IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF TEXAS
TYLER DIVISION

MARS, INC. and	**§**	
MARS PETCARE US, INC.	**§**	
	§	
v.	**§**	**Case No. 6:13-cv-526-RWS-KNM**
	§	
TRURX LLC; TRUE SCIENCE	**§**	
HOLDINGS, LLC; and NATURAL	**§**	
POLYMER INTERNATIONAL CORP.	**§**	

REPORT AND RECOMMENDATION

Before the Court are TruRX LLC's, True Science Holdings, LLC's, and Natural Polymer International Corporation's ("Defendants," collectively) Motion to Dismiss Mars Petcare US, Inc. and to Strike Plaintiffs' Second Amended Complaint (Doc. No. 139); Mars, Inc.'s Cross-Motion for Leave to Join an Additional Party and to Amend Plaintiffs' First Amended Complaint (Doc. No. 150); Defendants' Motion for Summary Judgment Regarding Plaintiffs' Claim for Damages (Doc. No. 206); Defendants' Motion to Strike Testimony of Adrienne Shumate (Doc. No. 219); and Plaintiffs' Motion for Leave to File Plaintiffs' Supplement (Doc. No. 258). For the reasons set forth below, the Court recommends that Defendants' Motion to Dismiss Mars Petcare US, Inc. and to Strike Plaintiffs' Second Amended Complaint be **DENIED**; Mars Inc.'s Cross-Motion for Leave to Join an Additional Party and to Amend Plaintiffs' First Amended Complaint be **GRANTED**; and Defendants' Motion for Summary Judgment Regarding Plaintiffs' Claim for Damages be **GRANTED-IN-PART** and **DENIED-IN-PART**. Furthermore, Defendants' Motion to Strike Testimony of Adrienne Shumate is **DENIED**; and Plaintiffs' Motion for Leave to File Plaintiffs' Supplement is **GRANTED**.

BACKGROUND

Plaintiff Mars, Inc. ("Mars"), filed this lawsuit on July 8, 2013, accusing Defendants TruRX LLC, True Science Holdings, LLC, and Natural Polymer International Corporation of infringing two of its patents—U.S. Patent Nos. 6,495,176 (the '176 Patent) and 6,652,892 (the '892 Patent)—which generally relate to breath-freshening pet food compositions. Several weeks later and before Defendants answered, Mars filed a First Amended Complaint, making only minor changes to the original complaint. Nearly two years later, Mars filed a Second Amended Complaint, adding its wholly-owned subsidiary, Mars Petcare US, Inc. ("Petcare"), as a co-plaintiff.

In their Second Amended Complaint, Mars and Petcare ("Plaintiffs," collectively) allege that Petcare operates as an exclusive licensee in certain retail channels under the '176 and '892 Patents. As a licensee, Petcare manufactures products under the patents that compete directly with Defendants' Minties® line of pet foods. Plaintiffs also allege that Defendants' infringing Minties® products compete directly with pet food products manufactured by another of Mars's wholly-owned subsidiaries, The Nutro Company ("Nutro"). The parties agree that Mars, itself, neither manufactures nor sells any products. Through this suit, Plaintiffs seek to recover lost profits on the products sold by Petcare and Nutro.

Defendants first ask the Court to dismiss Petcare from this suit and strike the Second Amended Complaint because Mars violated the Court's Docket Control Order by filing the complaint after the deadline for joining additional parties. Alternatively, Defendants seek dismissal because Petcare does not have standing to bring infringement claims on Mars's patents. Mars responds by seeking leave to join Petcare and to file the Second Amended Complaint. Defendants also filed a related motion for summary judgment on the issue of Petcare's standing, and in the motion, challenge Mars's ability to claim lost profits for products manufactured by its subsidiary companies.

APPLICABLE LAW

Leave to Amend

Rule 16(b) of the Federal Rules of Civil Procedure governs the amendment of pleadings after a scheduling order deadline has passed. *S&W Enters., L.L.C. v. SouthTrust Bank of Ala., NA*, 315 F.3d 533, 536 (5th Cir. 2003). Pursuant to Rule 16, the Court may permit amendment only if the moving party can show good cause. *See* Fed. R. Civ. P. 16(b)(4). "The good cause standard requires the party seeking relief to show that the deadlines cannot reasonably be met despite the diligence of the party needing the extension." *S&W Enters.*, 315 F.3d at 536 (internal quotation marks omitted). In considering whether good cause exists, the court must consider: (1) the explanation for the party's failure to meet the deadline; (2) the importance of what the Court is considering excluding; (3) the potential prejudice if the Court allows the thing it is considering excluding; and (4) the availability of a continuance to cure such prejudice. *See Good Sportsman Marketing LLC v. Testa Assocs., LLC*, No. 6:05-cv-90, 2005 WL 2850302, at *6 (E.D. Tex. Sept. 1, 2005) (citing *S&W Enters.*, 315 F.3d at 536). Once the movant has shown good cause, the more liberal standard of Rule 15(a) applies to the court's decision to grant or deny leave. *See id.*; Fed. R. Civ. P. ("The court should freely give leave when justice so requires.").

