.

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57. *See id.*

58. *Id.*

59. *See id.*

60. Poly-America, L.P. v. GSE Technology, Inc., 383 F.3d 1303, 1311 (Fed. Cir. 2004)

> ("Even though Poly-America and Poly-Flex seem to share interests as two entities collaborating in the manufacture and sale of textured landfill liners, that relationship by itself is not sufficient to permit Poly-America to claim Poly-Flex's lost profits from Poly-Flex's lost sales. Poly-America and Poly-Flex *have a common parent corporation and are not simply divisions of a single corporation, but are separate corporate entities. 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.*")

(emphasis added).

61. *Aspex Eyewear, Inc.*, 288 F.3d at 706; *Poly-America*, 383 F.3d at 1311.

IV. Foundation for a Potential Revival of Wholly-owned Subsidiaries

As the previous part explored, the Federal Circuit has never expressly ruled that it would allow a parent company to prove that a loss from a subsidiary would be passed onto the parent, creating a *de facto* loss to the parent company. The court has alluded, however, to the factual possibility that a parent company may be able to prove and recover damages from lost profits that would have gone directly from a subsidiary to the parent company. Because the court has yet to rule on this factual possibility, many questions remain, including how direct the parent's loss of profit must be or if any evaluator besides cash (i.e., loss of tax deductions) would be allowed as a compensable loss to the parent company. The court's new language represents a fairly significant departure from its original stance on the standing of subsidiaries to sue for lost profits due to infringement. An examination of the line of cases leading up to this potential shift helps illustrate the rationale and progression of the jurisprudence governing a subsidiary's standing.

Ironically, the case that first hinted at the possibility of a factual finding that the parent company suffered a direct loss from the subsidiary's lost profits was also the case that adamantly denied recovery based upon the close business relationship.[62] In *Poly-America*, the Federal Circuit admitted, "recovery of lost profits by a patentee is not limited to the situation in which the patentee is selling the patented device."[63] The court ruled that, in order to claim lost profits, the "patentee needs to have been selling some item, the profits of which have been lost due to infringing sales."[64] Since Poly-America (the parent) was not selling "any item on which it" claimed damages, Poly-America failed the first criteria and thus was barred from claiming any lost profits.[65] Furthermore, the court rejected the theory that a subsidiary's lost sales were legally compensable to the licensor.[66] The court, however, conceded that Poly-America might be able to recover damages *if* Poly-America could factually show it suffered lost profits from the infringement.[67] The court did not provide any guidance on how to prove direct damages, but rather remanded the case for the district court to make a factual determination on the issue.[68] While the court's language was slightly encouraging, the clear rejection of a parent's ability to claim a subsidiary's lost profits seemed to shut the door on any recovery short of the subsidiary being granted an exclusive license.

62. *Poly-America*, 383 F.3d at 1311.
63. *Id.*
64. *Id.*
65. *Id.*
66. *Id.*
67. *Id.*
68. *Id.* at 1312.

In 2008, however, the court seemed to reopen the argument on the parent's ability to claim a subsidiary's lost profits as its own. In *Mars, Inc. v. Coin Acceptors, Inc.*, the Federal Circuit was again confronted with a parent corporation trying to recover lost profits through a wholly-owned subsidiary.[69] Mars argued that "by virtue of the parent-subsidiary relationship and its consolidated financial statements, 'all MEI's lost profits were *inherently* lost profits of Mars.' "[70] The close business relationship consisted of the subsidiary paying a royalty to the parent corporation based on gross sales of machines using the patented technology.[71] Mars's theory was that, had the infringement not occurred, the subsidiary's profits would have flowed directly to the parent corporation. The court, surprisingly, entertained this legal theory, and upheld only the district court's denial for lost profits based on a factual determination that Mars did not show the subsidiary's profits would flow directly into the parent company. In fact, the court's language suggests that recovery on this theory may be permissible: "we, like the *Poly-America* court, need not decide whether a parent company can recover on a lost profits theory when profits of a subsidiary actually *do* flow inexorably up to the parent."[72] The court simply held that the "facts of [the] case cannot support recovery under a lost profits theory."[73] The court did say that, while determining lost profits is a very factually specific determination, a parent's mere ownership and control of a subsidiary was not enough to show that the profits flowed inexorably to the parent company.[74]

