

Infringement, Licensing & Operational Problems With IP Holding Companies: An Australian Perspective

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It is not unusual for reasons including administrative efficiency, tax planning, or protection against insolvency to establish a company within a group to be the owner of all intellectual property owned by group companies. The consequences of such structuring are not always carefully considered. This article considers some issues relating to:

- infringement and like proceedings
- licensing; and
- operational matters,

where all patents, trademarks, copyright and designs of a group are held by a separate company, whose only function is to hold and manage those assets (IP holding company). There are significant other issues that need to be considered but are beyond the scope of this article.

PATENTS Infringement

The decision of the United States Court of Appeal for the Federal Circuit in *Poly-America, LP v. GSE Lining Technology, Inc.* (GSE) 383 F.3d 1303 (cir 2004) is a reminder of the difficulties that an IP holding company can suffer when seeking to recover damages for infringement of patent rights held by it, but exploited by group companies. Similar difficulties arise in Australia, and will be discussed below.

Poly-America Case

In the Poly-America case, relevant patents were held by Poly-America. Poly-America commenced infringement proceedings in respect of those patents against GSE. GSE was found by the United States District Court

for the Northern District of Texas to have infringed the relevant patents. Among the remedies awarded to Poly-America were damages of US\$7.15 million in lost profits.

The issue that the Appeals Court had to consider was whether the District Court improperly permitted Poly-America to recover lost profits on sales made by Poly-Flex, a related sister corporation—there being no sales of relevant products by Poly-America.

Arising from the Appeals Court judgment, it appears that Poly-Flex was a non-exclusive licensee of the relevant patents from Poly-America and in that capacity, it was granted certain contractual rights including a right of enforcement concerning claims to past damages as well as the right to sublicense. Poly-Flex was entitled to, and did, assign those rights to Poly-America; Poly-America was also entitled to collect damages accruing from any infringement of the relevant patents.

Position Under U.S. Law

Section 284 of Title 35 of the United States Code provides that a patentee shall be awarded “damages adequate to compensate for the infringement, but in no event less than a reasonable royalty.” While the Appeals Court agreed that the relevant compensation could include lost profits, it also held that a “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.” As such, the Appeals Court concluded that in the present circumstances, the District Court

had misapprehended the law of damages and remanded that aspect of the case for consideration by the District Court.

In the course of its judgment, the Appeals Court made the following interesting observations:

(a) In response to Poly-America’s argument that Poly-America and Poly-Flex operated as a single economic unit for the purposes of production, marketing and sales of the patented liner, and as such, shared a “unity of interest,” the Appeals Court stated “that relationship by itself is not sufficient to permit Poly-America to claim Poly-Flex’s lost profits from Poly-Flex’s lost sales.”

(b) “Poly-America and Poly-Flex may not enjoy the advantages of their separate corporate structure and at the same time avoid the consequential limitation of that structure—in this case the inability of the patent holder to claim lost profits of its non-exclusive licensee.”

(c) That as regards licensees, only exclusive licensees have the right to sue for infringement and as such, claim damages. In the present case, as Poly-Flex was only a non-exclusive licensee, it had no entitlement under the patent statutes to itself recover loss of profit damages for any losses it incurred

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due to infringement. Additionally, the fact that the licence agreement provided that Poly-America had the right to “collect all damages accruing to Poly-Flex,” did not change that position. Simply put, therefore, a contract cannot create rights that do not exist at law and that even if Poly-Flex was added as a party to the proceedings, it would not have had the necessary standing to claim damages for infringement, as it was not an exclusive licensee of the relevant patents.

Position Under Australian Law

The position in Australia is similar to that in the Poly-America case. Section 122 of the Australian Patents Act 1990 (Patents Act) provides for relief that includes either damages or an account of profits. The U.S. and Australian concept of damages (as opposed to “account of profits”) is the same, in that in each country they are a court awarded sum of money which seeks to place a plaintiff in a position they would have been in had the relevant legal wrong not occurred—that is, they are a measure of the plaintiff’s loss and not the defendant’s gain. As in the Poly-America case, an Australian patentee would therefore be entitled to its lost profits under the umbrella of “damages” as long as the patentee sold some products, the profits of which would have been lost due to the infringing sales.

Section 120 of the Patents Act provides that the only parties entitled to commence infringement proceedings are the patentee or an exclusive licensee. Thus as in the Poly-America case, an Australian patentee who sought to recover damages on the basis of lost profits sustained by a non-exclusive licensee would also not be successful in such a claim. The only claims of a licensee that would be recognized by a court would therefore be those of an exclusive licensee or an assignee of the rights of an exclusive licensee.