Dismissal Based on Subject Matter Jurisdiction

Federal Rule of Civil Procedure 12(b)(1) authorizes dismissal of a claim for lack of subject matter jurisdiction when the district court lacks the statutory and constitutional power to adjudicate the case. *See Home Builders Ass'n of Mississippi, Inc. v. City of Madison*, 143 F.3d

1006, 1010 (5th Cir. 1998). When ruling on a motion to dismiss for lack of subject matter jurisdiction, a court may consider: (1) the complaint alone; (2) the complaint supplemented by undisputed facts in the record; or (3) the complaint supplemented by undisputed facts plus the court's resolution of disputed facts. *Den Norske Stats Oljeselskap As v. HeereMac v.o.f.*, 241 F.3d 420, 424 (5th Cir. 2001); *see also Clark v. Tarrant County*, 798 F.2d 736, 741 (5th Cir. 1986) (citing *Williamson v. Tucker*, 645 F.2d 404, 413 (5th Cir. 1981)). Where a defendant challenges the factual basis for the court's subject matter jurisdiction under Rule 12(b)(1), the plaintiff has the burden of establishing by a preponderance of the evidence that the court has the requisite jurisdiction. *Paterson v. Weinberger*, 644 F.2d 521, 523 (5th Cir. 1981). A court lacks subject matter jurisdiction over a cause of action if the plaintiff lacks standing to bring the cause of action. *Bhandari v. Cadence Design Sys., Inc.*, 485 F. Supp. 2d 747, 750–51 (E.D. Tex. 2007).

Summary Judgment

Federal Rule of Civil Procedure 56(a) provides for summary judgment when "there is no genuine dispute as to any material fact." A dispute about a material fact is genuine if "the evidence is such that a reasonable jury could return a verdict for the nonmoving party." *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 248 (1986). When the summary judgment movants demonstrate the absence of a genuine dispute over any material fact, the burden shifts to the non-movant to show there is a genuine factual issue for trial. *Celotex Corp. v. Catrett*, 477 U.S. 317, 323–24 (1986). Mere conclusory allegations are not competent summary judgment evidence, and thus are insufficient to defeat a motion for summary judgment. *Eason v. Thaler*, 73 F.3d 1322, 1325 (5th Cir. 1996). A court must draw all reasonable inferences in favor of the non-moving party. *BMC Res., Inc. v. Paymentech, L.P.*, 498 F.3d 1373, 1378 (Fed. Cir. 2007).

DISCUSSION

Whether Petcare Should be Permitted to Join This Suit

A. Mars's Alleged Violation of the Docket Control Order

Defendants first argue that the Court should dismiss Petcare from this suit and strike the Second Amended Complaint as sanctions under Rule 16(f). Defendants maintain that Mars should have obtained leave to join Petcare because the deadline for joining additional parties has passed. Because it did not do so, Defendants contend that Mars violated the Court's Docket Control Order. Mars counters that it was not required to seek leave because it filed its Second Amended Complaint prior to the deadline for amending pleadings. Nonetheless, Mars has also filed a motion requesting leave to add Petcare and amend its complaint. In light of Mars's motion, it is not necessary to decide whether the sanctions Defendants request are appropriate based on Mars's conduct. Instead, the Court will address the propriety of joining Petcare in the context of Mars's motion for leave to amend.

At the outset, the parties dispute whether Rule 15 or Rule 16 governs consideration of Mars's request for leave. But even under the more rigorous standard of Rule 16, Mars has demonstrated that good cause exists to grant its motion. First, Mars explains that it did not attempt to join Petcare prior to the January 10, 2014, deadline because Mars was unaware that Petcare had a lost profits claim until the parties completed discovery on the issue of lost profits in June 2015. One month later, Mars sought leave to amend its complaint after its damages expert had an opportunity to review the discovery materials. Mars's explanation is reasonable, and in the absence of any evidence of bad faith, this factor weighs in favor of granting Mars's motion to amend its complaint.

Second, Mars contends that Petcare's joinder is necessary to ensure that Plaintiffs are fully compensated for the lost profits caused by Defendants' infringing activities. Mars maintains that by joining this suit, Petcare will be able to seek lost profits for its own products, rather than relying on Mars to do so. Given the parties' vigorous disagreement over whether Mars can collect lost profits on products sold by its subsidiaries, Mars has demonstrated the importance of allowing Petcare to join as a co-plaintiff simply based on the fact that it will simplify the issues in this case. Moreover, Defendants' expert admitted that their Minties® products competed directly with and captured sales from Petcare's Dentastix® products. Doc. No. 176-2, Deposition of Dr. Stephen Becker, at 173:15–23. Accordingly, this factor favors granting Mars's motion.

Third, although Defendants claim they will be extremely prejudiced by Mars's amendment, they have not specifically articulated in what way. Their briefing largely focuses on the fact that Mars's motion came eighteen months after the deadline for the joinder of additional parties. Additionally, they argue that for more than two years, they have relied on Mars's First Amended Complaint in developing their case by "propound[ing] discovery in an effort to develop predictable boundaries in this case." *See* Doc. No. 166 at 11–12; *Id.* at 5 n.6. But delay alone—especially reasonable delay—is not enough to show prejudice. *See Mayeaux v. La. Health Serv. & Indem. Co.*, 376 F.3d 420, 427 (5th Cir. 2004). More importantly, though, a review of the record reveals that Defendants have repeatedly sought discovery from both Mars and Petcare through interrogatories, depositions, and requests for admission. *See, e.g.*, Doc. No. 149-1 at 1 ("'You' or 'Plaintiff' means and refers to Mars, Inc. . . . as well as . . . Mars Petcare US"). Further, two months before Mars attempted to file its Second Amended Complaint, Defendants served interrogatories as to both Mars and Petcare seeking their theory of lost profits, and one month later, served a Rule 30(b)(6) deposition notice on the issue of lost profits.

