

CLIENT ALERT

Supreme Court Affirms Decision Banning Royalties on Expired Patents, Notes Alternative Methods

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In a case watched closely by research institutions, technology companies, and intellectual property licensing professionals, the U.S. Supreme Court decided Monday of this week that Marvel Entertainment need not comply with its contractual obligation to continue to pay royalties to the inventor of a Spider-Man toy, after the inventor's licensed patent expired. In so ruling the Court affirmed its controversial 1964 decision, *Brulotte v. Thys Co.*, 379 U.S. 29 (1964), which held unlawful the collection of royalties based on post-expiration use of a patented invention. *Kimble v. Marvel Entertainment, LLC*, 576 U.S. __ (2015) (Slip Op.). With no contractually-set expiration date to Marvel's commitment to pay a fixed percentage royalty, the Court ruled that Marvel need not pay royalties on sales of products covered by a patent after its expiration, currently set by 35 U.S.C. § 154(a)(2) as 20 years after the date the patent application is filed. At the same time, the Court acknowledged that technology licenses can be structured with payments made after the patent expires if they are for use of the patent before it expired. The Court also provided some examples how that goal could be accomplished under the affirmed *Brulotte* rule.

Stephen Kimble invented and patented a device for shooting a foam string web from the palm of the hand (like Spider-Man). In settlement of litigation, Marvel Entertainment and Kimble entered into a license under which Marvel could practice the Kimble patent in perpetuity, in exchange for a 3 percent royalty on all future sales of Spider-Man toys embodying the patent. Neither party was aware of *Brulotte* when entering the agreement, but once Marvel learned of the case, it sued for a declaratory judgment that it could cease making payments under the license once Kimble's patent expired. Citing *Brulotte*, the district court granted Marvel's request, finding that "the [3 percent] royalty provision [is] unenforceable after the expiration of the Kimble patent." 692 F. Supp. 2d 1156, 1161 (D. Ariz. 2010). The Ninth Circuit affirmed, "reluctantly apply[ing] the rule" while acknowledging that "the *Brulotte* rule is counterintuitive and its rationale is arguably unconvincing." 727 F.3d 856, 857 (9th Cir. 2013).

The Ninth Circuit was not alone in its criticism of the *Brulotte* rule – the Seventh Circuit also has reluctantly followed *Brulotte*, but protested that a license requiring post-expiration royalty payments "does not extend the duration of the patent either technically or practically, because ... if the licensee agrees to continue paying royalties after the patent expires the royalty rate will be lower." *Scheiber v. Dolby Labs., Inc.*, 293 F.3d 1014, 1017 (7th Cir. 2002). The *Brulotte* rule merely "fixes the limit of the patentee's power to extract royalties [*i.e.*] whether he extracts them at a higher rate over a shorter period of time or a lower rate over a longer period of time." *Id.*

Despite this and other widespread criticism of the rule, the Court this week declined to overrule what it characterized as *Brulotte*'s holding that "a patent holder cannot charge royalties for the use of his invention after its patent term has expired." *Kimble*, 576 U.S. __, Slip Op. at *1. As Justice Kagan wrote for the Court's majority (Justice Alito wrote the dissent and was joined by Chief Justice Roberts and Justice Thomas), patents "endow their holders with certain superpowers, but only for a limited time." *Id.* at *3. Contracts to pay royalties for "post-expiration use of the invention" "continue 'the patent monopoly beyond' the statutory period and, therefore, 'conflict with patent law's policy of establishing a 'post-expiration ... public domain' in which every person can make free use of a formerly patented product." *Id.* at *5, quoting *Brulotte*, 379 U.S. at 33.

The *Kimble* majority Monday did not defend the substance of the 1964 *Brulotte* decision but upheld it on the grounds of *stare decisis*, while acknowledging that *Brulotte* may have been wrongly decided 51 years ago. The Court noted that "*Brulotte* has governed licensing agreements for more than half a century," and involves "property (patents) and contracts (licensing agreements)," two important areas for consistency, and areas of law where "considerations favoring *stare decisis* are 'at their acme'." *Id.* at *8-9.

