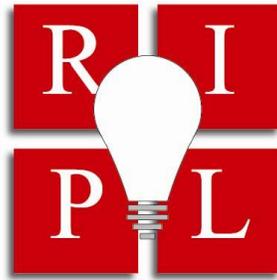


# THE JOHN MARSHALL REVIEW OF INTELLECTUAL PROPERTY LAW



## A STUDY ON THE LEGALITY OF ROYALTY COLLECTION CLAUSES AFTER EXPIRATION OF PATENT RIGHTS

WEI-LIN WANG

### ABSTRACT

Whether a contract clause may permit a patent owner to continuously collect royalty payments from a licensee after the expiration of its patent rights is a highly controversial issue in practice. Some believe that because patent rights are a kind of monopoly granted by the government, it shall not be extended after expiration; otherwise, it shall be regarded as patent misuse and/or unfair competition as the case may be. Nonetheless, others believe that this kind of clause is actually beneficial to a licensee because the licensee is allowed to make royalty payments throughout the whole patent term and even after expiration, which is helpful in terms of innovation. Regarding such debate, the Supreme Court of the United States adopts the view of the former, strongly opposing the collection of royalties after a patent's expiration. Recently in *Kimble v. Marvel*, the Supreme Court reviewed this issue all over again. The Supreme Court reasoned that, although its former judgment might have certain flaws, there are no special justifiable reasons to correct such former judgment, and according to the doctrine of *stare decisis*, a court must abide by its former judgment in order to maintain the reliability of judicial decisions. The Supreme Court leaves such issues to the hand of Congress, waiting for future amendments to the law. Hence, this issue has not yet been settled and needs further clarification by the judicial and legislative branches of the United States. The author believes that such clauses might be simultaneously good and bad for innovation and economic efficiency depending upon the circumstances and, therefore, the correct approach is to examine such clauses based on the "rule of reason" principle. The author offers suggestions regarding this issue after comparing different views and approaches adopted by the relevant authorities of the United States and Taiwan.

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## A STUDY ON THE LEGALITY OF ROYALTY COLLECTION CLAUSES AFTER EXPIRATION OF PATENT RIGHTS

WEI-LIN WANG\*

### I. INTRODUCTION

Whether a contract clause may permit patent owners to continuously collect royalty payments from a licensee after the expiration of its patent rights is a highly controversial issue in practice. Some believe that because patent rights are a kind of monopoly granted by the government, they shall not be extended after expiration; otherwise, it shall be regarded as patent misuse and/or unfair competition as the case may be. Nonetheless, others believe that this kind of clause is actually beneficial to a licensee because the licensee is allowed to make royalty payments throughout the whole patent term and even after expiration, which is helpful in terms of innovation. Regarding such debate, the Supreme Court of the United States adopts the view of the former, strongly opposing the collection of royalties after patent expiration.

Recently in *Kimble v. Marvel*, the Supreme Court reviewed this issue all over again. The Supreme Court reasoned that, although its former judgment might have certain flaws, there are no special justifiable reasons to correct such former judgment, and according to the doctrine of *stare decisis*, a court must abide by its former judgment in order to maintain the reliability of judicial decisions. The Supreme Court leaves such issues to the hand of Congress, waiting for future amendments to the law. Hence, this issue has not yet being settled, and needs further clarification by the judicial and legislative branches of the United States. The author believes that such clauses might be simultaneously good and bad for innovation and economic efficiency depending upon the circumstances, and therefore, the correct approach is to examine such clauses based on the “rule of reason” principle. The author offers suggestions regarding this issue after comparing different views and approaches adopted by the relevant authorities of the United States and Taiwan.

### II. CASE FACTS AND LITIGATION PROCESSES

In *Kimble*, plaintiff Stephen Kimble obtained a patent in 1990 for a toy that allows users to imitate Spider Man (Patent No. 5,072,486) by shooting foam string “webs” from pressurized canisters attached to gloves.<sup>1</sup> Kimble met with the president of Marvel Entertainment to discuss the possible transfer or license of this patent. Kimble wanted to license his patent to Marvel, but Marvel claimed that, at that time, the patent had no commercial value. However, they would compensate Kimble for the right amount if they later applied the concept of his invention.

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<sup>1</sup> See *Kimble v. Marvel Entertainment, LLC*, 727 F.3d 856, 857-58 (2013).

Marvel subsequently launched a product called “Web Blaster,” a Spider Man role-play toy.<sup>2</sup> In 1997, Kimble sued for patent infringement and breach of contract. Both parties settled in 2001,<sup>3</sup> with Marvel agreeing to pay a lump-sum compensation of \$500,000 and a 3% royalty for each Web Baster sold, even after patent expiration in 2010. However, this agreement did not specify the termination date for the royalty payments. Over the subsequent years, Marvel paid over \$600 million to Kimble<sup>4</sup>.

