

Client Alert

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Rebuffing Critics, Supreme Court Re-Affirms Ban on Post-Expiration Patent Royalties

By Sean Gates and Jeny Maier

Fifty years ago, in *Brulotte v. Thys Co.*,¹ the U.S. Supreme Court held that the collection of royalties after a patent's expiration constitutes *per se* patent misuse. *Brulotte* has been widely criticized as economically irrational. In particular, critics have contended that *Brulotte* was based on a faulty view of the competitive effects of post-expiration royalties and that the Court, as it has in several antitrust cases, should abandon the *per se* rule in favor of a "rule of reason" approach.

In *Kimble v. Marvel Enterprises, Inc.*, the critics finally had their day in court; the question presented was whether the Court should overrule *Brulotte*. While acknowledging that a "broad scholarly consensus" supports the "view of the competitive effects of post-expiration royalties," the Court nevertheless refused to overrule *Brulotte*, adhering to principles of *stare decisis*.² The Court was not convinced by claims that *Brulotte* posed a significant barrier to efficient licensing or that the case has discouraged technological innovation. Moreover, the majority emphasized that *Brulotte* involved an interpretation of the Patent Act, which requires stricter adherence to *stare decisis* than in antitrust cases.³ *Brulotte* may therefore have implications for other patent cases in which antitrust and competition policies concerns are at issue.

I. BRULOTTE'S CRITICS

In *Brulotte*, the Court reasoned that obtaining royalties for the use of patents post-expiration would expand the scope of the patentee's rights: "to use that leverage to project those royalty payments beyond the life of the patent is analogous to an effort to enlarge the monopoly of the patent by tying the sale or use of the patented article to the purchase or use of unpatented ones."⁴ The Court therefore held that "a patentee's use of a royalty agreement that projects beyond the expiration date of the patent is unlawful *per se*."⁵

This reasoning has been the subject of criticism from legal scholars, economists, and the lower courts.⁶ Some commentators argue that "post-expiration royalties merely amortize the price of using patented technology"⁷ and

¹ 379 U.S. 29 (1964).

² *Kimble v. Marvel Entertainment, LLC*, 576 U.S. ____ (2015), slip op at 7, 13

³ *Id.* at 14-15.

⁴ *Id.* at 33 (citations omitted).

⁵ *Id.* at 32.

⁶ For an in-depth discussion of the criticisms of the *Brulotte* rule and its impact on licensing practices, see Sean Gates and Jeny Maier, *Brulotte's Continuing Shadow Over Patent Licensing*, 4(3) *Oxford J. Intell. Prop. L. & Prac.* (2009), available at <http://jiplp.oxfordjournals.org/content/early/2009/01/18/jiplp.ipn247.short>.

⁷ 10 PHILLIP E. AREEDA, EINER ELHAUGE & HERBERT HOVENKAMP, *ANTITRUST LAW: AN APPLICATION OF ANTITRUST PRINCIPLES AND THEIR*

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“thus do not represent an extension in time of the patent monopoly.”⁸ Economists contend that “allocative efficiency considerations should permit a licensor and licensee to agree to longer royalty terms.”⁹ The Seventh Circuit has questioned whether obtaining post-expiration royalties “really ‘extends’ the patent,”¹⁰ and reasoned that “paying royalties after the patent expires 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.”¹¹ Such licenses are therefore nothing more than “a risk-shifting credit arrangement between patentee and licensee.”¹²

II. THE CASE BEFORE THE SUPREME COURT

The Ninth Circuit’s reluctant decision in *Kimble*—holding that it was bound to follow *Brulotte* despite these “particularly apt” criticisms—gave the Supreme Court the opportunity to consider whether to finally overrule *Brulotte*.