The majority opinion engaged in playful, superhero rhetoric, stating that in the face of such a "superpowered form of *stare decisis*, we [] need a superspecial justification to [reverse] *Brulotte*." *Id.* at *10. The Court concluded that such a justification had not been provided, nor was the Court in the position to evaluate and decide claims of economic or social need for reversing its existing rule. Ultimately, the Court deferred to Congress, concluding that the Court should "promote the rule-of-law values to which courts must attend while leaving matters of public policy to Congress." *Id.* at *18. The Court concluded that "Kimble's reasoning may give Congress cause to upset *Brulotte*, but does not warrant this Court's doing so." *Id.* at *12.

Kimble thus rejects the suggestions of leading commentators, the Ninth Circuit below and other circuit courts, which proposed replacing *Brulotte*'s blanket prohibition with a more case-specific approach, balancing the benefits and harms of possible expiration terms. Especially after *Kimble* was accepted for certiorari, many expected the Supreme Court would overrule *Brulotte*'s *per se* rule in favor of a more case-specific analysis, similar to the "rule of reason" applied in antitrust cases. The case-specific approach advocated by *Kimble* would have reflected the generally accepted economic view that longer duration licenses need not actually "extend" a "patent monopoly," so long as the royalty structure reflects the value of the use of patented technology during the patent's life. It was also argued that a reversal would have been consistent with the recent general trend of the Court eliminating simple, *per se* rules in antitrust and patent cases.

But this week's decision means the 1964 rule in *Brulotte* has not changed, notwithstanding the substantial criticism of that rule from economists, technology licensors, and legal academicians.

The Court upheld *Brulotte* even after noting the case "may pose an obstacle" to a "cash strapped licensee" or "when years of development work stand between licensing a patent and bringing a product to market." *Id.* at *5. On this critical point involving actual real-world licensing, however, the Court explained there are multiple ways to structure licenses for payment of pre-expiration use of patented technology after the licensed patents have expired. *Id.* at *6. In fact, the Court provided specific examples of such payment arrangements, which it suggested would be in compliance with the *Brulotte* rule affirmed in its decision:

- **Deferred payments.** "*Brulotte* allows a licensee to defer payments for pre-expiration use of a patent into the post-expiration period..."
- **Package licensing.** "Under *Brulotte*, royalties may run until the latest-running patent covered in the parties' agreement expires. ..."; also, "[P]ost-expiration royalties are allowable so long as tied to a non-patent right—even when closely related to a patent. ..."
- **Licensing of know-how and other unpatented intellectual property.** If technology without an expiration date, such as trade secrets or know-how, is also licensed, a high rate can be charged until the licensed patents expire and a lower rate can be charged for use of the non-patent rights thereafter.
- **Joint ventures and other arrangements.** "*Brulotte* poses no bar to business arrangements other than royalties—all kinds of joint ventures, for example" This suggests that profit sharing agreements would survive a *Brulotte* challenge.

Notably, the Court recognized a "consensus" that identified the faulty economic justifications for the *Brulotte* rule, and that in prior cases it had overturned precedent "in light of sounder economic reasoning." But the Court refused to apply that standard to what it classified "a patent rather than an antitrust case." *Id.* at *14. The dissent disagreed, noting that "*Brulotte* was an antitrust decision masquerading as a patent case." *Id.* at **7 (Alito, J., dissenting). In Justice Alito's words, the *Brulotte* Court "was principally concerned with patentees improperly leveraging monopoly power" and "characterized post-expiration royalties as anticompetitive tying arrangements" and therefore an antitrust approach to *stare decisis* should have applied. *Id.* The dissent highlights an issue of note for future cases in this area which may rely more clearly on analysis of competitive effects.

In the end, *Kimble* relies heavily on an expansive view of *stare decisis* in statutory interpretation cases—and a relatively narrow reading of *Brulotte*. Licensors and licensees of intellectual property will of course be well served by avoiding the simple structure of the Marvel-Kimble license. The Court, however, suggested that broad leeway should be afforded to a number of more creative license agreements, especially ones that make clear that post-expiration payments by the licensee are based on its pre-expiration use of the patented technology, or on the continuing use of related know-how. Given the express caveats and limitations on its affirmance of *Brulotte*, the Court signaled that *Kimble*'s impact on real word licenses—and licenses currently being negotiated—can be ameliorated by careful license drafting, but the extent of its reach will almost certainly depend on its further application and interpretation by the lower federal courts.

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