PATENT ROYALTIES CANNOT LAST BEYOND THE EXPIRATION OF THE PATENT: SCOTUS

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By: Gary S. Shuster

The Supreme Court decided Kimble v. Marvel Entertainment, LLC today. The holding is simple: The Court refused to change a rule they announced in the 1964 Brulotte case, holding that a patent holder cannot charge royalties for the use of his invention after its patent term has expired.

The patent at issue, 5,072,856, covers a toy that allows users to pretend to be "Spiderman" by enabling them to shoot pressurized foam string that looks like a web. The inventor filed for a patent on May 25, 1990 and the patent issued 19 months later, on December 17, 1991.

In a sadly common sequence of events, the inventor met with the president of Marvel to try to sell or license his patent. Marvel declined to buy or license the patent, but did start marketing their own toy — the suspiciously similar "Web Blaster" that lets users shoot foam webs. This eventually led to the inventor suing Marvel for patent infringement in 1997.

That litigation was settled by Marvel's purchase of the patent for around half a million dollars (presumably to cover past infringement) and a 3% royalty on Marvel's future sales of the Web Blaster. There was no sunset date on the royalty stream. The lower courts followed the 1964 rule and held that royalties expired when the patent expired. The Supreme Court took the case to decide whether Brulotte should be overturned.

The Supreme Court today declined to overturn Brulotte. The Court recognized that the rule might interfere with things that both the infringer and the patentee desire, like spreading payments out over time or allocating the risks and rewards associated with commercializing inventions. However, the Court held, "parties can often find ways around Brulotte, enabling them to achieve the same ends."

This is where it gets interesting: The Court provides an array of workarounds for inventors and licensees to avoid the very result that it imposed on Kimble in today's case:

– The parties can "defer payments for pre-expiration use of a patent into the post-expiration period";

– The parties can enter into a "licensing agreement [that] covers either multiple patents or additional non-patent rights. Under Brulotte", the Court held, "royalties may run until the latest-running patent covered in the parties' agreement expires."

– The parties may contract for "post-expiration royalties … so long as tied to a non-patent right — even when closely related to a patent…. That means, for example, that a license involving both a patent and a trade secret can set a 5% royalty during the patent period (as compensation for the two combined) and a 4% royalty afterward (as payment for the trade secret alone)." (Note that it is tough to reconcile patent law's command that the inventor teach the public how to make the invention with the idea that the inventor has withheld a related trade secret that could be licensed).

– The Court also suggests that parties enter into business arrangements other than royalties, such as joint ventures, as a way of giving the inventor an interest that lasts beyond the patent expiration.

The Court then quotes a SpiderMan comic book (seriously, they do) as part of their justification for not overturning Brulotte: The power to overturn established precedent should be used sparingly, because, as the comic book says, "In this world, with great power there must also come — great responsibility".

Implicit in today's case is the risk that if a patent gets invalidated, the Courts will hold that the royalty stream must cease. That is, patents can expire on their own (which is the case the Court was looking at) or they can be declared invalid before the expiration date. With regard to the latter, much has changed since Brulotte was decided 50 years ago:

– The internet and search engines have made finding prior art to invalidate a patent far easier. No longer must one hire a team of experts to comb through dusty library shelves. Google is even developing a tool that they hope will find invalidating prior art automatically.

– The America Invents Act has unleashed powerful new method to invalidate patents via an administrative tribunal, tribunals which have been so aggressive in invalidating

patents that the former Chief Judge of the Federal Circuit Court of Appeals has called patent "death squads".

– Patents that impact financial services are subject to a special second review as a "covered business method" under the America Invents Act.

– Infringers have become far more aggressive in using ex-parte reviews and inter-party reviews to attack patent validity.

– The numerous recent Supreme Court cases changing the standards for what is patentable has caused infringers to question — and challenge — the validity of many patents that they would simply have licensed a decade ago.

– Medimmune, Inc. v. Genentech, Inc. was decided, holding that a licensee of a patent can challenge the patent's validity without breaching the license agreement.

While it is easy to adjust to the rule upheld in Kimble today with regard to patent expiration (just follow one of the Supreme Court's "workarounds"), application of the Brulotte/Kimble rule to the risk of patent invalidation is much more complex.

As a practical matter, small companies and independent inventors usually have a disproportionate amount of their net value tied up in a few patent assets. In a world where the Supreme Court and Congress are shifting the patent landscape with surprisingly aggressive and frequent acts, the question of who bears the risk of patent invalidity, where the patent is the independent inventor's largest single asset, is a critical one. Typically, patent purchase price is negotiated with the risk of invalidity in mind. That is, the inventor will sell for less (in many cases, far less) than the true value of the patent because even a 10% chance of invalidity represents a 10% chance of the inventor's largest asset becoming valueless. If a middle-class independent inventor is holding a patent worth $10 million, and the inventor's lawyer estimates the chance of having the patent invalidated in a lawsuit at 10%, it would be tough for the inventor to turn down an offer for $1 million. $1 million in the pocket is, for many independent inventors, far preferable to a 90% chance of winning $10 million in five years (and a 10% chance of getting nothing).

Since independent inventors and small companies often sell patents at a steep discount to shift the risk to the purchaser, it is critical that the purchase and sale agreement for the patent not leave the inventor holding the risk. This is precisely

where Kimble case meets modern patent law's steeply increased risk of patent invalidity.

Patent purchase and sale agreements can be structured in a way that protects the inventor against this kind of risk. The easiest approach is to sell the patent for a fixed amount of money with no future royalties. This may not work well where the purchaser cannot afford to pay that amount in a lump sum, or where the purchaser is not sure that the invention will be commercially viable (so wants the inventor to share the risk of commercialization).

In that kind of case, one might assess a purchase price for the patent that reflects the actual value of the patent (for example, $10 million), require some amount to be paid up front (say, $1 million), and then tie the payout of the remaining $9 million to product sales (i.e. 3% of the gross sales are paid annually until the remaining $9 million is fully repaid). This decouples the patent license fee (which is fully paid up front) from the stream of payments (which now takes the form of repayment of the original lump sum licensing fee).

There are plenty of other ways to deal with the Brulotte/Kimble rule, but the one way that doesn't work is to ignore it. There is no substitute for good legal advice, and a lawyer well versed in the various risks that inventors and patents now face should be able to structure the deal in a way that avoids Stephen Kimble's very unpleasant surprise.

Gary S. Shuster LawyerGary S. Shuster is an inventor and technology lawyer. He provides representation to clients in the development, licensing, sale and funding of new technologies and business enterprises, the protection and enforcement of intellectual property and trade secrets and the prosecution and defense of complex commercial and intellectual property litigation. Learn more about Gary here.

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