

Tariff strategy to IP vulnerability: how corporate restructuring can damage patent enforcement and remedies

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In an era of heightened trade tensions and unpredictable tariff regimes, some multinational companies may turn to strategic corporate restructuring as a means of mitigating costly import duties.

Tax and tariff-motivated restructurings may involve shifting ownership or supply chain responsibilities across subsidiaries or affiliated entities, sometimes in ways that obscure or fragment ownership of intellectual property rights. While these manoeuvres may offer short-term economic relief, they can carry unintended legal consequences for patent enforcement and damages recovery.

Tariff management

To address this new tariff reality, companies have engaged in creative solutions that rely on the use of related or partnering entities. For example, some companies may restructure their supply chains to source materials and manufacturing from the US or countries that offer better tariff terms. These corporate arrangements could require splitting commercial tasks (e.g., manufacturing, distributing, owning IP) among various entities.

Multi-entity problems for patent damages

When adapting to these new tariffs, companies should be mindful that they do not undermine their



ability to enforce their IP and recover damages for infringement.

Patent damages

As background, a patentee who has established infringement of a valid patent may claim reasonable-royalty damages “adequate to compensate for the infringement” as a damages floor (35 US Code § 284). But a patentee can also obtain lost-profits damages by showing a reasonable probability that the patentee would have made the sales of the infringer but for the infringement. Lost-profits damages can be awarded in addition to a reasonable royalty and thus offer an opportunity to dramatically increase a damages award.

A patentee must sell some product to claim lost profits as damages

Generally, a patent owner is not entitled to recover under a lost-profits theory as a result of sales lost by a sister corporation, unless the patent owner itself has demonstrated a loss of profits. The Federal Circuit's decision in *Poly-America v GSE Lining Technology* articulates this rule, 383 F.3d 1303, 1311 (Fed. Cir. 2004).

In that case, the patentee, Poly-America, shared a common parent corporation with Poly-Flex, which sold the patented product. These "sister entities" operated together "as a single economic unit" for the purposes of the patented product sold by Poly-Flex. *Id.* at 1310. Further, Poly-Flex had a license that recited that the patentee, Poly-America, could collect infringement damages accruing to Poly-Flex. *Id.* at 1311. But the court held that the patentee, Poly-America, could not collect the lost profits of Poly-Flex because "the patentee needs to have been selling some item, the profits of which have been lost due to infringing sales." *Id.* at 1311. Notably, the Federal Circuit also rejected the entities' attempts to contract around that requirement. *Id.* at 1311.

The underlying rationale of this holding is that a company that has divided its operations and separated the owner of the patent from the seller of the patented product to enjoy some benefit—historically tax savings—may not enjoy the advantages of their separate corporate structure and, at the same time, avoid the consequential limitations of that structure." *Id.* at 1311. The parent which has "arranged their corporate identities and functions to suit its own goals and purposes" "must take the benefits with the burdens." *Id.*

Inexorable flow as part of the lost profits analysis

Some multi-entity parties seeking lost profits have attempted to show "inexorable flow" to connect the patent-holding entity with the entity that suffered lost profits. Namely, these plaintiffs argue that the corporate structure has been arranged such that the profits of one corporate entity "flow" to the related entity. This approach has had mixed results in trial courts across a variety of fact patterns.

The idea of inexorable flow traces back to the Federal Circuit's decision in *Mars v Coin Acceptors*, 527 F.3d 1359, 1367 (Fed. Cir. 2008), amended on other grounds, 557 F.3d 1377 (Fed. Cir. 2009).

In that case, the patentee Mars had a subsidiary, MEI, that practiced the asserted patent. The Federal Circuit rejected Mars's claim that "by virtue of the parent-subsidiary relationship and its consolidated financial statements, 'all MEI's lost profits were *inherently* lost profits of Mars.'" *Id.* at 1367. And the court concluded that "MEI's profits did not ... flow inexorably to Mars," though it abstained as to "whether a parent company can recover on a lost profits theory when profits of a subsidiary actually do flow inexorably up to the parent." *Id.* at 1367. The Federal Circuit cases following *Coin Acceptors* suggest that the Federal Circuit did not endorse inexorable flow as a path to lost profits. *Spine Solutions v Medtronic Sofamor Danek USA*, 620 F.3d 1305, 1319 (Fed. Cir. 2010); *Warsaw Orthopedic v NuVasive*, 778 F.3d 1365, 1376 (Fed. Cir. 2015). But trial courts have been mixed in their treatment of Mars and inexorable flow.

