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“I Can’t Believe It’s Not Vodka” – Diageo and ICB Settle Their Two-Year Dispute



At the end of last year leading alcoholic drinks producer Diageo North America Inc. (Diageo) and Intercontinental Brands Limited (ICB) settled their dispute concerning the sale by ICB of its VODKAT drink.¹ VODKAT is a mixture of vodka and neutral fermented alcohol with an ABV (alcohol by volume) of 22 percent. It is not classified as a “vodka” under the EU

regulations on spirits, which require that vodka be a minimum of 37.5 percent ABV and be produced from distilled alcohol. The duty payable on a liter of VODKAT is considerably less than is payable on a liter of vodka² due to the much lower ABV of VODKAT, giving ICB the opportunity to undercut the market.

After two years of litigation ICB has agreed to change the VODKAT brand name and its packaging to ensure it is clear to consumers that it is not vodka, and to pay Diageo a substantial, but undisclosed, sum in damages and legal costs. ICB planned to launch a new product by February 2011. They were permitted to continue selling VODKAT to wholesalers and retailers until January 31, 2011.

Background

VODKAT went on sale in April 2005. Since then, the branding and descriptions used on the bottles have undergone numerous changes due to pressure from regulatory and industry bodies. In February 2006 the words “alcoholic vodka blend” were removed due to an objection by Trading Standards that they were not appropriate under the relevant regulations. The Gin and Vodka Association, of which Diageo is a member, pressured Trading Standards to force ICB to change the product name. This was not achieved, but several minor changes to the appearance of the product were made. By July 2008 there had still not been sufficient changes to satisfy Diageo and so it commenced proceedings.

The High Court Decision

In January 2010 the High Court³ ruled in favor of Diageo.⁴ It found that the sale of a product that was not vodka under the name VODKAT constituted the extended form of passing off. Passing off in its classic form exists where there is a misrepresentation as to the origin of a product which attempts to hijack the goodwill attached to another brand. Examples include using a similar color scheme and font on packaging, giving the product a name similar to existing products or the use of confusing advertising.

Extended passing off takes this concept one stage further. Rather than applying to the brand, extended passing off can relate to the nature of the product itself. If a term applying to a product (rather than a brand) is sufficiently descriptive, any product which is wrongly represented as falling within the description could give rise to a claim for extended passing off. Some examples of products which have led to extended passing off claims include “sherry,” “Spanish champagne” and “old English advocaat.”

In its claim, Diageo, producer of the UK’s best-selling vodka SMIRNOFF, had concentrated on the assertion that VODKAT had passed off the descriptive term “vodka” rather than Diageo’s own trademarks. In order to establish extended passing off, Diageo had to establish that the term vodka described a “clearly defined class of goods” and that this class of goods had a reputation which gave rise to goodwill amongst a significant section of the public.

The judge held that vodka was a distinctive term that denoted a class of goods with a reputation and protectable goodwill. Vodka, thereby, joined champagne, whisky and sherry as a name of a drink that is protected from “lookalike” drinks.

The court decided that ICB had misrepresented VODKAT as a vodka. This finding was assisted by the bottle and labeling design initially used to sell the product, which was seen as attempting to give a “Russian” feel to the product, and the failure of ICB to make it clear to consumers that the product was not vodka. The fact that retailers sold VODKAT on the same shelf as vodkas and other spirits rather than with the specialty drinks and liqueurs, and that

ICB had done nothing to change this, further assisted the finding of a misrepresentation. Considerable evidence of actual confusion was found amongst both consumers and retailers.

Damage to Diageo was found to have occurred. First, there was evidence that bars and pubs had been selling VODKAT as a house vodka, thereby adversely affecting sales of Diageo's SMIRNOFF brand. Second, even if there had been no evidence of actual lost sales, damage would have been established due to the fact that the use of the term VODKAT was likely to erode the distinctiveness of the term vodka.

The Court of Appeal Decision

ICB appealed the High Court decision⁵ on the ground that only products that had a special cachet should be protectable by the extended form of passing off and that vodka was a generic term that did not have the requisite cachet. This argument was dismissed by the Court of Appeal, which confirmed that a product did not have to have a cachet in order to be protected by extended passing off.