The Federal Circuit's thorough analysis of Mars's theory that a parent may recover a subsidiary's lost profits if those profits would have inexorably gone to the parent seems to open the door to future claims of a direct loss theory based upon a close business relationship.[75] Furthermore, the Federal Circuit's inclusion of *Poly-America* in its statement accepting Mars's legal theory may even suggest a slight retreat from the hard-line rejection of an almost identical legal theory in that case. Rather, the court now seems willing, due to the emerging existence of subsidiaries and their use of patents to help the parent company, to grant legal validity to arguments that parent companies should be allowed to show a direct loss occurred due to the close business relationship. This appears to be a compromise between the need for a parent company to show a direct causation for damages through lost profits and the court's realization that these subsidiaries may exist to primarily function as a division within the parent

69. 527 F.3d 1359 (Fed. Cir. 2008).
70. *Id.* at 1367.
71. *Id.*
72. *Id.*
73. *Id.*
74. *Id.*
75. *See* Robert A. Matthews, Jr., *Legal Nuances when a Patent-Holding Company Seeks to Enforce a U.S. Patent*, 49 IDEA 549, 555 (2009).

company. While not a retreat from the direct causation standard, this new language may be granting companies a new avenue by which they can prove the parent directly lost profits due to the infringement of its subsidiary's product.

Since *Mars*, at least one district court has recognized the possible shift in the Federal Circuit's jurisprudence. The District of Hawaii interpreted the *Mars* decision as affirming that "[a] parent company that holds an infringed patent may only recover the lost profits of its subsidiary where it shows that the profits of its subsidiary flow 'inexorably' to the parent."[76] The district court ruled that, even though a sole proprietor owned both the parent and the subsidiary and he could move the funds between the two as he saw fit, there was no evidence that the profits would "inexorably" flow to the parent company.[77] The court was not willing to equate "inexorably" with possible, or even "standard" or "usual" practices.[78] Rather, the court needed express "evidence of inexorability, either contractual, structural or historical," before it would allow the parent to claim lost profits from its subsidiary.[79]

In application, the new language from *Mars* appears to have been implemented with some reservation, requiring a definite showing that the profits would have gone to the parent company. However, the phrasing of profits that "flow inexorably" up to the parent company need not be limited to strictly wholly-owned subsidiaries.[80] Rather, so long as the patentee can show that the subsidiary company's profits from the infringed patent would have been transferred to the patentee's company, courts may be willing to grant lost profits due to the commercial relationship.[81] The scope of *Mars* will likely be limited, if not isolated, until the Federal Circuit directly defines it. The expansion of the legal theory of causation, however, at least breathes life back into a subsidiary's ability, especially one with a close relationship with its parent company, to recover lost profits, even without being joined to the lawsuit. A parent company may now be able to recover the lost profits of not just its subsidiaries, but possibly even unrelated companies with which it maintains only a commercial relationship.[82]

76. Kowalski v. Mommy Gina Tuna Res., 574 F. Supp. 2d 1160, 1163 (D. Haw. 2008).

77. *Id.* (discussing a possible hypothetical scenario where an "S" corporation may not distribute its profits to the parent company).

78. *Id.*

79. *Id.*

80. Matthews, *supra* note 75, at 556.

81. *Id.*

82. *Id.* (positing this as a possibility, but then admitting that "[w]hether practical realities of the business world will permit a patentee to structure an arrangement with an unrelated nonexclusive licensee—that has a measure of the licensee's profits that flow inexorably to the patentee—presents a question beyond the scope of this Article.").