Thus, it appears that even before Mars attempted to join Petcare, Defendants were already treating Petcare as a co-plaintiff. Additionally, the complexion of this case will not change as a result of Petcare's joinder. Defendants will not be faced with materially different claims, nor will they be required to engage in additional discovery given that the parties continued to exchange discovery on the issue of lost profits even after the close of the discovery period. Because Mars's amendment "merely proposes [an] alternative legal theor[y] for recovery on the same underlying facts," and because Defendants have not sufficiently articulated how they will be prejudiced by Petcare's joinder, this factor weighs in favor of granting Mars's motion. *Mayeaux*, 376 F.3d at 427.

Finally, although a continuance might not be available due to the late stage of this case, as explained above, Defendants have not demonstrated that there is any prejudice to be cured. Accordingly, this factor is neutral. Based on these considerations, Mars has shown that good cause exists to allow it to file its Second Amended Complaint.

B. Petcare's Standing to Assert its Claims of Infringement

Defendants alternatively argue that the Court should dismiss Petcare and strike Mars's Second Amended Complaint under Rule 12(b)(1) because Petcare does not have standing to join this suit as a co-plaintiff. Defendants' Motion for Summary Judgment Regarding Plaintiffs' Claim for Damages also addresses Petcare's standing. Because this issue can be resolved by looking to the undisputed facts in the record, it is appropriate to take up the standing arguments raised in Defendants' Motion to Dismiss and their Motion for Summary Judgment together.

At bottom, the parties' disagreement turns on whether Petcare is an exclusive licensee of the two patents asserted by Mars in this case. Defendants contend that Petcare is not a licensee at all—exclusive or otherwise—whereas Mars maintains that Petcare holds an implied exclusive license to practice the patents in certain retail channels. The thrust of Defendants' argument is that Mars has not produced a written document evidencing the grant of a license to Petcare. Additionally, Defendants assert that Mars can point to no evidence that shows Petcare has the right to exclude others from practicing the patents-in-suit.

Generally, only a patentee has standing to bring a suit for patent infringement in its own name. *Textile Prods., Inc., v. Mead Corp.*, 134 F.3d 1481 (Fed. Cir. 1998). Exclusive licensees, however, "may possess sufficient interest in the patent to have standing to sue as a co-plaintiff with the patentee." *Rite-Hite Corp. v. Kelley Co.*, 56 F.3d 1538, 1552 (Fed. Cir. 1995). Conversely, "[a] nonexclusive license confers no constitutional standing on the licensee to bring suit or even to join a suit with the patentee." *Sicom Sys., Ltd. v. Agilent Techs., Inc.*, 427 F.3d 971, 976 (Fed. Cir. 2005). "To be an exclusive licensee for standing purposes, a party must have received, not only the right to practice the invention within a given territory, but also the patentee's express or implied promise that others shall be excluded from practicing the invention within that territory as well." *Rite-Hite*, 56 F.3d at 1552. Therefore, if a party has not received a promise of exclusivity under the patent, it cannot have co-plaintiff standing in an infringement action. *Id.* It is important to stress, however, that the exclusive license need not be express; it may be implied. *Id.*; *Aspex Eyewear, Inc. v. Altair Eyewear, Inc.*, 288 F. App'x 697, 705 (Fed. Cir. 2008).

As a preliminary matter, it is not incumbent upon Mars to produce a written license in order to join Petcare. *Aspex*, 288 F. App'x at 705 ("[A]n exclusive license need not be in writing for the exclusive licensee to have standing to sue with the patentee as a co-plaintiff."). An exclusive licensee must only produce a written license if it attempts to bring suit in its own name without joining the patentee. *See Speedplay, Inc. v. Bebop, Inc.*, 211 F.3d 1245, 1250 (Fed. Cir.

2000). In such a situation, the written license is necessary to confirm that the exclusive licensee holds all substantial rights in the patent, and thus, is effectively an assignee with the ability to bring suit. *Alps S., LLC v. Ohio Willow Wood Co.*, 787 F.3d 1379, 1382 (Fed. Cir. 2015), *cert. denied*, No. 15-567, 2016 WL 207273 (U.S. Jan. 19, 2016). Here, however, Petcare has never asserted that it possesses all substantial rights in Mars's patents, nor is it attempting to bring suit without the patentee. Therefore, in order to join this suit as a co-plaintiff, Petcare must only show that it received the right to practice Mars's patents in a particular area and Mars's express or implied promise that others would be excluded from practicing the patents in that area. *Rite-Hite*, 56 F.3d at 1552.