The Court refused ICB permission for leave to appeal to the UK Supreme Court. However, the injunction that prohibited ICB from continuing to sell VODKAT did not come into force pending an application by ICB to the Supreme Court for permission to appeal. At the time of the settlement, ICB had reportedly not yet received a decision from the Supreme Court.

The Wider Implications

This case may assist other vodka producers, as vodka is now protected from lookalikes. This in turn may help to maintain the long-term integrity of the vodka market in the UK. It may also assist other alcoholic beverage brand owners in their battle against lookalike diluted versions of their products. However, VODKAT is an extreme example of confusion, as a result of the brand name (differing from vodka only by the addition of a "t" at the end), the bottle design and labeling, market positioning and the failure to properly differentiate the product. All future attempts to

invoke the extended form of passing off will be decided on their own facts and rarely will they be so disposed to a finding of confusion

Interestingly, the High Court itself commented that, as VODKAT did contain some vodka, it would have been relatively easy for ICB to have used the name without it constituting passing off if they had taken sufficient care to clearly inform consumers what the product was and to differentiate it from vodka.

Whilst producers of "lighter spirits" should be on their guard, there is a great deal that they can do to reduce the risk of similar legal action. The key would appear to be to adduce evidence that sufficient measures have been taken to differentiate the product from the class of products they may be accused of passing off.

Francesca Fellowes, associate, Leeds

¹ Settlement announced on 15 December 2010.

² £2.85 on a litre of VODKAT compared to £8.49 on a litre of vodka.

³ The High Court deals at first instance with all high value and high importance cases, and also has a supervisory jurisdiction over all subordinate courts and many (but not all) tribunals.

⁴ *Diageo North America Inc. v Intercontinental Brands (ICB) Ltd* [2010] 3 All ER 147.

⁵ *Diageo North America Inc. v Intercontinental Brands (ICB) Limited* [2010] EWCA Civ 920.

Getting Your Shape Marks in Shape for Registration as Community Trademarks



Community trademarks may consist of any signs capable of being represented graphically, for example, the shape of goods or of their packaging, provided that such signs are capable of distinguishing the goods or services of one undertaking from those of other undertakings. In theory, the criteria for assessing the distinctive character of three-dimensional marks consisting of the shape of the product itself are no different from those applicable to other categories of trademarks. However, many applicants fail to meet the requirements for the registrability of shape marks,

set by case law, as did Lindt & Sprüngli. The European General Court has upheld decisions of the Office for Harmonization in the Internal Market (OHIM – the European Union’s trademark office) refusing applications for three-dimensional marks due to lack of distinctiveness.¹

It is possible to overcome a refusal based on lack of distinctiveness by showing that the mark has acquired distinctive character in consequence of the use of that mark made before the application date.

The *Lindt & Sprüngli* case teaches, first and foremost, that a carefully thought through and implemented strategy is necessary to educate the public that the shape or color of a particular product functions as a trademark. Second, at least in connection with Europe-wide community trademarks, the distinctive character acquired in consequence of the use of that mark must be demonstrated in a substantial part of the European Union.

Between February 2004 and November 2005, Lindt & Sprüngli applied to register the following three-dimensional marks as community trademarks for chocolate and chocolate products in international class 30:

- the shape of a chocolate rabbit with red ribbon²;
- the shape of a chocolate reindeer³;
- the shape of a chocolate rabbit without red ribbon⁴; and
- the shape of a small bell with a red ribbon⁵.

These shape marks did not bear the Lindt logo mark on their packaging. Lindt & Sprüngli is proprietor of a community trademark registration for its chocolate rabbit with a red ribbon which, contrary to the cases decided by the General Court, includes the Lindt mark on its foil wrapping.⁶

As to the above shape marks, i.e., without the Lindt identifier, the General Court dismissed Lindt & Sprüngli’s argument that the combination of the shape of the rabbit and reindeer with the red ribbon and the color of the

packaging enabled the public to identify the commercial origin of the chocolate products. In referring to well-established case law, it held that the perception of the average consumer is not necessarily the same as with regard to word or figurative marks whose subject matter is unrelated to the appearance of the product it designates. The average consumer is not in the habit of making assumptions as to the origin of products based on their shape in the absence of any graphic or word element, and it may thus be difficult to establish the distinctiveness of such a shape mark.⁷