V. Unanswered Questions from *Mars*

Like any emerging legal theory, this apparent shift in the Federal Circuit's jurisprudence has left many questions unanswered about the actual implementation of this new recovery theory. The Federal Circuit appears to have opened the door for parent companies to theoretically prove their personal losses but left no guiding principles other than existing remedies law to guide the lower courts. The real definition of this doctrine, at least until the Federal Circuit decides to correct it, will be established in the factual realm of the district courts. First, the courts will need to define the evidentiary burden a parent company must meet to show the subsidiary's profits "flow inexorably" to the parent. Additionally, the benefits transferred from a subsidiary to a parent company often entail more than mere cash flow. The courts will likely have to determine if profit includes all benefits that were denied to the parent company due to the infringement, or if it is limited to the percentage of profit that would have flowed to the parent company absent the infringement.

A. *"Flow Inexorably"—A Problem of Definition*

Up to this point, the Federal Circuit's guidance has been limited; it has simply stated that a parent company may recover when profits would "flow inexorably" from the subsidiary to the parent.[83] This language, although seemingly instructive, does not define the necessary nexus between the two companies' profits. The district courts will have to set their own parameters for the evidentiary burden of proving that the profit would move from the subsidiary to the parent.

As discussed *supra*,[84] a district court in Hawaii has already ruled that there must be a guarantee that the profit will flow into the parent company's coffers.[85] The court required contractual, structural, or historical evidence that the profits would go to the parent company—mere possibility or even a standard practice was not enough.[86] Even this definition, however, seems to allow for both explicit and implicit assurances that the profits will flow to the parent. Explicit assurances are often easily understood and definable—if a contract or agreement provides for the transfer, then the parent can recover. Implicit assurances, however, likely require a heavy reliance on circumstantial evidence to prove the profits would have been transferred to the parent company—in one case, even the presence of structural mechanisms was insufficient.[87]

83. Mars, Inc. v. Coin Acceptors, Inc., 527 F.3d 1359, 1367 (Fed. Cir. 2008).
84. *See supra* Part IV.A.
85. Kowalski v. Mommy Gina Tuna Res., 574 F. Supp. 2d 1160, 1163 (D. Haw. 2008).
86. *Id.*
87. *Id.* (holding that a structure that allowed a sole proprietor to decide to not transfer profits from a subsidiary to the parent was not sufficiently guaranteed).

Historical evidence of past corporate practices seems to be prone to more liberal interpretation. Acceptance of historical evidence of habitually transferring the profits from subsidiary to parent seems to suggest that the court is not requiring strict assurances that the transfer would have actually occurred, but rather only a high likelihood of transference based upon previous conduct. Circumstantial evidence may be all that is required to prove that the profits will "flow inexorably" to the parent company.

Kowalski is only one court's interpretation. Other districts could easily take a harder stance and require more direct proof. They could arguably disallow any circumstantial evidence and only allow evidence that would give strict assurance that the money was destined to go to the parent company. Both approaches would seem to be reasonable understandings of the Federal Circuit's intention but still present the same type of unpredictability that was originally problematic in defining a subsidiary's status as exclusive. This will likely be an issue that the Federal Circuit will have to consider and define in the next few years.

B. The Scope of Profit: Accounting Profit Versus Economic Profit

While many of the practical, purely logistical questions will be answered by the district courts, a bigger question remains: What can be included within the understanding of "lost profits"? Lost profits could be limited to cash transfers or it could include other benefits that would have been conferred upon the parent company had the subsidiary's rights not been infringed. Parent companies gain many advantages from their corporate setup and they are, theoretically and actually, directly damaged when their subsidiaries lose profits. This economic benefit can come in the form of a financial gain, but also in the form of a cost saved, such as having to pay less on a loan to the subsidiary or decreasing the need to subsidize the subsidiary's actions. These benefits can also be impacted by infringements.

The civil remedy for patent infringement is meant to make the plaintiff whole after the infringement. In fact, the statute provides that the goal is to "award the claimant damages adequate to compensate for the infringement."[88] The *Mars* court recognized the broad nature of the recovery statute.[89] However, as the company only sought lost profits in monetary terms, the court seems to have restricted its discussion to those terms.[90] The tension between the goal of complete recovery and the traditionally limited framework of lost profits prompts the discussion of expanding the definition of profits to alleviate that tension and to include restoration of all lost benefits to the parent company.

88. 35 U.S.C. § 284 (2006).