The evidence marshaled by Plaintiffs sufficiently establishes these requirements. First, Christopher Brandt—former Associate General Counsel for Petcare and Plaintiffs' 30(b)(6) witness designated to testify regarding licenses to the patents-in-suit—testified that at least since early 2008, Petcare has had the right to manufacture and sell products covered by the asserted patents. *See* Doc. No. 182-1, Deposition of Christopher Brandt, at 13:7–22. He also stated that as part of Mars's marketing strategy, Mars and its subsidiaries reached an understanding whereby each subsidiary would be confined to particular retail markets. *Id.* at 7:6–15, 9:18–10:11. Specifically, the Mars companies determined that Petcare would sell exclusively to the Food (grocery), Drug (*e.g.*, CVS and Walgreens), and Mass (*e.g.*, Walmart and Target) (FDM) markets. *Id.* at 13:15–16, 15:5–8. Nutro and another Mars subsidiary, on the other hand, were limited to selling products only in the pet specialty and veterinary markets; they would not sell to FDM customers. *Id.* at 9:23–10:2, 17:4–8, 36:22–37:1. Mr. Brandt testified further that since 2008, Mars and its subsidiaries have operated under this arrangement, and they do not intend to change their strategy in the future. *Id.* 30:25–31:13.

Defendants do not challenge the veracity of these facts. Instead, they question the existence of an implied exclusive license on the basis that Mr. Brandt testified that Petcare does not make royalty or lump sum payments under the license for the use of Mars's patents. *Id.* at 41:9–42:11. But Defendants cite no authority to support their argument that an exclusive license—and specifically, one between related companies—must contain particular financial terms. *See Mi-Jack Prods., Inc. v. Taylor Grp., Inc.*, No. 96-7850, 1997 WL 441796, at *8 (N.D. Ill. 1997) (concluding that a wholly-owned subsidiary had standing to join its parent in a patent infringement suit, even though the subsidiary was not formally designated as an exclusive licensee and paid no compensation to the parent for use of the patent). Rather, all that is required is Mars's express or implied promise that Petcare would be permitted to use the invention in a defined market to the exclusion of others. *Aspex*, 288 F. App'x at 706.

Defendants' assertion that Petcare has no right to exclude others from practicing Mars's patents is clearly contradicted by the abundance of evidence indicating that Petcare is the only Mars entity permitted to sell the patented products in the FDM channels. *See Blue Gentian, LLC v. Telebrands Corp.*, Civ. No. 13-4627(FSH), 2014 WL 2094089, at *10–11 (D.N.J. May 20, 2014) (holding that exclusive field of use licenses may be defined by market) (citing *WiAV Solutions LLC v. Motorola, Inc.*, 631 F.3d 1257, 1267 (Fed. Cir. 2010)). Furthermore, Defendants do not even address Mars's assertion that *no other company*, even one outside the Mars family, holds a license to sell products in the FDM channels under the patents-in-suit. *See generally* Doc. No. 217 at 4–7. And while the Court recognizes that this fact alone could not establish exclusivity, it is not the only one Plaintiffs put forth. *See Rite Hite*, 56 F.3d at 1553. Petcare's position as sole licensee in the FDM channels coupled with the corporate relationship between Mars and its subsidiaries, as well as Mars's marketing and sales strategy, is sufficient to demonstrate that Petcare has an implied right to exclude others from practicing Mars's patents in the FDM field.

Because Mars has shown good cause to amend its complaint and that Petcare has standing to join this suit as an exclusive licensee, the Court recommends: (1) that Defendants' Motion to Dismiss Mars Petcare US, Inc. and to Strike Plaintiffs' Second Amended Complaint (Doc. No. 139) be **DENIED**; (2) that Mars, Inc.'s Cross-Motion for Leave to Join an Additional Party and to Amend Plaintiffs' First Amended Complaint (Doc. No. 150) be **GRANTED**; and (3) that Defendants' Motion for Summary Judgment Regarding Plaintiffs' Claim for Damages (Doc. No. 206) be **DENIED** as to the issue of Petcare's standing.

Whether Mars May Recover Lost Profits for Products Sold by its Subsidiaries

The remainder of Defendants' Motion for Summary Judgment challenges Mars's ability to recover lost profits on products sold by its subsidiaries. Defendants argue that because Mars does not, itself, make or sell any products, Mars necessarily cannot show that it lost profits as a result of Defendants' alleged infringing activities. Mars responds that "[i]t is well-settled that a patent owner can recover its subsidiary's lost profits if those profits 'inexorably flow' to the parent/patentee—even if the subsidiary is not a party to the litigation." Doc. No. 211 at 17 (citing *Mars, Inc. v. Coin Acceptors, Inc.*, 527 F.3d 1359, 1367 (Fed. Cir. 2008)). Thus, Mars maintains that it may collect profits lost as a result of Defendants' conduct on Petcare's Dentastix® and Breathbuster® products and on Nutro's Greenies® products.

In support of its theory, Mars offers the declaration and deposition testimony of Adrienne Shumate, Mars's Americas Treasury Director, and the deposition testimony of Valerie Mars, the

Head of Corporate Development for Mars, Inc.[1] In her declaration, Ms. Shumate testified that all profits generated by Mars's subsidiaries are transferred daily to Mars's bank account:

> All daily Mars Petcare US revenue minus Mars Petcare US expenses (i.e., Mars Petcare US profit) flow[s] to Mars, Incorporated, with Mars Petcare US having a zero balance in its bank accounts at the end of the day. In other words, all cash earned by Mars Petcare US minus certain expenses flow[s] to Mars, Incorporated, showing a direct link between cash generation by Mars Petcare US that flow[s] to Mars, Incorporated as profits earned. If the profits of Mars Petcare US are diminished, then the profits of Mars, Incorporated are also diminished, and therefore there is less cash available in the system to fund the overall needs of the Mars business. The same structure and observations apply for The Nutro Company.

