

Research Article

## Patent Term under Review

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Kimble v Marvel Entertainment LLC: Patent Term and Innovation

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**Abstract:** If two parties entered into an agreement today for issuance of a Patent Licence whose term runs for more than the statutory duration of twenty (20) years, what backs a claim against the non-compliant licensee? Is it legal to run such a contract beyond its term? Has jurisprudence indicated otherwise with regard to the duration of patents? Do the rules of contracting have any bearing on this? It may be about time to consider a patent term capable of review beyond the normative.

**Keywords:** Parties, agreement, patent.

### Introduction

The respondent Marvel Entertainment's corporate predecessor agreed to purchase the petitioner Stephen Kimble's patent for a Spider-Man toy in exchange for a lump sum plus of a 3% royalty on future sales. The agreement set no end date for royalties. As the patent neared the end of its statutory 20-year term, Marvel discovered *Brulotte v Thys Co.*, 379 U.S. 29 principle on patent term. The *Brulotte*<sup>1</sup> principle states thus: a patent licensing agreement requiring a licensee to make royalty payments after the expiration date of the underlying patent is unenforceable or illegal *per se*. The respondent sought and was granted a declaratory judgment to discontinue further payment of royalties by both the District and Ninth Circuit Courts. However, Kimble appealed further to the Supreme Court seeking to overrule *Brulotte*.

More than half a century back the US Supreme Court, based on a fusion of two distinct lines of precedent, formulated the above principle which is now *stare decisis*. First, *Scott Paper Co. v Marcalus Manufacturing Co.*,<sup>2</sup> held that "any attempted reservation or continuation in the patentee or those claiming under him of the patent monopoly, after the patent expires, whatever the legal device employed, runs counter to the policy and purpose of the patent laws."<sup>3</sup> Second, the court found a hook on the anti-tying doctrine through *Motion Picture Patents Co. v Universal Film Manufacturing*.<sup>4</sup> The court ruled that a patentee who extends the life of a patent by tying the sale or utility of a patented article to unpatented ones was found to be acting contrary to public protection against extension of monopolization rights beyond patent life.<sup>5</sup> This trail of thought culminated in the rule that, "where the sales of an

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<sup>1</sup> *Brulotte v Thys Co.*, 379 U.S. 29 (1964).

<sup>2</sup> 326 U.S. 249 (1949).

<sup>3</sup> *Ibid*, at 256.

<sup>4</sup> 243 U.S. 502, 515 (1917).

<sup>5</sup> See also *Morton Salt Co., v G. S. Suppiger Co.*, 314 U.S. 488, 492 (1942).

unpatented product is tied to a patented article that is *per se* illegal since it is a bald effort to enlarge the monopoly of the patent beyond its term."<sup>6</sup>

The two decisions, according to M. Koenig,<sup>7</sup> were totally unrelated to *Brulotte*. This is because *Scott Paper* dealt with patent infringement based on estoppel while *Brulotte* was a contractual breach claim with patent misuse as a defence. The second claim covered anti-tying arrangements and antitrust violations a factor totally unconnected to *Brulotte*. Nonetheless, it remained the law. In 2003, *Scheiber*<sup>8</sup> was expected to spearhead change of the *Brulotte Grundnorm*.

In *Brulotte*, the defendant, Thys Company sold hop picking machines including both its patents and ideas for incorporation of these patents under one license. At expiry of the patent, Thys Co. gave a discount on further royalties due under the contract.<sup>9</sup> The licensees discontinued payments beyond life of patent giving rise to the rule that formed the decision in *Scheiber*. The latter case was quite similar to *Brulotte*.<sup>10</sup>

The Appellant, Peter Scheiber invented a system surrounded with several patents on this technology both in the USA and Canada.<sup>11</sup> During negotiations, the respondent contracted to continue paying royalties at a discounted rate until the last Canadian patent expired. Conversely, upon expiry of the USA patents, Dolby discontinued payments.<sup>12</sup> The court, after long criticism of *Brulotte*, ruled that post-expiration royalty agreements are alike to tying-arrangements whereby the patentee is using patent leverage or market power for pre-expiration to propel him into post-expiration market.<sup>13</sup> This decision came as a surprise after the court's- non-essential- revulsion for *Brulotte* describing it as "dubious", "out of touch with the Supreme Court's current thinking" and "silly".<sup>14</sup>

On 22<sup>nd</sup> June, 2015, scholars and critics of *Brulotte* waited with bated breath for the Supreme Court to overturn the *per se* illegal norm through *Kimble*<sup>15</sup> in vain. In retaining *Brulotte*, the court hammered a few non-novel points home to be discussed in the next section. It also gave a clean bill of health on *stare decisis*, simplicity of application and up-to-date viability of *Brulotte*.

