How IP Licensing Can Cost Small Entity Status

Intellectual Property

Cheat Sheet

USPTO fees. The United States Patent and Trademark Office assigns fees based on the size of the entity.

Licensing. Licensing a patent may affect the entity status of the patent.

Consider the sum. A patent may be licensed to multiple unaffiliated small entities as long as they remain unaffiliated. The equation changes if relationships become closer.

Alternatives. It is possible to structure an agreement with the large entity to achieve the desired results of collaboration without licensing a patent.

United States Patent and Trademark Office (USPTO) fees can be expensive. However, for small businesses, the USPTO has long recognized this, allowing them to take advantage of “small entity” status to reduce most fees by 50 percent. In the American Invents Act of 2012, Congress authorized a new category of “micro entity” that entitles businesses to a 75 percent reduction of most USPTO fees.

As these fee reductions are significant, there can also be substantial penalties for incorrectly claiming or maintaining small or micro entity status. Consequences can include invalidation of a patent. For this reason, it is important that the size of the entity of an applicant or patent owner is correct for a

given patent application or issued patent. In this article, an applicant and patent owner will be referred to simply as a patent owner and a pending patent application and issued patent will be referred to simply as a patent.

The USPTO recognizes that the status of the patent owner may change between a micro, small, or large entity through the life of a patent. As such, the entity status of a patent owner is determined at the time a particular fee is paid. Thus, during the life of a patent, some fees may be paid as a micro entity, some fees may be paid as a small entity, and other fees may be paid as a large entity.

For this reason, a patent owner must evaluate the appropriate status of a patent before any fee is paid to the USPTO. If the status is incorrect, the status can be updated when the fee is paid. In addition, if it is determined by the patent owner that any previous fee was paid as an incorrect status, the difference can be paid or a refund requested as long as the fee paid was not made with deceptive intent.

An applicant claims small entity status by checking a certification box. Before doing so, the applicant needs to meet two conditions:

1. Must be an individual, a small business, or a nonprofit organization; and
2. Have not assigned or are not under obligation by contract or law to assign, grant, or convey a license or other ownership interest in the application to a larger entity.

The Small Business Administration requires that the entity, including its affiliates, not exceed 500 employees. An important and sometimes forgotten element of a small business concern is determining what is considered an affiliate.

The term affiliate has been broadly construed and can include ownership, management, previous relationships with or ties to another business, and contractual relationships with a key factor being when one entity has control of the other or has the power to control the other. Given the ever-changing laws defining “affiliation” between companies, advice should be sought to determine if there is an affiliation with a licensed company.

To claim micro entity status an applicant, inventor, and joint inventor must file a separate certification of micro entity status form with the USPTO. The form certifies that the applicant, inventor, and joint inventor each:

1. Is eligible for small entity status;
2. Have not been named in more than four previously filed patent applications;
3. Have a gross income less than three times the US median household income (the current limit is US$206,109); and
4. Have not assigned or are not under obligation by contract or law to assign, grant, or convey a license or other ownership interest in the application to a larger entity.

Of note, there are two specific licenses or interests that are specifically excluded from affecting small entity status. First, a license to a federal agency, including a license under a funding agreement, does not prohibit an entity from claiming small entity status. Second, a security interest that does not transfer right except in default of the security interest does not prohibit an entity from claiming small entity status. These two exceptions are not explicit for micro entity status and may affect micro entity status.

IP Licensing

During the life of a patent, a patent owner may license its patents to other entities. Licensing a patent may affect the entity status of the patent. For example, if the patent is issued to a known large entity, the patent owner is no longer entitled to small entity status from the effective date of the licensee to the expiration date or the termination of the licensee.

In the event of such a license, the patent owner can request a change in status with the USPTO, which can be done electronically, or the patent owner can wait until the next fee is due and check a box to indicate that the entity status has changed. Either of these methods is acceptable as long as the correct fee amount is paid when it is due.

Why license?

There are many reasons why a small or micro entity may choose or be pressured to license a patent to a large entity. For example, a small or micro entity may require a partner to manufacture, research, or develop a product. In some instances, it may be necessary to license a patent to a large entity to obtain revenue or capital. In other instances, a license may allow a small or micro entity to prove up an idea, develop parts, or develop processes.

There are other times where a small or micro entity may license a patent as a part of a cross-license agreement with a large entity to allow the small or micro entity to obtain a license to patents owned by the large entity. When considering a license in any one of these situations, it important for a small or micro entity to consider the loss of status with the USPTO and the resulting increase in fees before entering into such a license.