Case law further suggests that, with regard to marks consisting of a shape of a product or its packaging, the norm or custom in the business sector at issue is the relevant area for assessing the distinctiveness of the mark. Subsequently, only those packaging shapes that “significantly depart” from the normal custom in the sector in question have a distinctive character.⁸

Lindt & Sprüngli failed to prove such distinctiveness. The General Court found the shapes of a chocolate rabbit, a reindeer and a small bell with a ribbon not to be distinctive because this form of chocolate packaging was already in general use in the European Union. It therefore concluded that the shape of the rabbit and reindeer were not unusual enough to distinguish them as indication of the specific commercial origin of chocolate products in this sector. Finally, with regard to the red ribbon with a small bell, the General Court stated that it was common to decorate chocolate animals or their wrapping with knots, red ribbons and small bells. As a mere decoration, the red ribbon with a small bell had, in the court’s view, no distinctive character.

It is possible to overcome a refusal based on lack of distinctiveness by showing that the mark has acquired distinctive character in consequence of the use of that mark made before the application date. This will, however, in many cases be difficult and costly to prove. In the case at hand, the court held that in order for a mark to be accepted the distinctive character acquired in consequence of the use of that mark must be demonstrated in a substantial part of the European Union

where it was devoid of any such character. It dismissed the argument that the shapes were not known beyond the geographical scope of Germany, Austria and the UK and that it was thus sufficient to prove acquired distinctiveness in these European Union countries only. It therefore dismissed this motion. A note of caution: the evidence must show that the shape mark has been used and is perceived by consumers as indicating origin and not, for instance, as simply an indication of the product in question.

Conclusion

Applicants who wish to register a mark consisting of a shape of a product or its packaging are well advised to choose a “radical” new shape for the product. The more the shape differs from the norm and custom of the business sector, the more likely the European trademark authorities will consider the mark as inherently registrable. In this scenario, trademark applications are best filed before the product launch. The potential downside of this approach is that the applicant will be unable to produce any evidence of acquired distinctiveness before the application date in case the examiner objects to the registration. In any event, to be able to claim acquired distinctiveness through use the applicant of a community trademark will have to significantly invest in marketing the product. Only if consumers are able to perceive the shape as an indication of origin will the applicant be able to overcome an objection of lack of distinctiveness based on the mark’s use. Moreover, acquired distinctiveness must be shown in a substantial part of the European Union. What accounts as a substantial part is often unclear, and the case law appears inconsistent in this respect. After all, if trademark protection is too difficult to achieve, registered designs remain the most appropriate means of protecting product shapes within Europe.

Florian Traub, senior associate, London

¹ *Chocoladefabriken Lindt & Sprüngli AG v Office for Harmonization in the Internal Market (OHIM)*, Cases T-336/08, T-337/08, T-395/08 and T-346/08, 17 December 2010.

² Community trademark application No. 003844446.

³ Community trademark application No. 004098489.

⁴ Community trademark application No. 003664372.

⁵ Community trademark application No. 004770831.

⁶ This registration is the subject of invalidity proceedings at the Austrian Supreme Court and invalidity proceedings before OHIM (the proceedings have been stayed pending the outcome of the proceedings in the Austrian national courts, cf. invalidity case No. 1176 C).

⁷ CJEU, *Mag Instrument v OHIM*, Case C-136/02 P, para. 30.

⁸ CJEU, *Deutsche SiSi-Werke GmbH & Co. Betriebs KG*, Case C-173/04 P.

Is the No-Challenge Clause in Your License Agreement Enforceable in the European Union?

No-Challenge Clauses in the United States



Whether a no-challenge clause is enforceable depends on how the clause is drafted and where it is being enforced. In the United States, license

agreements often contain no-challenge clauses that expressly prohibit licensees from challenging licensors’ patents or other intellectual property rights. A no-challenge clause might look like this:

Example 1:

Termination in the Event of a Patent Challenge. Licensor shall have the right to terminate this Agreement or any License granted hereunder, in the event Licensee directly or indirectly commences legal action or otherwise challenges the validity of licensor’s intellectual property rights.