### **Pillars of *Brulotte* recast in *Kimble***

Marvel, owner of Spiderman comic book and movie franchise entered into a settlement agreement with *Kimble* patentee for the invention of the Web Blaster toy. The agreement

<sup>6</sup> *White Motor Co. v United States*, 372 U.S. 253, 259 (1963) (Douglas J.).

<sup>7</sup> M. Koenig, *Patent Royalties Extending Beyond Expiration: An Illogical Ban From *Brulotte* to *Scheiber**, 2003, Duke Law Scholarship, at 4-7.

<sup>8</sup> *Scheiber v Dolby Labs., Inc.*, 293 F 3d 1014 (7<sup>th</sup> Cir. 2002), cert denied, 71 U.S.L.W. 3471 (2003).

<sup>9</sup> *Brulotte*, at 29-30&32.

<sup>10</sup> *Scheiber*, 293 F. 3d at 1017 (Chief Judge Posner found the two cases to be quite "indistinguishable. "However, *Brulotte* the license was limited and affiliated to the use of the particular hop-picking machine but in *Scheiber* license applied to equipment manufactured by Dolby incorporating *Scheiber*'s patents. Nonetheless, the distinction led to a license condemned by the dissenting opinion).

<sup>11</sup> *Scheiber*, at 1016.

<sup>12</sup> *Ibid*.

<sup>13</sup> *Brulotte* at 33; see *An Economic Analysis of Royalty terms in Patent Licences*, 67 MINN L. REV. 1198, 1217-22 (1983).

<sup>14</sup> *Scheiber*, at 1018 and audio recording: available at <<http://www.ca7.uscourts.gov/farg/arg/fwv?submit=showar&caseno=01-2466-001.mpg>> (last accessed on 31<sup>st</sup> August, 2016).

<sup>15</sup> *Kimble v Marvel Entertainment, LLC, Successor to Marvel Enterprises Inc.* 135 U.S. Ct., 2015.

assigned patent to the licensee and required payment of a 3% royalty indefinitely. Neither was aware of *Brulotte* or able to estimate how big a success Web Blaster would be. In *Brulotte* the patent was retained by patentee while in *Kimble* the licensee was assigned patent rights, but the quagmire in either case was extraction of royalties beyond expiration.<sup>16</sup>

The Supreme Court demanded '*special justification*' to overturn *Brulotte* for these reasons. First, *Brulotte*, is an embodiment of the rule of law or *stare decisis* to promote "even handed, predictable and consistent development of legal principles fostering reliance on judicial decisions, and... integrity of judicial process."<sup>17</sup> *Stare decisis* must be upheld even if it is a wrong decision because "*it is more important that the applicable rule of law be settled than that it be settled right.*"<sup>18</sup> To overturn, if at all, the courts require special justification over and above mere belief that they got it wrong.<sup>19</sup> The decision carries the "enhanced force when interpreting statute, the undoing of which can only be a work for Congress."<sup>20</sup> Unfortunately, as it stands, Congress has, on a series of occasions, rebuffed every opportunity to reverse *Brulotte*.<sup>21</sup>

Second, *Brulotte's* doctrinal grounding remains good law as it has not eroded over time, thus, overruling it may pose a threat to the web of precedents. Third, no element of *Brulotte* has proven unworkable due to its simplicity as opposed to the complex propositions of *Kimble*, such as antitrust considerations likely to result in high litigation costs and unpredictable results.<sup>22</sup> Finally, depriving the public of the advantage of an asset meant to be within its domain after the set patent terms undermines patent laws.<sup>23</sup> The court, however, listed these exceptions: where pre-expiration payments have been deferred to post-expiration period;<sup>24</sup> where a device is covered by multiple patents, royalties could run until the latest-running patent in the parties' agreement expires- on condition that combinations of patent and non-patent rights shall only continue running at a discounted rate in the post-expiration era; and parties are free to contract in other forms of business such as joint ventures and other risk sharing ventures for sharing technology.<sup>25</sup>

### Flawed Reasoning

*Kimble* reiterated *Brulotte* unyielding to any of the alternative reasoning offered. First, the Appellant argued that the rule hinged on an economic error or an assumption that post-patent royalties are always anti-competitive. The court pointed to the difference between the wide policy formulation powers given to the court under the Sherman Act as compared to Patent Law specific provisions. If anything should change, only Congress can fix that, yet it has

<sup>16</sup> *Kimble* 576 U.S. \_ (2015)- at 1-3, preliminary pages and 7

<sup>17</sup> *Kimble* at 7 citing *Payne v Tennessee*, 501 U.S. 808, 827-828 (1991)- saves parties of endless re-litigation costs and "*Brulotte* implicates property and contract law, two contexts in which considerations favoring *stare decisis* are at their acme"- *Payne*).