Doc. No. 211-14, Declaration of Adrienne Shumate, at ¶ 27. She stated further that this profit flow occurs by an automatic transfer of funds between bank accounts.[2] *Id.* ¶ 6, 11. Ms. Mars confirmed Ms. Shumate's explanation. Doc. No. 224-3, Deposition of Valerie Mars, at 54:6–16. Defendants do not dispute these facts, but contend that, as a matter of law, Mars is not entitled to recover lost profits, even under these circumstances.

Mars's lost profits theory is not as "well-settled" as it suggests. In *Coin Acceptors*, Mars advanced the inexorable flow theory in support of its claim for lost profits, asserting that "all [of its subsidiary's] lost profits were *inherently* lost profits of Mars." 527 F.3d at 1367. The Federal Circuit disagreed and found that the record did not support Mars's position because evidence indicated that Mars required the subsidiary to make royalty payments regardless of whether it made any profits. *Id.* The court went on to say, "Because we conclude that [the subsidiary's]

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[1] Defendants' Motion to Strike and their objection to Plaintiffs' Motion for Leave to Supplement will be taken up separately below.

[2] Whether the funds transferred from Petcare and Nutro's bank accounts are properly characterized as profit is questionable, given that Ms. Shumate testified in her deposition that not all of these companies' expenses are deducted before the funds are transferred to Mars. *See* Doc. No. 259-1, Declaration of Adrienne Shumate, at 90:14–91:21. For example, Ms. Shumate testified that at least some of the subsidiaries' vendor costs are paid directly from a different, separately-managed bank account on behalf of the subsidiaries by another Mars sub-entity. *Id.* at 89:25–93:1. This point, however, is not central to the Court's ultimate resolution of the lost profits issue.

profits did not—as Mars argued—flow inexorably to Mars, we . . . 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." *Id.* Thus, the court explicitly withheld consideration of the issue Mars now represents is binding precedent.

Plaintiffs also rely on four district court cases which cite *Coin Acceptors* for the proposition that a parent corporation may seek to recover the lost profits of its subsidiary as long as the subsidiary's profits do, in fact, flow inexorably up to the parent. *See Corning Optical Commc'ns Wireless Ltd. v. SOLiD, Inc.*, No. 5:14-CV-03750-PSG, 2015 WL 5723403, at *7 (N.D. Cal. Sept. 16, 2015); *Advanced Fiber Techs. (AFT) Trust v. J & L Fiber Servs., Inc.*, No. 1:07-CV-1191 (LEK/DEP), 2015 WL 1472015, at *25 (N.D.N.Y. Mar. 31, 2015); *Callaway Golf Co. v. Acushnet Co.*, 691 F. Supp. 2d 566, 575 (D. Del. 2010); *Cordis Corp. v. Boston Sci. Corp.*, No. Civ. 03-027-SLR, 2009 WL 3160270, at *4 (D. Del. Sept. 30, 2009). However, in each of the cases, as well as in two others not cited by Plaintiffs, the court made the same analytical leap Plaintiffs make here; it accepted without question that the inexorable flow test is the settled standard prescribed by the Federal Circuit. *See also Fujitsu Ltd. v. Tellabs, Inc.*, No. 09 C 4530, 2013 WL 2285794, at *3 (N.D. Ill. May 23, 2013); *Kowalski v. Mommy Gina Tuna Res.*, 574 F. Supp. 2d 1160, 1162 (D. Haw. 2008).

In *Kowalski v. Mommy Gina Tuna Resources*—the first case to address the inexorable flow theory after *Coin Acceptors*—the patentee and owner of a sole proprietorship attempted to recover profits lost by the company as a result of the defendants' infringement. 574 F. Supp. 2d at 1163. The patentee claimed that as the sole owner, president, and CEO of the company, its profits inexorably flowed to him because he had complete discretion to dispose of the profits as he saw fit. *Id.* Citing *Poly-America, L.P. v. GSE Lining Tech., Inc.*, 383 F.3d 1303 (Fed. Cir.

2004), the defendants argued that "the general rule in patent litigation is simple, straightforward, and clear—[a] patentee must sell some product to claim lost profits as damages." *Id.* Therefore, the defendants maintained that the patentee could not recover the sole proprietorship's lost profits as his own. *Id.* The court disagreed with the legal principle recited by defendants and, instead, concluded that "the more recent decision in [*Coin Acceptors*] demonstrates that the key question is whether the profits from the subsidiary flowed 'inexorably' to the parent." *Id.* Thus, in the *Kowalski* court's view, *Coin Acceptors* held 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." *Id.* at 1162.

The issue next arose in the context of a discovery dispute in *Cordis, Corp. v. Boston Scientific Corp.* There, the defendant requested discovery of profits made by the plaintiff's related entities, even though the parties had stipulated earlier in the case to forego discovery on that topic. 2009 WL 3160270 at *4. The parties had also agreed that the lost profits recoverable by either party could include the lost profits of their respective affiliates. *Id.* In refusing to permit the requested discovery, the court stated in a footnote without further analysis that in *Coin Acceptors*, "the Federal Circuit reaffirmed the legal proposition that a parent is entitled to the profits associated with the lost sales of its subsidiary only when such profits 'actually do flow inexorably up to the parent.'" *Id.* at *4 n.14 (quoting *Coin Acceptors*, 527 F.3d at 1367).