Example 2:

No-Challenge. Licensee shall not challenge or cause any third party to challenge the validity or enforceability of licensor’s intellectual property rights.

Notably in *MedImmune, Inc. v. Genentech, Inc.*, 549 U.S. 118, 135 (2007), the US Supreme Court reasoned that the absence of a no-challenge clause in the parties’ license agreement was a basis for upholding the licensee’s right to challenge the licensor’s patent – “it is not clear where the prohibition against challenging the validity of the patents is to be found [and this] can hardly be implied from the mere

promise to pay royalties on patents.” If there is one lesson to learn from *MedImmune*, it is that licensors should take care to negotiate and execute license agreements containing no-challenge clauses that either bar or otherwise deter a licensee from challenging a licensor’s intellectual property rights. Such clauses may provide for larger upfront license fees, increased royalty rates, or licensor’s right to terminate upon a licensee’s challenge of licensor’s intellectual property rights, as well as a right to receive advance notice of licensee’s claims.

Under EU law, no-challenge clauses pose a potential antitrust problem.

No-Challenge Clauses in the EU

Under EU law, however, no-challenge clauses pose a potential antitrust problem. Thus, when negotiating a license agreement that may be subject to EU law (e.g., license territory includes EU), it is helpful to be familiar with a few basic principles of EU competition law.

EU Competition Law and License Agreements

Article 101(1) of the Treaty on the Functioning of the European Union¹ prohibits agreements that have an anticompetitive effect on trade between Member States within the EU.² License agreements, because of their restrictive covenants and various limitations on the parties, can come under the purview of Article 101(1) unless the parties’ positions in the applicable market or industry are relatively insignificant.³ License agreements, however, may be exempt from Article 101(1) under the following two conditions: (1) by qualifying for a Technology Transfer Block Exemption; or (2) by meeting the requirements of Article 101(3) (see endnote 2). Since the latter option under Article 101(3) entails a complex, fact specific analysis that varies case by case, we will tackle only the Technology Transfer Block Exemption⁴ here.

Technology Transfer Block Exemption (TTBE)

In essence, the TTBE provides a safe harbor from antitrust challenge for certain types of license agreements⁵ and generally applies to:

- Agreements effective after October 31, 2005;⁶
- Agreements involving patents, know-how, software, design rights and the use of those rights to manufacture products or goods (e.g., license agreements);
- Agreements between two parties; and
- Parties who meet certain market share requirements⁷ – the combined market share of parties are above 10 percent (or 15 percent if parties are non-competitors) and the total market share of competitors must not exceed 20 percent (or for non-competitors neither exceeds 30 percent).⁸

Blacklisted Provisions

In addition to meeting the above criteria, license agreements seeking the TTBE safe harbor also cannot contain any “blacklisted” (also known as “hardcore”) provisions, which are deemed anticompetitive *per se*. Examples of “blacklisted” provisions include clauses that fix re-sale prices, place restrictions on licensee to use and employ its own technology, impose restrictions on research and development activities, or otherwise restrict output.⁹

Excluded Restrictions

Additionally, to the extent license agreements seeking TTBE protection contain any “excluded restrictions” (which are not necessarily *per se* prohibited), such provisions will be assessed on a case-by-case basis to determine their anticompetitive effect. Unlike blacklisted provisions, which disqualify the entire license agreement from the TTBE, excluded restrictions abrogate the TTBE safe harbor only with respect to the specific offending provision. Examples of excluded restrictions include no-challenge clauses (except provisions allowing termination upon challenge by the licensee); mandatory assignments by licensee to licensor for improvements or new application of the technology; and exclusive grant back clauses. For these reasons, a no-challenge clause of the type found in Example 1 (above) may be safe under the TTBE, whereas

a clause of the type found in Example 2¹⁰ may be subject to further scrutiny as an excluded restriction under the TTBE.

