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Intellectual Property Law Alert - Supreme Court Affirms Ban On Patent Royalties After Patent Expiration

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The Supreme Court's 6-3 decision in *Kimble et al. v. Marvel Entertainment LLC*, 576 U.S. _____ (2015) upholds a 50-year-old precedent that "it is per se unlawful for a license to require royalty payments for the use of a patent after the patent expires." The decision specifically relies on the principle of stare decisis, upholding the Supreme Court's 1964 decision in *Brulotte v. Thys Co.*, 379 U.S. 29 (1964) and applying the Patent Act to limit royalties to the patent term. The high court referred any future reconsideration of the *Brulotte* rule to Congress, stating: "In the absence of any 'special justification' to overturn such precedent, the court defers to the legislature to address the issue."

Justice Elena Kagan's straightforward majority opinion leans heavily on the principle of *stare decisis* (Latin for "standing by that which is decided"). Upholding its longstanding *Brulotte* holding, the high court ruled that "a patent holder cannot charge royalties for the use of his invention after its patent term has expired." The Supreme Court directed that "critics of [this] rule must seek relief not from this court but from Congress."

The practical takeaway from *Kimble* for patent licensors and licensees is that once a patent expires (generally, 20 years from the filing date) the owner cannot receive royalties directly attributable to the patent's post-expiration use. However, as the high court noted, there are ways to work around this *per se* limitation and achieve similar outcomes. It might be advisable to review patent license agreements with the *Kimble* decision in mind. Licensors might consider amending existing agreements, if necessary, to avoid potentially unenforceable agreements. Licensees might consider whether any of their agreements are unenforceable under *Kimble* and, perhaps, stop paying royalties or renegotiate terms.

Kimble can provide predictability in the cutoff date for patent royalty payments. However, experienced attorneys and clients will continue, as appropriate, to draft license terms to avoid the *Brulotte-Kimble* bright-line termination date. Parties wishing to license a patent and extend payments beyond the expiration date need to be thoughtful about how to negotiate and document the negotiations in the license agreement to embody the desired payment terms without prematurely terminating the royalty payments on the patent's expiration date.

The Supreme Court acknowledged circumstances in which the parties may wish to better share and balance risks and rewards of commercializing an invention. Under such circumstances, the parties might negotiate a rate which is lower and extends longer than the patent's

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term. The court identified potential options to work around the *per se* unlawful rule, noting, for instance, the *Kimble* holding does not prevent a licensee from deferring payments for a patent's pre-expiration use to a post-expiration period. In other words, the parties might agree on a reasonable royalty, calculate the royalty over the patent term, and then amortize the payments over a period of time longer than the patent term. The post-expiration payments represent the parties' contractual decision to extend the pre-expiration payments over a longer period.

The Supreme Court also explained that the parties may continue to develop license agreements which cover multiple patents or other non-patent rights. Agreements involving more than one patent allow the parties to extend royalty payments until the last of the patents covered by the agreement expires. This is a common technique found in many license agreements. Regarding non-patent rights, agreements may continue to allow for payments after expiration based on some other non-patent right, such as a trade secret.

By way of background, *Kimble* involved a patent (U.S. Pat. No. 5,072,856) for a Spider-Man-related toy, including a glove for carrying a canister and dispensing foam string to imitate Spider-Man's web-shooting capabilities. After *Kimble*'s patent issued, he sued Marvel for patent infringement and breach of contract based on an alleged agreement regarding the toy's commercialization. The parties negotiated a resolution of the lawsuit resulting in Marvel's purchase of the patent along with an agreement to pay a three percent royalty on Marvel's future sale of the toy and similar products. The parties did not set a date for royalty payments to end, apparently contemplating that they would continue for as long as there was demand for the toy.

Interestingly, both parties admitted that they did not know of the *Brulotte* decision at the time they entered into the royalty agreement. After learning of *Brulotte*, Marvel sought declaratory judgment confirming that it could cease paying patent royalties when *Kimble*'s patent expired on May 25, 2010. The district court ruled in Marvel's favor, holding that *Brulotte* made "the royalty provision . . . unenforceable after expiration of the *Kimble* patent" (692 F. Supp. 2d 1156, 1161 (D. Ariz. 2010)). *Kimble* appealed to the U.S. Court of Appeals for the Ninth Circuit, which affirmed the district court based on the principle of *stare decisis* despite expressing reservations with the *Brulotte* holding.

In affirming the Ninth Circuit, the Supreme Court concluded that reversing the *Brulotte* precedent would require "special justification." The majority stated, "absent special justification, [the Supreme Court's decisions] are balls tossed into Congress's court, for acceptance or not as that branch elects." The decision emphasized that Congress had multiple opportunities to reverse *Brulotte* through each of the numerous times Congress had amended the Patent Act. Without such amendments to overcome the *Brulotte* decision, the rule set forth in the Patent Act (35 U.S.C. § 154(a)(2)) holds that a patent expires 20 years from the patent's filing date. The court used the 20-year expiration date (subject to slight adjustments specifically permitted by statute) as a bright-line test for determining when a patent holder can no longer charge royalties under a patent.

In the dissent, Justice Samuel Alito, joined by Chief Justice John Roberts and Justice Clarence Thomas, disagree that the principle of *stare decisis*

must be maintained if the court wishes to overrule what it perceives to be an obvious mistake by its predecessor.

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