Reverting to small-entity status

When such a license expires or is terminated, the owner may be able to reestablish small entity status if the patent owner is still a small entity and there are no other licenses requiring the patent owner to be considered a large entity.

For example, a licensed large entity may spin off a division that licensed a patent to a new entity that has less than 500 employees such that the patent is no longer licensed to a large entity. If the new spin-off is unaffiliated with the previous large entity, then it may be possible for the licensor patent owner to reclaim small entity status.

However, in such a scenario, it is important to do an affiliation analysis to verify that a previously licensed large entity would not still be seen as affiliated with the spin-off. For example, does the large entity have control over aspects of the new spin-off? If a patent owner can reclaim small entity status after the expiration or termination of a license, the patent owner can check a box indicating a change of entity status when paying the next fee with the USPTO without submission of a separate form.

Consider the sum

Some licensing scenarios may be less obvious to a patent owner if a patent is still entitled to small entity status. For example, a patent may be licensed to multiple unaffiliated small entities but the total number of employees of the patent owner and the licensees is greater than 500. In such a scenario, if the patentee is not affiliated with any of the licensees' and the licensees are not affiliated with one

another, then the patent owner is still entitled to claim small entity status for the licensed patent.

In contrast, if a patent is licensed to a licensee that is affiliated with another entity such that the licensee and the affiliated entity have more than 500 employees total, then the affiliated licensee is actually a large entity. As a result, the patent owner licensed the patent to a large entity and is no longer entitled to small entity status.

Similarly, if a patent is licensed to two or more of the licensees that were previously unaffiliated with one another and the licenses merge or otherwise affiliate with one another such that the affiliated licensees have a total of more than 500 employees. The affiliated licensees become a large entity. As a result of the licensees affiliating with one another, the patent is licensed to a large entity such that the patent is no longer entitled to small entity status. This may occur if two or more licensees set up another entity related or unrelated to the patented technology.

Becoming affiliated

In another scenario, a patent owner may enter into an agreement with a licensee where the licensee has control over aspects of the patent owner's business. If the licensee has the power to control aspects of the patent owner's business, the licensee and the patent owner may be seen as affiliated. As such, if the licensee and the patent owner have more than 500 employees combined, then the patent is no longer entitled to small entity status.

Similarly, if the patent owner enters into an agreement where the patent owner gains control over aspects of one or more of the licensees' businesses and the total number of employees of the patent owner and the licensees for which the patent owner has control is over 500. The patent owner may become affiliated with the licensees, and thus, become a large entity by virtue of the license agreement.

From the scenarios above, it is clear that the question of whether small entity status is preserved when the patent is licensed comes down to an affiliation analysis of the patentee, the licenses, and whether the license creates an affiliation between the patentee and the licensees or an affiliation between one or more of the licensees.

Alternatives to licensing

In many circumstances, it may be possible to structure an agreement with the large entity to achieve the desired results of collaboration without licensing a patent, and thus, without jeopardizing small or micro entity status with the USPTO. For example, when approached by a large entity, it may be possible to structure the agreement in such a way that the small or micro entity sells a product including the patented product or process to the large entity. Such a structure would allow the large entity to gain the benefits of offering patented products without requiring a licensee.

Similarly, when there is a joint development project with a large entity, it may be possible to structure the agreement that any product resulting from the joint development is manufactured by the small or micro entity and sold to the large entity.

In such agreements, other terms should be considered when appropriate, such as an exclusivity agreement for innovations developed during the collaboration, limited term for such an exclusivity agreement, a minimum quantity term for products developed during the joint innovations, and

secondary source agreements. Such terms may allow for the large entity to get the benefits of the collaboration while allowing the small or micro entity to maintain status with the USPTO.

When manufacturing capability or capacity is required, the terms can be structured so that the large entity produces the product for the small or micro entity without granting a license to the large entity. This can allow for the small or micro entity to maintain status with the USPTO and may also prevent the large entity from selling over capacity of a patented product without approval from the small or micro entity.

David Mason

Director of IP Security and Strategy

Tula Technology, Inc.

David Mason is director of IP security and strategy for Tula Technology, Inc.

Dan Ovanezian

Partner

Womble Bond Dickinson

Dan Ovanezian specializes in developing intellectual property strategies and portfolios for companies through the

spectrum of their development from early stage startup through successful exist strategy and post initial public offering (IPO) maturation.

Cory Schug

Associate

Womble Bond Dickinson