Conclusion

Reliance on boilerplate no-challenge clauses can potentially cause serious problems under EU law. If deemed anticompetitive, not only does the license agreement become void and unenforceable, but the parties may also be subject to civil damages, penalties, fines, and sanctions.¹¹ A well crafted no-challenge clause drafted by parties cognizant of these issues can provide the expected benefits, while minimizing the risk of antitrust scrutiny.

Kate E. Kim, associate, Tokyo

¹ Prior to the enactment of the Lisbon Treaty in December 2009, Article 101 of the Treaty on the Functioning of the European Union was known as Article 81 of the Treaty Establishing the European Community (EC Treaty).

² Article 101 (ex Article 81 EC Treaty)

1. The following shall be prohibited as incompatible with the internal market: all agreements between undertakings, decisions by associations of undertakings and concerted practices which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the internal market, and in particular those which:

- (a) directly or indirectly fix purchase or selling prices or any other trading conditions;
- (b) limit or control production, markets, technical development, or investment;
- (c) share markets or sources of supply;
- (d) apply dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;
- (e) make the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.

2. Any agreements or decisions prohibited pursuant to this Article shall be automatically void.

3. The provisions of paragraph 1 may, however, be declared inapplicable in the case of:

- any agreement or category of agreements between undertakings,
- any decision or category of decisions by associations of undertakings,
- any concerted practice or category of concerted practices, which contributes to improving the production or distribution of goods or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit, and which does not:
 - (a) impose on the undertakings concerned restrictions which are not indispensable to the attainment of these objectives;
 - (b) afford such undertakings the possibility of eliminating competition in respect of a substantial part of the products in question.

³ Assuming a license agreement does not contain any "blacklisted" provisions (discussed further below), whether a license agreement falls under Article 101(1) ultimately depends on the relevant facts, e.g., does the agreement affect trade between EU Member States, does it affect trade between member states, are the terms of the license restrictive,

and/or are the parties above certain de minimis thresholds (agreements between small and medium sized entities with fewer than 250 employees and assets less than €43 million (approximately US\$58 million) or turnover of less than €50 million (approximately US\$67 million) are exempt from Article 101(1)).

⁴ Note the Technology Transfer Block Exemption is deemed to satisfy the requirements of Article 101(3).

⁵ Other types of agreements are subject to different block exemptions, e.g., agreements between insurer and reinsurer are covered under the Insurance Block Exemption Regulation; vertical agreements in the automobile sector are covered under the Motor Vehicle Block Exemption.

⁶ For agreements prior to this date, the 1996 Block Exemption may be applicable.

⁷ The parties self-determine their market shares and/or whether they are competitors or non-competitors.

⁸ To the extent the parties' market shares exceed these thresholds, the parties will not be able to take advantage of the TTBE safe harbor.

⁹ The lists of "blacklisted" provisions vary depending on whether the parties are deemed competitors or non-competitors, pursuant to Article 4(1) and Article 4(2) TTBE, respectively. Note also that an agreement that includes a "blacklisted" provision will not be eligible for exemption under Article 101(3).

¹⁰ Note some practitioners and courts may broadly interpret the reasoning in *Lear, Inc. v. Adkins*, 395 U.S. 653 (1969) (in which the Supreme Court upheld a licensee's right to bring an invalidity action against a licensor's patent and cease making royalty payments) as precluding no-challenge clauses of the type found in Example 2.

¹¹ Guidelines adopted by the European Commission provide for fines up to 30 percent of the company's annual sales, which may be increased proportionally by the number of years during which the anticompetitive acts or measures were in place. The European Commission and any national competition authority of the EU may apply and enforce Article 101 – typically on the authorities' own initiative or based on third party complaints.