Corporate structure and inexorable flow

Even where trial courts will entertain the theory, inexorable flow is difficult to establish. The mere fact that a subsidiary's lost sales "may have caused harm" to its parent company is not sufficient, by itself, to establish lost profits damages. And courts have also not found an inexorable flow where the patentee receives payments from related companies based on their sales of the product at issue. *See, e.g., Warsaw Orthopedic*, 778 F.3d 1365 at 1376 (holding that license agreements, royalty payments, and transfer pricing agreements were insufficient to show inexorable flow).

Courts have also considered a case where a domestic subsidiary sells the patented products of its foreign parent corporation. In *Fujitsu v Tellabs*, the patentee Fujitsu Limited was a Japanese company whose wholly owned subsidiary, FNC, located in the US, had a non-exclusive license to the patent and sold the product at issue. No. 09-4530, 2013 WL 2285794, *6 (N.D. Ill. May 23, 2013). But the court held that "Fujitsu Limited's tax strategy is designed to minimize the taxes Fujitsu Limited and FNC pay to governmental entities in their respective countries and is not a transfer of profits from FNC to Fujitsu Limited." *Id.* at *8. Fujitsu Limited was thus not allowed to present a theory of lost profits at trial.

The patentee's selling of patented products to its subsidiary may also be insufficient for inexorable flow. *See, e.g., Edgewell Pers. Care Brands v Munchkin*, No. 183005, 2022 WL 18932811, at *1 (C.D. Cal. July 6, 2022). And courts have also found that controlling

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a subsidiaries' cash flow is not the same as inexorably receiving the subsidiary's profits. See, e.g., *Kowalski v. Mommy Gina Tuna Res.*, 574 F. Supp. 2d 1160, 1163 (D. Haw. 2008) (holding that "[m]ere ownership and control is insufficient to prove that profits flowed inexorably from a subsidiary to a parent.").

Multi-entity problem for standing

Another pitfall for companies using corporate structure manoeuvring to adapt to tariffs is a potential loss of standing to bring suit for patent infringement in the first place.

Only the party holding legal title or exclusionary rights to a patent (i.e., a patent owner or an exclusive licensee) can have constitutional standing to bring an infringement suit. *Mars*, 527 F.3d at 1367. For example, a contracted domestic distributor or a manufacturer of products for a foreign patentee cannot bring suit or collect damages unless that entity has an exclusive license. That the distributor or manufacturer may be a wholly owned subsidiary of the patentee does not confer standing. Nor does a subsidiary inherit standing from a parent or that parent's business practices with respect to the subsidiary's practice of the patent. In *Spine Solutions*, the patentee SSI added its parent corporation Synthes and sister company Synthes Spine to the lawsuit. 620 F.3d at 1317. With respect to Synthes Spine, the court rejected SSI's argument that it had made an implied promise to exclude entities other than Synthes Spine. *Id.* at 1318. Otherwise, the court held, any company related to the patentee could be an exclusive licensee if the patentee allows only that company to practice the patent. *Id.* at 1318.

Takeaways

As companies restructure to adapt to tariffs, they may inadvertently undermine their ability to enforce patent rights and recover lost profits. Companies seeking short-term trade advantages must weigh the long-term litigation risks these structures impose on patent recovery and strategy.

- **Lost profits cannot be claimed for another entity's injury:** Courts have consistently rejected attempts to claim damages suffered by a related company, even with a close economic connection.
- **The "inexorable flow" theory is disfavoured:** Attempts to argue for economic unity across affiliates have largely failed, and there is little indication courts will adopt this lost-profits approach.
- **Bring patent counsel to the table:** Involving patent counsel in corporate restructuring planning is critical to ensure that the distribution of profits post-restructuring does not preclude a potential lost-profits claim and that sufficient exclusionary rights exist for standing to sue.



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