Kimble concerned a long-running dispute between Stephen Kimble, the inventor of a patented toy that allows users to shoot foam string out of a glove, and Marvel Enterprises, the owner of the Spider-Man comic book franchise. In 1997, Kimble sued Marvel for patent infringement and breach of an oral contract. As part of a settlement agreement to resolve the litigation, Marvel agreed to purchase Kimble’s patent for a cash payment plus a 3% royalty. A number of years later, the parties found themselves in litigation over the amount of royalties due to Kimble under the settlement. The district court granted summary judgment for Marvel, holding that the settlement was a “hybrid” license and, because it did not specify different royalty rates for the patent and non-patent rights, the royalties had to end when the patent expired, as dictated by *Brulotte*.

On appeal, the Ninth Circuit acknowledged that its “application of the *Brulotte* rule in this case arguably deprives Kimble of part of the benefit of his bargain based upon a technical detail that both parties regarded as insignificant at the time of the agreement,” but the circuit court nevertheless held it was bound by *Brulotte* to affirm the judgment in favor of Marvel.¹³

Kimble’s case brought out a number of amici, nearly all supporting Kimble’s argument that *Brulotte* is ripe for reconsideration because (i) it prevents efficient and procompetitive licensing transactions, and (ii) it is inconsistent with the Supreme Court’s current jurisprudence regarding the market power conferred by ownership of a patent.¹⁴

APPLICATION § 1782c, at 492 (2004); see also Michael Koenig, *Patent Royalties Extending Beyond Expiration: An Illogical Ban from Brulotte to Scheiber*, 2003 Duke L. & Tech. Rev. 5 (2003).

⁸ Harold See & Frank M. Caprio, *The Trouble with Brulotte: The Patent Royalty Term and Patent Monopoly Extension*, 1990 Utah L. Rev. 813, 814, 851 (1990).

⁹ Richard Gilbert & Carl Shapiro, *Antitrust Issues in the Licensing of Intellectual Property: The Nine No-No’s Meet the Nineties*, 1997 Brookings Papers on Econ. Activity, Microeconomics 283, 322 (1997).

¹⁰ *USM Corp. v. SPS Techs., Inc.*, 694 F.2d 505, 510-11 (7th Cir. 1982).

¹¹ *Id.*

¹² *Id.*

¹³ *Kimble v. Marvel Enters., Inc.*, 727 F.3d 856, 866-67 (9th Cir. 2013).

¹⁴ See Sean Gates and Jeny Maier, *Will the Supreme Court Remove Brulotte’s Shadow Over Patent Licensing?* (Dec. 16, 2014), available at <http://www.mofo.com/~media/Files/ClientAlert/2014/12/141216PatentLicensing.pdf>

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Amicus briefs from academic and research organizations maintained that *Brulotte* emphasizes form over function, discouraging flexible licensing agreements needed for commercialization of inventions, particularly in the pharmaceutical and biologic areas. These amici argued that licensing arrangements incorporating post-expiration royalties can be economically efficient for both licensor and licensee and can benefit society by facilitating the introduction of new treatments to the market.

Despite the history of scholarship criticizing *Brulotte*, the Solicitor General's amicus brief in *Kimble* recommended that principles of *stare decisis* should apply. The government argued that *Brulotte* should be left undisturbed because it reflects the policies of the federal patent laws—not the antitrust laws. In the government's view, the economic critique of *Brulotte* does not justify overturning a settled rule of patent policy.

III. THE COURT'S DECISION

The majority (Kagan, Scalia, Kennedy, Ginsburg, Breyer, and Sotomayor) agreed with the Solicitor General, relying on *stare decisis* to decline to overrule *Brulotte*. Justice Kagan, writing for the majority, explained that *stare decisis* carries enhanced force when interpreting a statute and, absent "special justification," Court decisions interpreting a statute "are balls tossed into Congress's court, for acceptance or not as that branch elects."¹⁵ Against this "superpowered form of *stare decisis*," the Court demanded a "superspecial justification" warranting reversal.¹⁶

The Court was not persuaded by *Kimble*'s arguments (and those of the amici supporting him) that the *Brulotte* rule posed a problem so severe as to require reversing this settled precedent: "an argument that we got something wrong—even a good argument to that effect—cannot by itself justify scrapping settled precedent."¹⁷ The Court reasoned that the statutory and doctrinal underpinnings of *Brulotte*—i.e., cutting off patent rights after a set number of years—have not eroded over time.