<sup>18</sup> *Ibid* quoting Justice Brandeis in *Burnet v Colorado Oil & Gas Co.*, 285 US 393, 406 (1932).

<sup>19</sup> *Ibid* citing *Halliburton Co. v Erica P. John Fund, Inc.*, 573 U.S. \_ ' 2014

<sup>20</sup> The court reasoned that all decisions interpreting statute, in whatever form, become part of the statutory scheme subject to congressional change

<sup>21</sup> *Kimble* 576 U.S. \_ (2015) See also *Watson v United States*, 552 U.S. 74, 82-83. For more than 14 years Congress has revised Patent laws including the very 35 U.S.C. §154, the core foundation of *Brulotte*, and only increased the term of the patent or limiting misuse claims.

<sup>22</sup> *Kimble* 576 U.S. \_ (2015) at 2-3 preliminary pages.

<sup>23</sup> *Ibid* at 4 citing *Scott Paper*, *supra* note, at 255-256 and *Edward Katzinger Co. v Chicago Metallic Manufacturing Co.* 329 U.S. 394, 400-401 (1947).

<sup>24</sup> *Ibid* at 5-6.

<sup>25</sup> *Ibid*.

spurned every motion to alter the rule. In short, the court's hands are tied.<sup>26</sup> Second, *Kimble* indicated that *Brulotte* has led to a reduction in incentives to innovate, thereby, affecting the economy. In dismissing the allegation, the court found no empirical evidence in support of reduced innovation and subsequent negative economic impact to warrant a change. In any event, reasoned the court, assuming this to be true, only Congress can intervene legislatively.<sup>27</sup>

This doctrine does not uphold the tenets of freedom of contract,<sup>28</sup> legitimate expectations,<sup>29</sup> the pro-competitive effects of post-expiration royalties,<sup>30</sup> the economic benefits,<sup>31</sup> and public interest.<sup>32</sup> Besides the dissenting opinion in *Kimble*, *Brulotte's* critics make further arguments thus: 1. The patent misuse condemned in *Brulotte* overstated the harm likely to accrue from certain patent licensing arrangements such as tying<sup>33</sup> and constantly overlooked the likely benefits.<sup>34</sup> 2. As a rule it is blamed for locking out otherwise beneficial transactions to the parties and the general public.<sup>35</sup> 3. It has also trampled over contractual sanctity and self-help through non-litigious means. Therefore, all roads lead to court.<sup>36</sup> 4. The deals sealed in *Kimble* or *Scheiber* were free of vitiating factors such as coercion (with or without market power considerations) hence *Brulotte's* analogy between tying arrangements and post-patent royalties is greatly undermined.<sup>37</sup> 5. It makes a misguided assumption of the effect of patent expiration because for an extended patent term to have a detrimental effect on competition, the patent must give the patentee market power to drive out competition in the post-expiration market.<sup>38</sup>

### Drafting survival tactics

A hybrid contract may involve a patent and the device that embodies the patent but often the sales or lease of the device rarely refer to the patent and neither does the public care for the

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<sup>26</sup> Ibid at 3 and Pp 12-16

<sup>27</sup> Halliburton, 573 U.S., at \_\_. See also *Kimble*, at Pp. 16-18

<sup>28</sup> Alito J. dissenting opinion quotes from *Easterbook, Contract and Copyright*, 42 Hous. L. Rev. 953, 955 (2005). He argues that once the patent term has expired exclusivity ebbs away and all that is left is an ideal or optimal contractual structure or design.

<sup>29</sup> *Kimble*, 576 U.S. \_\_ (2015) at 3 (Dissenting opinion of Justice Alito as joined by the Chief Justice and Justice Thomas).