The same court again confronted the issue in *Callaway Golf, Co. v. Acushnet Co.* when the defendant criticized the plaintiff's damages expert for calculating lost profits on sales by companies that did not own the asserted patents. 691 F. Supp. 2d at 575. The court rejected the defendant's challenge, stating without elaboration, "I conclude that where the profits of a wholly-owned subsidiary flow up to the parent, inclusion of such profits is appropriate." *Id.* (citing *Coin Acceptors*, 527 F.3d at 1367).

The first post-*Coin Acceptors* case to discuss with any substance whether a parent company may recover its subsidiary's lost profits was *Fujitsu Ltd. v. Tellabs, Inc.* The court began by distinguishing a situation in which a patentee attempts to recover its subsidiary's lost profits as its own from one in which a patentee seeks to recover its own lost profits. *See* 2013 WL 2285794 at *3. The court explained that in seeking its own lost profits, "[t]he patent owner is required . . . 'to have been selling some item, the profits of which have been lost due to infringing sales.'" *Id.* (quoting *Poly-America*, 383 F.3d at 1305). The court then surveyed a number of cases arising both before and after *Coin Acceptors* and summarily concluded that "[t]he issue governing whether a parent company patent owner may be compensated under the damages theory of lost profits for its wholly-owned subsidiary's lost sales turns on whether the subsidiary's profits 'flowed inexorably' to the patent-owner parent." *Id.* at *3–6 (citing *Coin Acceptors*, 527 F.3d at 1367).

In *Advanced Fiber Technologies (AFT) Trust v. J & L Fiber Services, Inc.*, the defendant sought summary judgment on the plaintiff's entitlement to lost profits from sales made by its foreign subsidiaries. 2015 WL 1472015 at *25. The defendant argued that the plaintiff had not produced evidence demonstrating that profits from those sales flowed inexorably from the subsidiaries to the plaintiff. *Id.* The court accepted the defendant's suggestion that the inexorable flow test governed without discussion, but concluded that the plaintiff's evidence was sufficient to withstand summary judgment. *Id.* ("[A] rational trier of facts could conclude that the profits of [Plaintiff's] European and Asian subsidiaries flow inexorably to [Plaintiff].")

Finally, the inexorable flow test was discussed most recently in *Corning Optical Communications Wireless Ltd. v. SOLiD, Inc.* There, the patentee—an Israeli corporation—brought suit against two competitors seeking damages in the form of lost profits. 2015 WL 5723403 at *3, *6. Although the plaintiff did not sell products directly to end consumers in the United States, its American parent corporation did. *Id.* at *6. The Defendants moved for summary judgment on the plaintiff's lost profits claim, contending that the plaintiff was improperly attempting to recover its parent company's lost profits. *Id.* The court disagreed and explained, instead, that the plaintiff was claiming "lost profits only from the sales that it would have made, not its parent." *Id.* at *7.[3] But even though the plaintiff was not pursuing its parent's lost profits, the court nonetheless analyzed the situation under the inexorable flow test, stating that "[i]n lost profits cases involving related companies, the Federal Circuit has required exactly what [the plaintiff] alleges: the loss of profits that would have "flowed inexorably" to the patentee." *Id.* (citing *Coin Acceptors*, 527 F.3d at 1367). Thus, the court seemed to suggest that the inexorable flow test was appropriate because, under the plaintiff's damages theory, a higher number of sales by the parent corporation would have resulted in an increased number of sales by the plaintiff:

> . . . Corning does not sell DAS products directly to end customers in the United States. But Corning's American parent does, and Corning derives 95% of its revenue from that sales channel. . . . [At trial,] Corning will have to prove that its transfer pricing arrangement guarantees that sales by its American parent result in an inexorable flow of revenues to Corning.

Id. at *6–*7.

[3] The Court did not clearly identify where or to whom the plaintiff sold products but implied that the plaintiff sold primarily to its parent company, which in turn sold those products to end customers in the United States.

Each of these cases made the same leap Plaintiff asks this court to make. But the Federal Circuit in *Coin Acceptors* expressly refused to decide whether a parent company could collect on a lost profits theory when its subsidiary's profits flowed inexorably up to the parent. Although, each court above approached the issue as if the Federal Circuit had endorsed the inexorable flow test, in *Coin Acceptors*, however, the court stated "simply that the facts of [the] case [could not] support recovery under a lost profits theory." 527 F.3d at 1367. This is because Mars required its subsidiary "to make [] royalty payments whether or not it made any profit" and because "Mars identified no record evidence that it ever received or recognized any form of profit or revenue from [its subsidiary] apart from these royalty payments." *Id.* Therefore, the court held only that Mars had failed to prove that profits flowed inexorably from its subsidiary to Mars. *Id.* Again, the court went on to say:

> Because we conclude that [Mars's subsidiary's] profits did not—as Mars argued—flow inexorably to Mars, we . . . 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.

Id. Thus, the court left open the question for another day.