Practical Implications

The Poly-America case is a clear reminder that in seeking to establish an IP holding company in a corporate group structure, a crucial

question which must be asked in the context of patents is—“what if patent infringement proceedings have to be commenced?” In answering such a question, the following lessons, arising from the Poly-America case, are relevant in both an Australian and U.S. context:

The only parties entitled to commence patent infringement proceedings and recover damages are the relevant patent holder, their exclusive licensee or any assignee of the relevant rights held by such parties.

(d) A patent holder cannot recover damages referable to lost profits sustained by its licensees.

(e) Where a licence is not an exclusive licence, a patent holder cannot by contract create in that licensee a right to initiate infringement proceedings and recover damages.

Licensing

Whilst the decision in the Poly-America case does not consider what is required for a licensee to be an “exclusive licensee,” this is a fundamental issue that needs to be considered in any group company structure involving a patent holding company. The issue centres around whether under relevant patent legislation, there can ever be more than one exclusive licensee of a patent. For example, whether one group company can be given the exclusive right to make a product and another be given an exclusive right to sell that product, with each of them being viewed as “exclusive licensees,” or whether one group company can be given the exclusive right to exploit an invention in respect of human health applications and another be given the exclusive right for animal health applications and each of them be viewed as “exclusive licensees” for the purposes of relevant patent legislation. This is a difficult question on which courts in Australia have expressed differing views.

TRADEMARKS Infringement and Like Proceedings

Registered Trademark

The analysis which follows is

based on facts identical to the Poly-America case but referable only to a registered trademark. In particular, it is assumed that:

(a) the IP holding company has not sold any products bearing the relevant registered trademark;

(b) all sales of such products were made by a member group company in its capacity as a non-exclusive licensee of the IP holding company; and

(c) the member group company had been granted certain contractual rights including the right to commence infringement proceedings; it was also entitled to and did assign those rights to the IP holding company. The IP holding company was also entitled to collect the damages accruing from any infringement of the registered trademark.

Section 126 of the *Trademarks Act 1995 (Trademarks Act)* is for relevant purposes identical to section 122 of the Patents Act in that it provides for relief that includes damages or an account of profits.

A combination of sections 20 and 26 of the *Trademarks Act* mean that each of the registered owner of a trademark, and subject to any agreement to the contrary, an “authorized user” of a relevant trademark may bring an action for infringement. In the case of an “authorized user,” subject to any agreement to the contrary, that entitlement arises:

(i) at any time with the consent of the registered owner; or

(ii) during two months from the day on which an authorized user asks the relevant registered owner to bring an action, if the registered owner refuses to bring such action during that period; or

(iii) following expiration of the two months referred to above, if the registered owner has failed to bring such action during that period.

Whilst the definition of “authorized user” will be considered in greater detail below under the heading “Licensing,” for present purposes, it is important to note the following: firstly, that unlike in the case of patents, an “authorized user” does not need to have any

rights of an exclusive nature, comparable to an “exclusive licensee,” in order to have the necessary standing to bring infringement proceedings. Secondly, the right to bring infringement proceedings, must not be excluded in any agreement between an IP holding company and member group companies that are “authorized users,” otherwise not only will those rights be lost to the relevant member group companies, but they will also not be available for assignment to the IP holding company. The implications of the preceding in the context of the above assumed facts are that whilst the IP holding company will still not be able to recover damages referable to lost profits sustained by a member group company, the member group company will either be able to recover those damages in its own right or be able to assign its right to recover such damages to the IP holding company.

Thus, subject to issues relating to “authorized users” discussed below, an IP holding company is in a much stronger position to recover damages or an account of profits arising from infringement of a registered trademark than is the case arising from infringement of a patent.

Common Law Trademarks

For the purposes of this article, common law trademarks are trademarks that are neither registered as trademarks under the *Trademarks Act*, nor are they subject to an application for registration under that Act. At common law, such trademarks cannot be assigned separately from the goodwill of the business in which the trademarks are used. Registered trademarks and trademarks whose registration is being sought, may however be assigned with or without the goodwill of the business in which such trademarks are used.

The principal right of action given to owners of common law trademarks is that in “passing off.” The premise of an action in “passing off” is to protect the goodwill of a business. The very nature of an IP holding company is that it does

not conduct any business referable to the activities of the group—its sole function is to hold and manage relevant intellectual property. Thus, both because common law trademarks cannot be assigned separately from the goodwill of the business in which the trademarks are used and because IP holding companies do not conduct any business referable to member group companies, common law trademarks are not suited to being held by an IP holding company.