<sup>30</sup> In fact Alito J, dissenting states that for reasons such as uncertainty of the salability of the product or significance in economic value which may take years to monetize the innovation before inventor realizes benefit therefore parties prefer post expiration patents than upfront fees.

<sup>31</sup> If parties are able to freely spread out payments over a long period then the amounts are much lower, if forced to compress the rates are much higher and more detrimental to the public within the limited period.

<sup>32</sup> False is the assumption that the non-patent right, in a hybrid agreement, ought to only continue raking in benefits at a discounted rate in the post-expiration period because it is possible that the value may increase or decrease depending on the market demand.

<sup>33</sup> For example, Posner J. in *Scheiber* supra note at 1020 extensively writes in favor of tying arrangements; *Morton Salt supra note; Carbice Corp of Am v American Patents Dev., Corp* 283 U.S. 27, 29 (1931)

<sup>34</sup> *N. Pac. Ry. V United States*, 356 U.S. 1, 10 n.8 (1958).

<sup>35</sup> For instance, M. Koenig, supra note at 6-8 gives the example of a revolutionary cure for baldness which is expensive to manufacture and works only on a small population which is bald. The inventor does an economic analysis which shows that he can only realize profits within thirty years. Since he cannot benefit if he patents it he decides to guard the formula as a trade secret depriving the public of an otherwise useful formula for the balding population. Undesirable as it sounds, *Brulotte* has forced the inventor and the public to walk down that rocky path.

<sup>36</sup> *Kimble* is a perfect example, in 1990 after one round of adjudication parties wisened up and drew a Settlement Agreement but once they learnt of *Brulotte*, the licensee was first to obtain orders to preclude further payments leading to unstoppable litigation to the very end. The same can be said of cases such as *Scheiber*.

<sup>37</sup> M. Koenig, supra note at 7.

<sup>38</sup> See *Morton Salt*, supra note at 491-94.

patent as no separate royalty is charged. For instance, computers, smart phones or automobiles incorporate several patents. However, *Brulotte* did not contemplate a price reduction upon patent expiration in any of these cases. The drafting trick is to load the price onto the device instead of the patent, unless, patentee and manufacturer are separate entities making it harder to implement.<sup>39</sup>

Further, since *Brulotte* does not care for the calculating base of the royalty rate. Where a contract covers multiple Intellectual Property rights, load as much of the royalty as possible on the rights that will last the longest time. For instance, in a hybrid of a patent and trade secret- load most if not all royalties on the latter for its life goes on beyond the patent term without violating *Brulotte*.<sup>40</sup>

### Stuck with *Brulotte*: *Quo Vadis*?

There is no doubt that the value of a product is in terms of 'market' or 'time', meaning its terms of protection is its source of value.<sup>41</sup> Snap time and value or market dwindles. Inventors are becoming aware of *Brulotte*, thus, skeptical to exercise leniency for public good. If an invention is guarded as a trade secret, it is assumed that it results in an almost absolute bar to further innovation, negative economic impact or the greater good deprived of societal utility. However, right here is the paradox. Innovation has not stalled and the economy is continually benefiting from IP- patents included.<sup>42</sup> Posner J.'s blunt criticism of the rule and the blatant reliance on *stare decisis* by the *Kimble* court shows that even the judiciary is covertly ashamed but too proud to concede. Drafting tactics keep emerging until contract sanctity can be respected as does Canada<sup>43</sup> and like jurisdictions.

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<sup>39</sup> Herbert Hoverkamp, *Brulotte's Web*, 2015 at 11 available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2626758](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2626758)

<sup>40</sup> Ibid, at 10.

<sup>41</sup> Gibson Johanna, *The Logic of Innovation: Intellectual Property and What the User Found There*, 2014, Ashgate Publishing Ltd, England at 97.

<sup>42</sup> Raustiala K. & Sprigman C. J., *The Piracy Paradox: Innovation and Intellectual Property in Fashion Design*. Virginia Law Review, Vol. 92, p. 1687, 2006; UCLA School of Law Research Paper No. 06-04.

<sup>43</sup> *Culzean Inventions Ltd. v. Midwestern Broom Company Ltd (1984)*, 82 C.P.R. (2d) (Sask. Q.B.) 175, at 193/194 - The court held that in the absence of an express provision, a licence continues until the expiration of the term of a patent, but not beyond. However, an express stipulation in the contract as to the duration of the licence, even beyond expiry of the patent, controls and the obligation to pay royalties arises by virtue of the agreement, not the patent, and may extend beyond expiry of the patent.