Client Alert

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Supreme Court Upholds Longstanding Precedent That Accrual of Patent Royalties Ends With Expiry of Patent

Yesterday, the US Supreme Court in *Kimble v. Marvel Enterprises*, No. 13-720 (June 22, 2015), upheld the longstanding precedent provided by *Brulotte v. Thys Co,* 379 U.S. 29 (1964), which stated that "a patentee's use of a royalty agreement that projects beyond the expiration date of the patent is unlawful *per se*." *Id.* at 32. Justice Kagan, writing the opinion of the Court, stated that *stare decisis* requires the Court to adhere to the decision in *Brulotte*.

In 1990, Kimble met with Toy Biz (the predecessor to Marvel) to discuss "ideas and know-how" relating to a toy glove for shooting string foam, the subject matter of US Patent No. 5,072,856 ("the '856 patent"). These discussions led to an alleged oral agreement between the parties. Kimble then sued Marvel for breach of this agreement as well as patent infringement. As a result of the litigation, Kimble and Marvel entered into a settlement agreement, where Marvel purchased the '856 patent for an up-front sum and 3 percent of "net product sales." The agreement did not have a termination date.

Marvel then entered into a licensing agreement with Hasbro, which led to a disagreement between Kimble and Marvel over the calculations of the "net product sales." Kimble sued Marvel for breach of contract, and Marvel counterclaimed and sought a declaration that the payments due from the settlement agreement were no longer required because the '856 patent had expired. Both the district court and the Ninth Circuit found that the settlement agreement was a "hybrid" agreement that transferred both patent and non-patent rights, invoking the rule of *Brulotte*, which states that "a patentee's use of a royalty agreement that projects beyond the expiration date of the patent is unlawful *per se*" (*Brulotte*, 379 U.S. at 32), unless there is a discount for the non-patent rights upon expiration of the patent rights.

Many courts have acknowledged that *Brulotte* is longstanding Supreme Court precedent and must be followed unless or until the Supreme Court overturns it. However, numerous commentators have expressed their dislike of the rule of *Brulotte*, stating that, for example, it "is an anachronism with little or no economic justification[,] ... a lonely *per se* outpost in a rule-of-reason world." William M. Landes & Richard A. Posner, *The Economic Structure of Intellectual Property Law* 380 & 418 (Harvard Univ. Press 2003). Judge Posner has additionally been critical of *Brulotte* from the bench in *Scheiber v. Dolby Laboratories, Inc*., 293 F.3d 1014 (7th Cir. 2002), stating that *Brulotte* "has … been severely, and as it seems to us, with all due respect, justly, criticized." *Id.* at 1017. Additionally, the Ninth Circuit has twice stated its displeasure with the rule, including in the appellate decision in *Kimble*, but has remained bound to apply the binding precedent.

Several justifications have been proffered for why *Brulotte* should be overturned. First, the rule places too much emphasis on any patent rights included in the "hybrid" license, without any regard to the non-patent rights, such as know-how, that could be just as valuable, if not more valuable, than the patent rights. Second, *Brulotte* focuses on an alleged extension of the patent monopoly beyond the "limited times" contemplated by the Constitution. However, as Judge Posner stated in *Scheiber*, the monopoly right ends the moment that the patent expires; parties may contract beyond that, but are inherently appreciating a value that arose during the patent monopoly period. Additionally, parties can structure the allocation of risk and reward as they see fit, keeping in mind that the patent monopoly expires with the expiration of the patent. If the parties deem post-expiration royalty payments to be suitable terms, they

should be able to include such terms in a license. Justice Alito, joined by Chief Justice Roberts and Justice Thomas, dissented, agreeing with these justifications against *Brulotte*, and arguing that the rule of *Brulotte* "erects an obstacle to efficient patent use." *Kimble*, slip op. at 3 (Alito, J., dissenting).

In upholding *Brulotte*, the Court suggests that the reasoning in *Brulotte* is not a problem without solutions. First, a license can be structured to allow for a "licensee to defer payments for pre-expiration use of a patent into the post-expiration period." *Kimble*, slip op. at 6. Second, "post-expiration royalties are allowable so long as tied to a non-patent right—even when closely related to a patent." *Id.* Third, the Court suggests that alternatives to royalty structures are available, such as joint ventures and other business arrangements, that "enable parties to share the risks and rewards of commercializing an invention." *Id.*

Notably, the Court states that *stare decisis* cannot be overcome by stating that "we would decide a case differently now than we did then," and, instead, a "special justification" is required. *Id.* at 8. In the case of *Brulotte*, Congress has not overturned the precedent, even when it has had a number of chances, including refusing to enact provisions that would have affected the changes suggested by Kimble in the present matter. The Court further reasons that contracts have been entered into based on the precedent provided by *Brulotte*, and overturning the longstanding precedent would be detrimental to those that relied upon it. *Id.* at 9–10.

Finally, in refusing to adopt Kimble's proffered reasoning for overturning *Brulotte*, the Court reiterates that *Brulotte* is a patent case, and not an antitrust case. Thus, *Brulotte* should not be given the "less-than-usual force" standard for *stare decisis* that is found in antitrust cases, and, instead, should be given the full effect of statutory *stare decisis* unless and until Congress acts to amend the law.

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