The Court also concluded that nothing about the *Brulotte* rule has proved unworkable. The Court admitted that the *Brulotte* rule "prevents some parties from entering into deals they desire," but explained that, nevertheless, "parties can often find ways around *Brulotte*, enabling them to achieve those same ends."¹⁸ In particular, the Court noted that parties could agree to amortize payments beyond the term of the patent, so long as the post-expiration royalties were not for post-expiration use of the patent.¹⁹ In fact, the Court explained, trading in *Brulotte* for the antitrust rule of reason (as *Kimble* advocated) would make the law less workable than it is now.²⁰

The Court also went to great lengths to explain that this was a patent case, not an antitrust case, and that this distinction was meaningful to the outcome. The Court explained that if "*Brulotte* were an antitrust rather than a

¹⁵ *Kimble*, slip op at 8.

¹⁶ *Id.* at 10.

¹⁷ *Id.* at 8.

¹⁸ *Id.* at 5-6.

¹⁹ *Id.*

²⁰ *Id.* at 12 ("whatever [the rule of reason's] merits may be for deciding antitrust claims, that 'elaborate inquiry' produces notoriously high litigation costs and unpredictable results").

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patent case,” the Court might agree that an “economic mistake [could] suffice to overcome *stare decisis*.”²¹ According to the Court, Congress intended the Sherman Act’s “reference to ‘restraint of trade’ to have ‘changing content,’ and authorized courts to oversee the term’s ‘dynamic potential.’”²² The Court has therefore “felt relatively free to revise our legal analysis as economic understanding evolves and ... to reverse antitrust precedents that misperceived a practice’s competitive consequences.”²³

“But *Brulotte* is a patent rather than an antitrust case.” Thus, “even assuming that *Brulotte* relied on an economic misjudgment,” the Court explained, “Congress is the right entity to fix it. By contrast with the Sherman Act, the patent laws do not turn over exceptional law-shaping authority to the courts.”²⁴

Finally, the Court was unconvinced by *Kimble*’s claims that the *Brulotte* rule has discouraged technological innovation and harmed the American economy. The Court recognized that while “post-patent royalties are sometimes not anticompetitive, we just cannot say whether barring them imposes any meaningful drag on innovation.” Neither *Kimble* nor his amici offered any empirical evidence connecting the *Brulotte* rule to reduced innovation, and the Court declined “to take their word for the problem,” commenting that “[t]ruth be told, if forced to decide that issue, we would not know where or how to start.”²⁵

In dissent, Justice Alito (joined by the Chief Justice and Justice Thomas) rejected the foundation of the majority’s *stare decisis* theory. The dissent contended that *Brulotte* was not a decision interpreting a statute; rather it was a “bald act of policymaking,” and one that is “based on a policy that is difficult to defend.”²⁶ Accordingly, the dissent concluded that the Court’s traditional approach to *stare decisis* does not require retention of *Brulotte*’s *per se* rule and that the Court should “reconsider and overrule our obvious mistake [*i.e.*, *Brulotte*’s assumption that post-expiration royalties represent an enlargement of a patentee’s monopoly].”²⁷

IV. CONCLUSION

With regard to the *Brulotte* rule, the Court’s decision in *Kimble* merely continues the status quo. Parties engaged in patent licensing will have to continue to find ways to work within the construct of the rule.

The decision may, however, have implications for other challenges in patent cases. In several areas, parties have raised antitrust and competition policy concerns in support of certain interpretation of the patent statutes, such as the definition of “reasonable royalties” under 35 U.S.C. section 284. *Kimble* may mean that such concerns have less force in cases challenging established interpretations of those statutes.

²¹ *Id.* at 14.

²² *Id.*

²³ *Id.*

²⁴ *Id.*

²⁵ *Id.* at 17.

²⁶ *Kimble v. Marvel Entertainment, LLC*, 576 U.S. ____ (2015), slip op at 2 (Alito, J., dissenting).

²⁷ *Id.* at 8.

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