

June 24, 2015

## U.S. Supreme Court Preserves 50-Year-Old Rule Barring Post-Patent Royalties

On Monday, June 22, 2015, the U.S. Supreme Court issued a 6-3 decision in *Kimble v. Marvel Entertainment*, declining to reverse longstanding, yet controversial, precedent holding post-patent term royalties to be unlawful *per se*. The majority opinion, authored by Justice Elena Kagan, reaffirmed *Brulotte v. Thys Co.*, 379 U.S. 29 (1964), which had characterized royalty payments extending beyond the expiration date of a patent as an unlawful extension of the duration of a patent monopoly. The petitioner in *Kimble* had sought to replace the bright-line *per se* prohibition with a more flexible antitrust test called the rule of reason, which would have carried far-reaching implications for licensing agreements. Instead, the Court decided on the basis of *stare decisis* to preserve the *Brulotte* rule. Practically, this means that the status quo will continue to govern, and licensors should structure license agreements to avoid running afoul of *Brulotte*, such as by including a step-down in royalty rates after the expiration of a patent in a “hybrid” licensing scheme bundling both patent and non-patent rights.

**Attorneys**  
[Edward G. Black](#)  
[Marc A. Rubenstein](#)  
[James S. DeGraw](#)  
[Susan M. Galli](#)  
[Harry Rubin](#)  
[Lowell A. Segal](#)  
[David McIntosh](#)  
[Mark W. Bellomy](#)  
[Geoffrey Lin](#)

The *Kimble* case arose over sales of a popular Spiderman Web Blaster toy that could shoot foam string. Kimble had shared such a concept with Marvel’s predecessor, Toy Biz, but Marvel later created a competing product after allegedly renegeing on a promise to pay Kimble. Part of Kimble’s idea was also said to have been covered by a then-pending patent application filed by Kimble. Consequently, a patent infringement and breach of contract lawsuit followed, which resulted in a settlement under which Marvel agreed to buy the patent for about a half-million dollars, plus 3% of net product sales (including sales of infringing products and the Web Blaster). However, the parties were unaware of *Brulotte* and did not provide an end date for the royalties. At some point after signing the settlement agreement, Marvel stumbled upon the *Brulotte* decision and sought a declaratory judgment that no royalties were due after Kimble’s patent expired. Both the U.S. District Court and the U.S. Court of Appeals for the Ninth Circuit subsequently held that Marvel indeed was under no obligation to pay Kimble royalties post-patent expiration given that *Brulotte* controlled. *See, e.g.*, 727 F.3d 856, 857 (9th Cir. 2013).

In affirming the Ninth Circuit, the U.S. Supreme Court argued that patents bestow on their holders certain “superpowers,” but Congress sought to balance those rights against the public’s right to access discoveries through 20-year patent terms. The Court explained that *Brulotte* carefully guards that balance, and Justice Kagan drew parallels to other Court cases that preserve patent subject matter limitations and prevent patent misuse. The Court also observed that Congress spurned multiple opportunities to overturn *Brulotte*, including rebuffed bills to adopt Kimble’s proposed rule of reason analysis.

The Court’s reasoning rested wholly on the principle of *stare decisis*. The Court observed that “*Brulotte* lies at the intersection of two areas of law: property (patents) and contracts (licensing agreements),” and *stare decisis* is particularly relevant since “parties are especially likely to rely on such precedents when ordering their affairs.” The Court noted that under its precedential rulings, it may only overturn older case law if a “special justification” – namely, a change in legal underpinnings or the unworkability of a prior ruling – warrants reversal. However, the Court could not find either of these two special justifications in the case at hand.

First, it noted that the patent statute has remained largely unchanged, while the precedents underlying *Brulotte* are still good law. In addition, the Court remarked that “the decision’s close relation to a whole web of precedents means that reversing it could threaten others,” such as case law concerning unpatentable discoveries.

Second, the Court explained that the *Brulotte* rule has proved workable in light of alternative financing schemes that can be used by parties. The majority singled out and even sanctioned three alternatives: 1) deferring payments for royalties accrued for pre-expiration use of patents to the post-expiration period, 2) tying royalties to non-patent rights in a hybrid license with a step-down in royalty rates upon the expiration of the patent, and 3) using non-royalty-based business arrangements like joint ventures. In comparison, the Court argued that Kimble’s proposed approach would be more unworkable, since such “‘elaborate inquiry’ produces notoriously high litigation costs and unpredictable results.” Justice Kagan concluded that the Court may only reverse itself sparingly since, to quote Spiderman, “with great power there must also come – great responsibility.”

The majority also dismissed the justifications provided by Kimble for overturning *Brulotte* – namely, that *Brulotte* hinged on the mistaken economic assumption that post-expiration royalties are always anticompetitive and that *Brulotte* suppresses technological innovation by preventing parties from reaching agreement. The Court characterized *Brulotte* as a patent rather than an antitrust case, and noted that patent law does not give courts exceptional law-shaping authority as in the case of antitrust law. If there were a mistaken economic assumption, Congress would be the appropriate entity to revise *Brulotte*. Additionally, the Court observed that *Brulotte* did not even turn on the argument that post-patent royalties harm competition; rather it relied on the principle that all benefits stemming from a patent must end when the patent term expires. The Court also added that Kimble offered no empirical evidence tying *Brulotte* to any decrease in innovation.

Justice Samuel Alito authored a dissenting opinion in which Chief Justice John Roberts and Justice Clarence Thomas joined. The dissent rejected the application of *stare decisis* on grounds that *Brulotte* was an act of policymaking that did not attempt to engage in statutory interpretation of the Patent Act. The dissent also argued that *Brulotte* functions to upset parties’ expectations, since many parties are unaware of *Brulotte*, as in the case of the parties in *Kimble*. Justice Alito also argued that *Brulotte*’s reasoning has been “thoroughly disproved,” and it “poses economic barriers that stifle innovation.”

Though the Court’s decision may be the end of a long saga, *Kimble*’s key message to practitioners and intellectual property companies is to carefully monitor the law pertaining to patent monetization, since parties can find themselves unaware of key developments that can obstruct their intentions. The case also underscores the need for creative solutions to achieve commercial objectives consistent with applicable law. To discuss this development and strategies relating to royalties in license agreements, please contact [Ed Black](#), [Marc Rubenstein](#), [Jim DeGraw](#), [Susan Galli](#), [Harry Rubin](#), [Lowell Segal](#), [David McIntosh](#), [Mark Bellomy](#), or [Geoffrey Lin](#), or any other member of our [intellectual property transactions](#) or [life sciences](#) teams.