The CAFC Strengthens Divided Patent Infringement Defense



Wrapping up a trilogy of cases refining the rule regarding "joint" or "divided" infringement of method claims, the Federal Circuit recently ruled that a patentee must show an agency or contractual relationship in order for joint liability on patent infringement to exist.¹

It is a longstanding rule that direct infringement of a method claim only inures where a single accused infringer performs each and every step of the method.² Joint infringement issues can arise when a patent holder asserts method claims over activities whose steps are not carried out by a single party. The Federal Circuit crafted an exception to direct infringement in two previous decisions leading up to *Akamai*. In *BMC Resources*, the court explained the "control or direction" test in which a

district court can justifiably impose “vicarious liability on a party for the acts of another where the liable party controlled or directed the conduct of the acting party.”³ The court concluded that “it would be unfair indeed for the mastermind in such situations to escape liability” and, therefore, “[a] party cannot avoid infringement . . . simply by contracting out steps of a patented process to another entity.”⁴

The Federal Circuit... held that the requisite level of control or direction over the acts committed by a third party is met in circumstances in which “the law would traditionally hold the accused direct infringer vicariously liable for the acts committed by another party.”

The control or direction test explained in *BMC Resources* left several questions unanswered, such as whether furnishing instructions to another opens the door to liability. Thus, the court clarified the test in *Muniauction, Inc. v. Thomson Corp.*, 532 F.3d 1318 (Fed. Cir. 2008). At issue in *Muniauction* was an Internet-based auction service. While *Muniauction* performed several steps of the method claim in the patent at issue, a critical step – bidding – was performed by *Muniauction*’s customers. However, the patentee, Thomson Corp., argued that because *Muniauction* furnished its customers with instructions on how to use its online auction system, it directed and controlled those customers and was, therefore, liable as a joint infringer. The Federal Circuit disagreed and held that the requisite level of control or direction over the acts committed by a third party is met in circumstances in which “the law would traditionally hold the accused direct infringer vicariously liable for the acts committed by another party.”⁵ The court determined that providing instructions to one’s customers was insufficient to trigger vicarious liability and, therefore, Thomson’s divided infringement theory failed.⁶

The Federal Circuit further refined this test in its decision in *Akamai*. *Akamai* sued its direct competitor *Limelight* for patent infringement. *Limelight* performed most of the claimed steps, but had its customers perform some of the other claimed steps. Because the performance of steps

was split between *Limelight* and its customers, *Akamai* relied on a theory of joint liability, arguing that *Limelight* controlled or directed the activities of its customers. Acknowledging that the control or direction test established a “foundational basis” on which to determine joint infringement of method claims, the Federal Circuit nevertheless explained in this case that “[w]hile control or direction is a consideration, as is the extent to which instructions, if any, may be provided, what is essential is not merely the exercise of control or the providing of instructions, but rather whether the relationship between the parties is such that acts of one may be attributed to the other.”⁷ The court stated that such attribution is proper when the relationship between the accused infringer and the acting party is that of principal and agent, or when the acting party is contractually obligated to the accused infringer to perform a method step.⁸

Applying this rule to the facts of the case, the court determined that *Limelight* and its customers were not jointly liable for infringing *Akamai*’s patent. “[T]here is nothing to indicate that *Limelight*’s customers are performing any of the claimed method steps as agents for *Limelight* . . . [*Limelight*’s] customers are provided instructions on use of [*Limelight*’s] service and are required to perform some steps of the claimed method to take advantage of that service . . . the customers decide what content, if any, they would like delivered by *Limelight*’s CDN and, then perform the step of “tagging” that content. *Limelight*’s customers also perform the step of ‘serving’ their own web pages.”⁹ Moreover, there could be no joint infringement because the contract between *Limelight* and its customers did not obligate the customers to do anything.¹⁰

This case will precipitate an increase in the number of successful divided infringement defenses raised where accused infringers do not perform every step of method claims themselves. In such a situation, the patentee’s infringement claims will fail unless it can show a principle-agent or contractual relationship. Patent applicants should seek to avoid this potential pitfall by structuring their method claims to capture infringement by or enforceable

against a single party. In other words, it would be advisable to have at least one independent claim, either a method claim or an apparatus claim, in which every element would be performed by or included in (either literally or by equivalents) a single party.