89. Mars, Inc. v. Coin Acceptors, Inc., 527 F.3d 1359, 1366 (Fed. Cir. 2008).

90. *Id.* ("Nevertheless, Mars expressly elected to pursue only lost profits and reasonable royalty theories, and it stipulated that it would not seek 'any other damages other than lost profits or a reasonable royalty.'").

Economic profits capture the value from any deal, which can be more than the profit line on an income statement. Economic profit is the difference between the benefits conferred minus the opportunity cost.[91] The loss in benefits would be considered the opportunity cost, as they should have been realized by the best alternative—no infringement. The lost benefits are the benefits that the subsidiaries would have conferred on the parent company in the form of some source of financial gain, whether it be royalties, tax benefits, increased ability to cover the start-up cost of the subsidiary, or greater financial independence from the parent company.[92] These economic rents may not be recognized in traditional accounting profits, but are still benefits conferred on the parent company and would be captured with an economic profit analysis.

This distinction between profits does not come into play if the parent can prove that the financial gain from the subsidiary's profits would have flowed directly into the parent company.[93] Depending on how strictly district courts define "flow inexorably," parent companies may struggle in establishing a direct linkage. At a minimum, a parent company may seek to recover the cash that would have inexorably flowed into its coffers had the subsidiary realized the lost profits. Unfortunately for the parent company, this amount may be less than the actual damage, though it is better than just receiving a royalty. The opportunity cost of the infringement to the parent company is an actual, personal damage and should be compensable, especially considering the goal of the patent legislation to make the claimant whole. The likelihood of the conferral of these economic rents on the parent company would be easier to prove, as they could take many forms and would likely be the very benefit sought when the parent chose a subsidiary organizational structure.

The allowance for recovery of economic profits would seem to be a neutral position between the goal of making the claimant whole again and the need to restrict awards to direct damages. This recognition would also increase predictability in companies' awards for patent infringement suits—they could be assured they would have the opportunity to capture the entire value from their choice to utilize subsidiaries. The *Mars* court, however, chose to limit its discussion to recovery for direct lost profits, which is a traditional framework for recovering infringement damages.[94] Furthermore, due to the added difficulty of capturing the full value of a business arrangement rather than simply the cash value of lost profits, courts may simply

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91. *See* DOMINICK SALVATORE, MANAGERIAL ECONOMICS IN A GLOBAL ECONOMY 339 (6th ed. 2007).

92. *See supra* notes 5–19 and accompanying text in Part II for a discussion of these economic benefits.

93. *See* St. Jude Med., Inc. v. Access Closure, Inc., No. 08-CV-4101, 2010 WL 4968147, slip op. at *6 (W.D. Ark. Dec. 1, 2010).

94. *Mars, Inc.*, 527 F.3d at 1366.

avoid the problem entirely by requiring a clear, inevitable flow of cash from the subsidiary to the parent in order for the parent to recover the subsidiary's lost profits.[95] The fight between economic profits (and the loss of benefits that would have been conferred directly upon the parent company had there been no infringement) and mere accounting profits will likely necessitate uniformity among the districts, requiring the Federal Circuit to rule on this issue.

VI. Conclusion

Over the past century, intellectual property has emerged as a mainstay for many businesses. Companies guard their proprietary trade secret information with great fervor, often going to extreme measures to edge out their competition. Within intellectual property, however, patent law has proven to be an incredibly important facet of the business world.[96] Patent law is often the only way to ensure that a company's product is protected from being copied or infringed upon, stealing away coveted market share. In fact, the fate of many companies lies most profoundly in their ability to retain and enforce their patents. All product-oriented companies need to be able to exclude others from using their products and be allowed an avenue to seek redress from a company wrongfully using their patented technology.

Congress knew of this business need and enacted laws to grant specific monopoly power to companies and equipped the law with the proper means by which to seek remedies against infringing parties. Congress meant for these laws to deter theft or infringement of business intellectual property, as well as to make the infringed party whole again after the illegal act.[97] The law was apparently meant to be flexible to ensure full recovery and protection. Knowing that they could never write a law that would accommodate all changes in the business world, Congress trusted the courts to interpret the patent law in a manner that would be true to both the wording and the intention behind the laws. The courts, while certainly not failing in this regard, arguably may have fallen behind the realities of the business world.