Licensing

The legal effectiveness of an IP holding company in the context of registered trademarks depends on whether following the transfer of the registered trademark to the IP holding company:

(a) the relevant member group companies are “authorized users” within the meaning of the Trademarks Act, or put it another way, whether the relevant group member companies use the relevant registered trademark in relation to goods or services “under the control” of the IP holding company (Control Issue);

(b) the use of the registered trademark is likely to deceive or cause confusion (Deception Issue);

(c) the registered trademark is and remains distinctive of the IP holding company (Distinctiveness Issue).

If the answer to any of these questions is “no,” then the validity of the relevant registered trademark is at risk. Each of the above issues are considered briefly below.

Control Issue

Section 8 of the *Trademarks Act* 1995 defines “under the control” in a non-exhaustive manner which includes two examples. The first is where the trademark owner exercises “quality control over the relevant goods or services” and the second is where the trademark owner exercises “financial control over the relevant licensee’s trading activities.” Australian courts have however accepted broader interpretations of “control,” interpretations that equate “control” with there being “sufficient connection” between

the user of the trademark and the owner of the trademark, particularly where those parties are members of the same group of companies. Failure to exercise the relevant control is significant in that it places a registered trademark at risk of being removed for non-use under section 92 of the Act. This risk arises because use by the relevant licensee will not be deemed to be use by the owner of the trademark for the purposes of section 7(3) of the Act.

As it seems most unlikely that there would be circumstances in which an IP holding company would exercise “financial control over the relevant licensee’s trading activities,” the choice of the type of control to be exercised by an IP holding company over member group companies would likely be out of “quality control over the relevant goods or services” of the member group company or relying on the “sufficient connection” approach mentioned above. Prudence, however, would dictate that the “quality control” approach be adopted. This would entail the appropriate quality control provisions being imposed on member group companies, and those provisions being properly enforced. Such provisions would normally be contained in a licence agreement.

Deception Issue

Section 88(2)(c) of the *Trademarks Act* entitles an aggrieved person to apply, among other things, for the cancellation of the registration of a trademark because at the time the relevant application is made, “the use of the trademark is likely to deceive or cause confusion.” Where a member group company that was previously the registered owner of a trademark becomes a licensee of that trademark and otherwise all other matters remain the same so far as purchasers of relevant goods or services are concerned, including the quality of the relevant goods or services, then subject to one reservation, there should not be significant cause for concern about section 88(2)(c). One reservation is discussed below in the context of the “Distinctiveness Issue.”

Distinctiveness Issue

The reservation referred to above relates to a basic concept of trademark law, that the relevant trademark must be distinctive of the goods or services of the relevant registered owner of the trademark. A risk that arises in the context of an IP holding company is that the trademark transferred to an IP holding company would continue to be distinctive of the member group company that is now the licensee. The existence of such a risk would be mitigated by the clear identification to the public that the relevant member company is now the licensee rather than the owner of the relevant trademark.

It would also be a mistake to view the risks arising from the application of section 88(2)(c) as merely theoretical. Competitors with similar marks whose registration has been thwarted, and former member companies that have been sold out of a group company structure and who covet the trademarks used within the relevant group are among the ready candidates for the role of “aggrieved person.”

COPYRIGHT & DESIGNS Infringement and Licensing

In the case of copyright and registered designs, the infringement and licensing position is summarized as follows:

(a) each of the *Copyright Act 1968* (*Copyright Act*) and the *Designs Act 2003* (*Designs Act*) provides damages or an account of profits as a remedy for infringement;

(b) a combination of section 115 and section 119 of the Copyright Act mean that each of the copyright owner and exclusive licensee of copyright may bring an action for infringement;

(c) under the Copyright Act an “exclusive licence” is defined to mean “a licence in writing... authorizing the licensee to the exclusion of all others to do an act, that by virtue of this Act, the owner of copyright would but for the licence, have the exclusive licence to do and ‘exclusive licensee’ has a corresponding

meaning. Thus, by reason of exclusivity being defined, by reference to each of the acts that the copyright owner is entitled to exercise—e.g. reproduction—it is clear that in respect each work in which copyright exists, there can be more than one exclusive licensee. As mentioned above, there is no such clarity in the case of patents;

(d) the only party entitled under the Designs Act to commence infringement proceedings is the registered owner of the relevant registered design.

Practical Implications

Arising from the preceding and assuming facts identical to the Poly-America case are referable to each of copyright and registered designs, the implications are as follows:

(a) the copyright owner will not be able to recover damages referable to loss of profits sustained by a member group company except as assignee of a member group company that is exclusive licensee of the relevant copyright work, and where the member group company is not an exclusive licensee, that member group company will not have the standing in its own right to recover damages. As mentioned above, however, there is a definitional difference between “exclusive licensee” in a patent context and in a copyright context;

(b) in the case of a registered design, an IP holding company will neither be able to recover damages referable to loss of profits sustained by a member group company, nor will the member group company have any standing to be compensated for its loss. Such an outcome means there is no merit in an IP holding company being used to hold registered designs as part of a larger intellectual property portfolio.