Moreover, since *Coin Acceptors* was decided, the Federal Circuit has twice indicated that it would be unwilling to allow a patentee to recover the lost profits of a related company as its own under the inexorable flow theory. *See Spine Solutions, Inc. v. Medtronic Sofamor Danek USA, Inc.*, 620 F.3d 1305, 1319 (Fed. Cir. 2010); *Warsaw Orthopedic, Inc. v. NuVasive, Inc.*, 778 F.3d 1365, 1375 (Fed. Cir. 2015), *cert. granted, vacated sub nom. on other grounds*, *Medtronic Sofamor Danek USA, Inc. v. Nuvasive, Inc.*, No. 15-85, 2016 WL 207240 (U.S. Jan. 19, 2016). In *Spine Solutions*, the patentee amended its complaint before the district court to add its parent and sister corporations to the suit as co-plaintiffs. 620 F.3d at 1317–18. On appeal, the Federal Circuit held that the district court abused its discretion by allowing the patentee to amend its complaint because the record evidence was insufficient to establish that the parent and sister corporations had standing to sue as exclusive licensees. *Id.* Based on its decision that neither of the patentee's affiliated companies had standing to sue on the asserted patent, the court held that the patentee could not recover any lost profits suffered by either its parent or sister company. *Id.* at 1319. In arriving at that conclusion, the court explained that because the patentee did not itself sell any products, it was not entitled to any lost profits damages. *Id.*

Then, in *Warsaw*, the Federal Circuit emphasized that "[u]nder our case law a patentee may not claim, as its own damages, the lost profits of a related company." 778 F.3d at 1375. There, the patentee sought damages in the form of lost profits based on three different sources of income, two of which—royalty payments and "true-up" payments—came from the patentee's subsidiaries. *Id.* at 1374. The patentee argued that because it licensed its patents to its subsidiaries in exchange for royalty payments tied to the subsidiaries' sales, and because the subsidiaries' sales were negatively affected by the defendant's infringement, it should be permitted to recover the lost royalty payments as lost profits. *Id.* at 1376. The patentee maintained that it was not seeking damages based on the lost profits of its subsidiaries, but instead, was asking only for the royalty payments that the subsidiaries would have remitted to the patentee but for the defendant's infringement. *Id.* Similarly, the patentee argued that it should be allowed to recover as lost profits the true up payments that another of its subsidiaries would have made to the patentee had the subsidiary's sales of patented products been higher.[4] *Id.* at 1376–77.

Rather than focusing on the intricacies of the financial arrangements between the patentee and its subsidiaries, the Federal Circuit stated more generally that "[t]o be entitled to lost profits,

[4] In order to comply with the relevant tax and accounting laws, the patentee required the subsidiary to make the true up payments to ensure that the patentee received fair market value for various transactions, such as licensing arrangements, that occurred between the patentee and the subsidiary throughout the year. 778 F.3d at 1376–77.

we have long recognized that the lost profits must come from the lost sales of a product or service the patentee itself was selling." *Id.* at 1376. And because the patentee had not proven that the revenue streams it was seeking were attributable to lost profits on some product the patentee would have sold, the court held that the patentee could not recover those revenue streams under a lost profits theory. *See id.* at 1376–77.

In reaching its decisions in *Spine Solutions* and *Warsaw*, the Federal Circuit relied principally on *Poly-America, L.P. v. GSE Lining Tech., Inc.*, 383 F.3d 1303 (Fed. Cir. 2004). In *Poly-America*, the patentee sought to recover lost profits on products sold by its sister company based on a contractual provision in a license between the two parties. 383 F.3d at 1310. The license stated that the patentee "desire[d] to have the contractual right to collect all damages accruing to [the licensee] for certain past infringements of the Patents." *Id.* at 1311. Therefore, the patentee argued that it should be permitted to collect its sister company's lost profits as its own because the two companies operated as a "single economic unit" for purposes of manufacturing and selling the patented products. *Id.* at 1310. In refusing to allow the patentee to do so, the court noted 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." *Id.* at 1311. It further explained that companies "may not enjoy the advantages of their separate corporate structure and, at the same time, avoid the consequential limitations of that structure." *Id.* Therefore, because the patentee's parent had chosen to form the patentee and its sister company as separate entities "to suit its own goals and purposes," the court held that the patentee was limited to recovery of its own lost profits and not those of its sister company. *Id.* Then, because the record was unclear regarding whether the patentee itself sold any products that could form the basis of its lost profits claim, the court remanded the case for a determination on that issue. *Id.* at 1311–12.

Because the Federal Circuit left open the question in *Coin Acceptors* regarding the viability of Mars's inexorable flow theory for lost profits, the Court is left only with the Federal Circuit's guidance in *Warsaw*, *Spine Solutions*, and *Poly-America*. Although none of these cases speaks directly to the inexorable flow theory, they do address situations in which a patentee attempted to recover a related company's lost profits as its own, as Mars does here. And each of these cases, without exception, holds squarely that "[t]o be entitled to lost profits, . . . the lost profits must come from the lost sales of a product or service the patentee itself was selling." *Warsaw*, 778 F.3d at 1376; *see Spine Solutions*, 620 F.3d at 1319; *Poly-America*, 383 F.3d at 1311; *see also Rite Hite*, 56 F.3d at 1548 ("Normally, if the patentee is not selling a product, by definition there can be no lost profits."). Here, Mars admits that it does not sell the products that form the basis of its lost profits claim; its subsidiaries do. Doc. No. 211 at 17. Furthermore, *Warsaw* unambiguously states that "a patentee may not claim, as its own damages, the lost profits of a related company," 778 F.3d at 1375, which is precisely what Mars attempts to achieve here, *see* Doc. No. 211 at 16 ("Mars Inc. can recover its subsidiaries' lost profits even if Mars Petcare is not joined.").