Businesses are using subsidiary companies as they used divisions and departments in previous eras. This structure allows the parent company to outsource the duties to smaller entities within the company (as opposed to keeping all aspects of every product within the same company) without necessitating direct oversight from headquarters—allowing economies of

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95. The practical limits of recovery due to problems showing direct causation and other factual evidentiary problems may also prompt the courts to follow an economic profit theory, but in practice adopt a *de facto* accounting profit theory if they consistently rule that companies cannot show the added benefits would have "flowed inexorably" to the parent company. Evidentiary problems like that may make this distinction moot, but at least the acceptance of an economic profit theory would allow companies the opportunity to attempt to prove and recover lost profits.

96. David A. Allgeyer, *Protecting Your Company's Most Important Assets*, RiskVue (Sept. 2002), http://www.riskvue.com/articles/rb/rf0209b.htm.

97. 35 U.S.C. § 281 (2006); *see* 35 U.S.C. § 284 (2006).

learning and specialization to be more quickly achieved. Furthermore, this structure provides tax gains as well as increased liability protection and intellectual property security.[98] This structure has netted greater efficiency for businesses and has become a lucrative option for expanding businesses.

The courts, however, have been slow to recognize the close business relationship and common purpose of some of these subsidiaries. They have refused, or simply felt it beyond their authority, to amend their jurisprudence to acknowledge the changing business world. The Federal Circuit, however, finally seems willing to recognize the emerging business model of using subsidiaries. It allowed the close business relationship to imply an exclusive license, allowing the subsidiary standing to join suit for lost profits. More importantly, the Federal Circuit signaled that parent companies may recover lost profits that would "inexorably flow" from the subsidiary into the parent company.

The *Mars* decision marks a dramatic shift in jurisprudence and broadening in scope of recovery that will likely have far-reaching implications. Businesses may no longer need to live in fear that their subsidiaries will not be able to join in lawsuits for lost profits due to an unpredictable, factually intensive balancing test that places millions of dollars and companies' entire futures at the mercy of the district court's factual findings. Rather, businesses can now try to grant their subsidiaries exclusive licenses, yet have alternative theories for recovery if the court deems them to have failed to convey legal title to the subsidiary—they can now sue for their subsidiaries' lost profits in their own name if they can show the profit would have gone to the parent companies. Businesses will be free to continue to reap the benefits of their internal organizational structuring without having to worry they will not be able to recover patent infringement awards.

Apart from recognizing the business world's need for, and widespread use of, subsidiaries, this shift in jurisprudence may also rectify the current failure to account for all of the damages that are caused by an infringement. In the current framework, neither the parent nor the subsidiary is made whole after the infringement—they are not allowed full *economic* recovery. This is in tension, if not contradiction, with the intent of Congress by creating civilly enforceable patent rights. Furthermore, the lack of recovery suggests the infringing party is getting the better part of the bargain—it is being allowed to disgorge (pay in damages) less than the benefit it received from infringing. This result certainly does not discourage patent infringement, as businesses may start to realize they can make a profit by infringing. The *Mars* precedent is likely an attempt to correct the unintended consequence of incentivizing patent infringement (or, at the very least, reverse the decreasing deterrence to patent infringement) by providing companies more theories on which they can recover their full loss.

98. *See supra* Part II.

As monumental as this shift may have been, businesses still have reason to be conservative when interpreting *Mars*. The Federal Circuit has only begun to explain the scope and breadth of this new allowance for recovery. There are still many questions to be answered and it will take trial and error coupled with strategic and creative legal thinking to test and chart these unprecedented waters. While the future of patent awards may have been dismal in the past for parent-subsidiary organizations, the Federal Circuit appears to be showing at least a glimmer of hope that a safe harbor of recovery may actually exist within the close business relationship of these organizations. So, while not totally revived, businesses can again be hopeful that they will be able to have the best of both worlds—all the benefits of subsidiaries plus the full protection of their patents. Consequently, there may be life on *Mars* after all . . . for subsidiaries, at least.