Christopher D. Mays, associate, Palo Alto

¹ *Akamai Technologies, Inc. v. Limelight Networks, Inc.*, Case No. 09-1372 (Fed. Cir. Dec. 20, 2010) (Linn, J.).
² See, e.g., *BMC Resources, Inc. v. Paymentech, L.P.*, 498 F.3d 1373, 1378-79 (Fed. Cir. 2007) (citing *Warner-Jenkinson Co., Inc. v. Hilton Davis Corp.*, 520 U.S. 17, 40 (1997)).
³ *Id.* at 1379.
⁴ *Id.* at 1381.
⁵ *Id.* at 1330.
⁶ *Id.*
⁷ *Akamai Technologies, Inc.*, Case No. 09-1372 at 16.
⁸ *Id.* at 17.
⁹ *Id.* at 16-17.
¹⁰ *Id.* at 22

Taxation of Patent Profits – The UK Is Open for Business



The UK government recently announced reforms to the taxation of patent profits. The intention is to make the UK a more attractive location for businesses seeking to enhance their patent portfolios.

The “Patent Box”

The reforms will result in a preferential regime for the taxation of patent profits, known as the “Patent Box.” The headline rate of corporation tax for patent profits will be reduced from the main rate (currently 28 percent) to 10 percent, effective April 1, 2013. The Patent Box regime will be optional and the profits to which it will apply include net royalty income and “embedded income” included in the price of patented products. All patents first commercialized after November 29, 2010 will qualify for inclusion in the Patent Box.

Why Reform?

The government’s intention is to enhance UK tax competitiveness; in fact, it aims to create the most competitive corporation tax regime amongst the G20 nations. In 1997 the UK had the 10th lowest corporation

tax rate amongst the 27 EU member states. By 2010 it had slipped into 20th position. One of the consequences was that businesses were given little, if any, incentive to headquarter themselves in the UK. From a patent perspective, this meant that technology companies with a focus on R&D chose to base themselves in other jurisdictions which provided specific fiscal incentives to innovate. In 1970 the then Patent Office received 62,101 patent applications, a number that has declined steadily each year. The number of applications filed in 2009 was 22,465, a reduction of almost two thirds over a 30-year period.

The government believes that reducing the rate of corporation tax for patent profits will result in technology companies remaining in or returning to the UK. This will bring a number of benefits to the UK including more jobs and a higher overall tax yield, both of which will contribute to sustained economic recovery. The government’s focus is on patents, rather than intellectual property generally, because of the link between high-tech R&D and manufacturing activity which, in the current economic climate, the government is particularly keen to foster in the UK.

Other Supporting Reforms

The reduction in the headline rate of corporation tax for patent profits will be supported by other reforms to benefit companies for which intellectual property is the most significant asset. For example, the government intends to introduce a more territorial approach to the taxation of intellectual property with changes to the Controlled Foreign Companies regime. This means that the monies generated from the exploitation of intellectual property that has little connection with the UK will be beyond the reach of the UK tax system, although steps will also be taken to ensure that companies do not artificially divert such profits to low tax jurisdictions. The government also intends to review how well the existing R&D tax credits support innovation.

The Timeframe

The government’s announcement is just the first stage in a phased introduction of the reforms. The announcement

merely outlines the government's plans; more detail will be given when a formal consultation on the proposals is launched in spring 2011. Draft legislation is to be published this autumn and a Finance Bill passed into law in 2012, coming into force on April 1 of that year.

Criticisms

The reforms have been criticized by some including the Institute for Fiscal Studies. The criticisms center on the fact that the reforms focus too much on the commercialization of patents once obtained, rather than providing additional tax breaks at the earlier R&D stage. In addition, it is generally recognized that the new Patent Box regime still does not match the patent profit tax rates of some other countries although the government's view is that the new 10 percent rate strikes a balance between affordability and competitiveness.

Next Steps

Despite these criticisms, the reforms will be welcome to companies engaged in research and innovation. To take maximum advantage of the reforms, companies will need to base themselves in the UK and ensure that their patent portfolios are adequately exploited. The new regime rewards commercialization rather than the passive holding of patent rights. Companies may want to review their existing patent portfolios. Should patents be obtained for technology currently protected by other intellectual property rights, such as confidentiality? Also, companies should ensure that they retain comprehensive records of which patents were first commercialized after November 29, 2010.