Thus, based on the current precedent, it appears that no matter how profits flow between Mars and its subsidiaries, Mars cannot recover lost profits on the Dentastix®, Breathbuster®, or Greenies® products at issue in this case because Mars itself does not sell those products. This result is also consistent with the *Poly-America* court's rationale for refusing to allow the plaintiff there to disregard the formalities of its corporate organization. *See* 383 F.3d at 1311. Here, Mars has chosen to organize the corporate identities and functions of its wholly-owned subsidiaries "to suit its own goals and purposes," and as a result, must take the benefits of that decision with their corresponding burdens. *Id.* Consequently, Mars may not recover lost profits from products sold by its subsidiaries.

None of this is to say, however, that a patentee in Mars's position is categorically barred from collecting income derived from sales by a subsidiary or licensee in a patent infringement suit. As the court in *Coin Acceptors* cogently explained:

> . . . [W]hile lost profits is plainly one way to measure the amount of damages that will "fully compensate" the patentee under [35 U.S.C.] § 284, we have never held that it is the only one. . . . We have previously recognized that patentees may be entitled to damages above a reasonable royalty on theories entirely distinct from lost profits.

527 F.3d at 1366. Here, though, Mars has chosen to style its damages theory as a claim for lost profits. And according to the cases discussed above, a claim for lost profits is not synonymous with a claim for lost income. Therefore, because Mars does not itself sell the products that give rise to its lost profits claim, the Court recommends that Defendants' Motion for Summary Judgment Regarding Plaintiffs' Claim for Damages (Doc. No. 206) be **GRANTED** as to Mars's ability to recover its subsidiaries' lost profits.

The Disputes Surrounding the Testimony of Adrienne Shumate

Defendants object to Mars's reliance on Ms. Shumate's declaration in support of Mars's lost profits theory. They contend that Mars did not identify Ms. Shumate as a potential witness on the issue of lost profits until after the close of discovery. Therefore, Mars should not be permitted to offer her declaration now as an exhibit to its summary judgment briefing because Defendants never had an opportunity to take her deposition. *See generally* Doc. No. 219, Defendants' Motion to Strike Testimony of Adrienne Shumate. Mars counters with justifications for its late disclosure and has also filed a motion for leave to supplement the record with Ms. Shumate's deposition testimony from an ongoing case in Virginia between Mars and the True

Science Defendants involving issues similar to those in this case. *See generally* Doc. No. 258, Plaintiffs' Motion for Leave to File Plaintiffs' Supplement. In her deposition, Ms. Shumate testified more fully on the subject of profit flow between Mars and its subsidiaries. Defendants also object to Mars's supplement.

The Court strongly disfavors the practice of late disclosure and is not persuaded by Plaintiffs' justifications for such a late disclosure. However, in order to gain a complete understanding of the issues presented regarding Mars's lost profits theory, the Court has considered Ms. Shumate's declaration and deposition testimony in reaching its conclusion that Mars may not recover its subsidiaries' lost profits. As such, Defendants' Motion to Strike (Doc. No. 219) is **DENIED**; and Plaintiffs' Motion for Leave (Doc. No. 258) is **GRANTED**. Even taking Ms. Shumate's testimony into account, the Court's analysis remains unchanged. Because Mars does not itself sell the products which form the basis of its lost profits claim, Mars may not collect damages in the form of lost profits, regardless of the flow of profits between Mars and its subsidiaries who sell the products.

CONCLUSION

For the foregoing reasons, the Court recommends that Defendants' Motion to Dismiss Mars Petcare US, Inc. and to Strike Plaintiffs' Second Amended Complaint (Doc. No. 139) be **DENIED**; Mars Inc.'s Cross-Motion for Leave to Join an Additional Party and to Amend Plaintiffs' First Amended Complaint (Doc. No. 150) be **GRANTED**; and Defendants' Motion for Summary Judgment Regarding Plaintiffs' Claim for Damages (Doc. No. 206) be **GRANTED** as to Mars's ability to recover its subsidiaries' lost profits and **DENIED** as to the issue of Petcare's standing. Furthermore, Defendants' Motion to Strike Testimony of Adrienne Shumate

(Doc. No. 219) is **DENIED**; and Plaintiffs' Motion for Leave to File Plaintiffs' Supplement (Doc. No. 258) is **GRANTED**.

Within fourteen days after receipt of the Magistrate Judge's report, any party may serve and file written objections to the findings and recommendations of the Magistrate Judge. 28 U.S.C. § 636(b). A party's failure to file written objections to the findings, conclusions, and recommendations contained in this Report within fourteen days after service shall bar that party from de novo review by the District Judge of those findings, conclusions, and recommendations, and except upon grounds of plain error, from attacking on appeal the unobjected-to proposed factual findings and legal conclusions accepted and adopted by the district court. *Douglass v. United Services Auto. Assn.*, 79 F.3d 1415, 1430 (5th Cir. 1996) (en banc), *superseded by statute on other grounds*, 28 U.S.C. § 636(b)(1) (extending the time to file objections from ten to fourteen days).

So ORDERED and SIGNED this 14th day of March, 2016.

K. Nicole Mitchell

K. NICOLE MITCHELL
UNITED STATES MAGISTRATE JUDGE