OPERATIONAL MATTERS Present or future property?

A key question to address in any proposed IP holding company structure is “what is the subject matter to be assigned to the IP holding company, and specifically is it subject matter that is presently in existence

or does it also encompass subject matter that will come into existence in the future?”—e.g. patents and patent applications in existence at a certain date only or those patents and patent applications together with patents and patents applications yet to come into existence. If an IP holding company is truly to be a repository of all patents and patent applications for a corporate group, then both present and future subject matter needs to be captured and properly administered.

Conflicting dealings with IP

Leaving aside the significant legal issue of properly assigning future rights, a significant operational issue that arises from having an IP holding company is to ensure that the IP holding company and the operational company which is the source of the relevant rights do not deal with the same subject matter in a conflicting manner. Problems commonly occur at both internal and external levels. At the internal level, it is not unusual for IP holding companies to grant exclusive licences to relevant intellectual property rights to group member companies on a territorial basis together with rights to relevant future intellectual property rights as they come into existence. Payments are made by those group member companies for those rights and those payment invariably have tax implications. At the same time, care must be taken to ensure that the operational company that is the source of the relevant rights does not continue to deal with those rights as if they are still the owner of those rights. Thus, for example, collaboration or licence agreements must not be entered into by such companies with third parties relating to the same subject matter as assigned to the IP holding company in a manner which conflicts with the rights granted by the IP holding company. If proper systems are not established to address such matters, then among the difficulties that can arise are those with tax authorities and with third parties claiming breaches of warranties, whether express or implied.

Title Documents

A further issue for consideration is the IP holding company's access to documents evidencing title to relevant intellectual property—e.g. laboratory notebooks, employee contracts and inventor assignments. A clear process relating to which company within the group holds such documents needs to be established and properly implemented. This is important in numerous contexts, including the efficient handling of infringements and the disposition of assets, whether separately or as part of an ongoing business.

Trademarks

Among the additional operational matters to be considered in the context of trademarks are having proper processes in place to ensure that:

(a) common law trademarks remain with member group companies that supply relevant goods or services under those trademarks and that those trademarks are properly used and managed by the relevant member companies;

(b) appropriate quality control provisions exist and are implemented vis-a-vis the goods or services supplied by member group companies under the trademarks licensed by the IP holding company.

Third Party Interests

As with any transaction involving the transfer of assets to another party, the transfer of intellectual property rights to an IP holding company will need to address the following questions:

“Whether, and if so, in what way, are the intellectual property rights that are being transferred, subject

to third party interests—e.g. rights of licensees, mortgagees and equitable assignees?”

This will require a due diligence investigation at least equivalent in rigor to that applying if the relevant intellectual property rights are being transferred to a company outside the group structure. Among the matters to be particularly aware of in such context are the following:

(a) that assignments of registered intellectual property rights, whether to assignees within or outside the group, may not be recorded in the relevant register of such rights maintained by the government authority in the relevant jurisdiction;

(b) that intellectual property rights may be subject to security interests either as an identifiable asset—e.g. a specific list of patents—or without such specific identification, bundled with all the assets of the company;

(c) that third party interests may arise through the operation of law—e.g. section 196(4) of the Copyright Act provides that “a licence granted in respect of the copyright by the owner of the copyright binds every successor in title to the interest in the copyright of the grantor of the licence to the same extent as the licence was binding on the grantor.”

CONCLUSION

The preceding is by no means an exhaustive review of the issues that need to be considered when planning for the establishment of an IP holding company. It does however highlight the importance of considering a number of matters that are frequently not uppermost in the minds of those planning such a structure.

In the case of infringement, it is particularly important to understand that losses sustained by one member of a group of companies are *prima facie* not recoverable as damages by another company in the group and that each of the forms of intellectual property discussed in this article deal with the entitlement to commence proceedings differently. Those differences must be properly factored into the proposed structure in order to ensure that no impediments to the recovery of financial losses and the protection of a group's intellectual property rights arise.

In the case of licensing, it is particularly important to understand that there are matters of substance and not just form that need to be addressed, and if not addressed properly, will undermine the effectiveness of the relevant structure.

In the case of operational matters, two lessons stand out in order to maximize the success of an IP holding company structure. Firstly, the establishment of such a structure, including the transfer of intellectual property to an IP holding company, should be treated no less rigorously than any arms length third party transaction. Secondly, there must be a transparent operational alignment between the activities of the IP holding company and the activities of group member companies exercising the intellectual property rights held by that company. If this is not achieved, not only will the structure be inefficient from an administrative perspective, but it is also highly likely to cause financial damage to the business of the group as a whole.