A Tangled Web of Post-Patent Expiry Royalty Obligations



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A key principle of the patent system is that in exchange for fully disclosing to the public how to make and use a claimed invention, upon issuance of the patent the inventor is granted the exclusive right to practice that invention for the term of the patent. Upon expiration of the patent term, which in the United States is twenty years from the earliest filing date, the public can freely practice the claimed invention.

Consistent with this tenet of patent law, the U.S. Supreme Court's 1964 decision in *Brulotte v. Thys Co.*[1] held that a patent license agreement requiring a licensee to make royalty payments beyond the expiration date of the underlying patent was unlawful per se because it represents an improper attempt to extend the patent monopoly beyond the term of the patent. Last year, the U.S. Supreme Court had an opportunity to reconsider its earlier and widely criticized *Brulotte* rule.

The U.S. Supreme Court recently heard oral arguments in *Kimble v. Marvel Entertainment Inc.* The dispute in Kimble concerns a patented toy that allows users to shoot foam string from the user's wrist. Sometime after the issuance of Kimble's patent, Marvel began selling a similar toy called the "Web Blaster," fashioned after its superhero Spider-Man. Kimble sued Marvel for patent infringement, but that litigation ultimately settled, with the parties entering into a Settlement Agreement whereby Kimble assigned the patent to Marvel in exchange for Marvel's paying Kimble a 3% royalty based on sales of the Web Blaster toy. The parties' Settlement Agreement failed to define a date upon which Marvel's royalty obligation would conclude and did not include a provision discounting the royalty rate post-patent expiry, as is common in license agreements in which both patent and non-patent rights are licensed.

Marvel's sales of its Web Blaster toy were significant and resulted in royalty payments to Kimble under the Settlement Agreement in excess of $6 million. Following the expiration of the Kimble patent in May 2010, disputes arose between the parties concerning, among other things, Marvel's continued obligation to make royalty payments under the Settlement Agreement. Kimble filed suit alleging that Marvel breached the Settlement Agreement and, citing *Brulotte*, the District Court held that Kimble could not recover royalties under the Settlement Agreement beyond the expiration date of the patent.

Kimble appealed and, bound by *Brulotte*, the U.S. Court of Appeals for the Ninth Circuit "reluctantly" affirmed the District Court's decision, holding that Marvel's royalty obligation concluded upon patent expiry.[2] In rendering its decision, the Ninth Circuit acknowledged that its application of *Brulotte* "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."[3]

Kimble filed a petition for certiorari asking the Supreme Court to overturn *Brulotte's* rigid *per se* prohibition of licensing arrangements involving post-patent expiration royalties, characterizing the decision as outdated and questioning a key premise of that decision, namely, that once a

patent has expired, it can no longer be used to prevent anyone from practicing the claimed invention. In particular, Kimble proposed overturning *Brulotte* because the decision: (i) incorrectly assumes that post-expiration patent royalties extend patent rights, (ii) suppresses innovation by proscribing procompetitive licensing practices, and (iii) relies on the outdated irrebuttable presumption that patents confer market power. Instead, the petitioners proposed replacing *Brulotte's* rigid *per se* rule with a more flexible rule of reason analysis, requiring the parties to demonstrate the anticompetitive effects of such post-patent expiry royalties in order to render such licenses unlawful.

In a 6-3 decision, the U.S. Supreme Court affirmed the Ninth Circuit and refused to overrule its earlier precedent in *Brulotte*, explaining that Kimble's proposed rule of reason analysis would require an "elaborate inquiry" that "produces notoriously high litigation costs and unpredictable results," and concluding that "trading in *Brulotte* for the rule of reason would make the law less, not more, workable than it is now."[4] The U.S. Supreme Court's holding thus maintains a key tenet of patent law, namely, that upon expiry of a patent, the right to make or use the claimed inventions passes to the public and any agreement purporting to restrict the use of such claimed inventions "would deprive…the consuming public of the advantage to be derived" from free exploitation of the discovery and thereby impermissibly undermine the patent laws.[5]

In view of the U.S. Supreme Court's decision to uphold the *Brulotte* rule, your "Spidey senses" should be tingling when contemplating entering into royalty-bearing licenses of patent rights, particularly if the royalty obligations extend beyond expiry of the licensed patents.

For more information or to discuss the *Brulotte* rule and its impact on patent licensing, please contact **Stanley F. Chalvire**.

Footnotes.

1. *Brulotte v. Thys Co.*, 379 U.S. 29 (1964).
2. *Kimble v Marvel Enterprises Inc.*, 727 F.3d 856 (9th Cir. 2013), cert. granted, 135 S.Ct. 781, U.S. (2014)
3. *Id.* at 866.
4. *Kimble v Marvel Entertainment, LLC*, 135 S. Ct. 2401, at 2411 (2015).
5. *Id.*, at 2407.