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Contributor Profiles

Editor



Alicia M. Choi focuses her practice on the area of patent law. Her experience includes preparing and prosecuting utility patent applications in the areas of electrical and computer engineering including information technology, software systems, wireless communication, medical diagnostic devices, semiconductors, analog and digital circuitry, and consumer electronics such as optical storage media and audio devices for US and international clients. Her experience also includes conducting novelty, patentability, invalidity and infringement analyses for various electrical devices and systems. In addition Ms. Choi has been involved in reissue and reexamination proceedings and provided litigation support in patent infringement claims.



advising on the compliance aspects of and project-managing multijurisdictional projects for global clients.

Kate E. Kim focuses her practice on corporate matters, particularly mergers and acquisitions. She represents buyers and sellers with stock and asset acquisitions and divestitures, mergers, joint ventures, strategic alliances and similar transactions. Ms. Kim has worked with clients in medical diagnostics, pharmaceuticals, electronic components manufacturing, and other industries including real estate, and information and communications technology. She also advises clients on US litigation and international arbitration matters. Ms. Kim has represented clients in general commercial, securities, intellectual property, insurance and complex construction litigation cases.



Aredhel Darnley has experience in a wide variety of taxation matters relating to corporate finance, employment, pension, real estate and commercial transactions. She regularly advises on tax implications of corporate transactions including mergers and acquisitions as well as group restructuring.

Ms. Darnley also has extensive experience of the implementation and administration of employee share schemes. She also provides regular advice to the Sports & Entertainment Industry Group and its clients in relation to tax efficient arrangements for clubs and individuals.



Christopher D. Mays is a registered patent attorney focusing his practice on intellectual property and complex commercial litigation. Mr. Mays has experience in high technology disputes concerning patent infringement. While in law school, Mr. Mays competed in numerous advocacy competitions including the Carr Mock Trial, where he was a semifinalist, and the King Hall Negotiations competition. Mr. Mays is a member of the American Bar Association, the American Intellectual Property Law Association, and the San Francisco Intellectual Property Law Association.



Francesca Fellowes' practice covers both commercial and intellectual property work. She has substantial experience in all aspects of non-contentious commercial work and specializes in both contentious and non-contentious IP work. She also has experience with data protection law and, in particular,

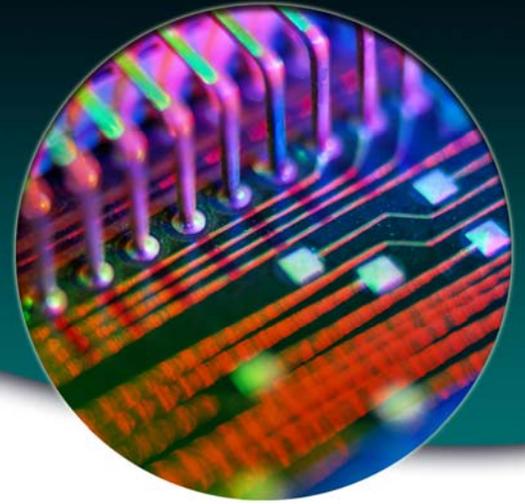


Carl Rohsler leads the Intellectual Property and Technology Practice Group in Europe. His practice covers the full range of intellectual work including patents, trade marks and designs, copyright and confidential information. Although working on both contentious and non-contentious matters, Mr. Rohsler is best known for his work as a trial lawyer,

having been involved in a number of leading cases in this field since 1995. He is a solicitor advocate (High Court: Civil 2001). Mr. Rohsler is also known as one of the UK's leading experts on gambling law, acting for a number of the leading online and bricks and mortar gambling operations in the UK and across the world. In addition to his expertise in intellectual property and gambling regulation, he has considerable experience in advertising and marketing regulation, data protection, e-commerce and labelling and packaging law.



Florian Traub is a senior associate in our London office as well as a German Rechtsanwalt (Attorney-at-Law). His particular expertise covers advice in relation to all aspects of trademarks from pre-filing searches and clearance through filing and prosecution to post-registration matters and third-party conflicts. He also specializes in contentious work including trademark and trademark infringement actions. Furthermore, he advises in relation to designs and copyright as well as in matters of unfair competition law.



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The contents of this newsletter are not intended to serve as legal advice related to individual situations or as legal opinions concerning such situations. Counsel should be consulted for legal planning and advice.

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