#### A. Decision from Federal Court

Eventually, Marvel stopped paying the royalties and Kimble sued Marvel for breaching the agreement. Marvel counterclaimed referring to the Supreme Court’s 1964 decision in *Brulotte v. Thys Co.* Marvel argued that it was no longer obligated to pay royalties after the 2010 expiration of the patent in question. The district court entered summary judgment in favor of Marvel, holding that, according to the principles of the *Brulotte* case, the patent owner shall not continue to claim royalties based on a royalty agreement once the patent expires.<sup>5</sup>

The patent in contention in the *Brulotte* case was about hop-picking machines, for which the licensing agreement between the patent owner and the licensee required a lump-sum payment and a running royalty based on the pricing mechanism for each harvesting season.<sup>6</sup> The licensing agreement covered multiple patents in hop-picking machines and required royalty payments in perpetuity beyond the duration of the patents.<sup>7</sup> The patent owner argued that the continued collection of royalties after patent expiration was based on the concept of the “total average” and paid by installments according to a reasonable compensation to the patents concerned. The absence of the continued royalties beyond patent expiration would have increased the contract price, both the lump-sum payment and the amount of royalties. This could have disadvantaged the licensee and would not be conducive to the licensing agreement.<sup>8</sup>

It was the Court’s opinion that the price per machine may be averaged but the annual royalty is not part of the price for the machines. The royalty is the payment for the right to use the patents and should not continue after patent expiration. In other words, the claim by a patent owner for royalty payments on the basis of a

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<sup>2</sup> *Id.* at 858.

<sup>3</sup> *Id.*

<sup>4</sup> *Id.* at 858-59.

<sup>5</sup> *Kimble v. Marvel Enters.*, 692 F. Supp. 2d 1156, 1162 (D. Ariz. 2010).

<sup>6</sup> A licensing agreement typically breaks down the licensing fee into two parts so as to evenly distribute risks to the licensor and the licensee. The first part of the licensing fee is a lump-sum payment, usually paid at the time of the agreement signing in order to protect the minimum return to the licensor. The second part of the licensing fee is a running royalty to the licensor based on the percentage of production units or sales amount generated by the licensee during the agreement period. In *Brulotte v. Thys Co.*, the licensing fee mechanism was no different from typical agreements. The agreed licensing fee was \$500 per hop picking season or the product of \$3.33 per 200 pounds of hops harvested, whichever was higher. *Brulotte v. Thys Co.*, 379 U.S. 29, 29-30 (1964).

<sup>7</sup> *Id.*

<sup>8</sup> *Id.* at 37.

royalty agreement beyond the duration of the patent concerned is “unlawful *per se*.”<sup>9</sup> Patent laws grant to patent owners monopolies that may be used as leverage to reach agreements regarding licensing fees; continuing to seek such leverage by claiming royalty payments after patent periods, however, is inappropriate. This is because “the right of monopoly vanishes when the utilization of a patent enters the public domain.”<sup>10</sup>

### *B. Decision from The U.S. Court of Appeals for the Ninth Circuit*

After the district court ruling, Kimble appealed the case to the U.S. Court of Appeals for the Ninth Circuit. Whilst affirming the decision below, the U.S. Court of Appeals for the Ninth Circuit mentioned that the decision was made “reluctantly” and described the *Brulotte* rule as “frequently-criticized,” “counterintuitive,” and “unconvincing.”<sup>11</sup> However, the *Brulotte* rule is the principle issued by the Supreme Court of the United States and hence governs all subordinate courts. Whilst the U.S. Court of Appeals for the Ninth Circuit disagrees with the *Brulotte* rule, it must abide by it and use it as the basis of decisions unless and until the Supreme Court revisits the issue.

The Ninth Circuit criticized the *Brulotte* rule for reaching beyond the presumption of federal laws because it assumes the royalty payments after patent expirations is an extension of patent rights. The Ninth Circuit contended that the *Brulotte* rule runs against the principles of contract law, which generally tend to uphold the validity of contracts. However, the *Brulotte* rule forces a contract to be invalid and unenforceable for the portion exceeding the duration of the patents. Regarding the hypothesis of the *Brulotte* rule that the free competition of the market will continue to be influenced by the monopoly associated with the patent if royalties beyond patent expirations are allowed, the Ninth Circuit argued that the continued royalty payments by the licensee do not alter the fact that the public may use the patents without constraint once the patents expire.<sup>12</sup>

### *C. Decision by the Supreme Court of the United States*

Kimble then brought the case to the Supreme Court of the United States and argued for the Court to overrule *Brulotte* because the Court’s decision was based on the erroneous presumption that royalties beyond patent expiration are against competition. In fact, a revisit to, and overturn of, the *Brulotte* rule was in order from the perspectives of patent policies, economic considerations, and industry competition. Kimble agreed with the Ninth Circuit’s critique and emphasized that royalty collections post patent expiration do not hinder the public use of the patents in question. Kimble appealed for the abandonment of the *Brulotte* rule to enable a

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<sup>9</sup> “[A] patentee’s use of a royalty agreement that projects beyond the expiration date of the patent is unlawful *per se*.” *Id.* at 32.

<sup>10</sup> See *Brulotte*, 379 U.S. at 33.

<sup>11</sup> See *Kimble v. Marvel Entertainment*, 727 F.3d 856, 857 (9th Cir. 2013).

<sup>12</sup> *Id.* at 866.

balanced sharing of risks between licensors and licensees. This would promote invention and commercialization of new technologies through the lowering of royalty percentages by allowing royalty payments beyond the duration of patents. Merchandise can be sold at a lower price and in a greater volume during the patented period if the royalties are levied at a lower percentage over a longer period of time. This will encourage new entrants and invite competitors once the patents expire.<sup>13</sup>

Finally, Kimble indicated that Congress and the courts have recently argued against the presumption that patent owners always have market power. Kimble requested the application of the “rule of reason” in lieu of the *Brulotte* rule and for court decisions to be based on the general principle that licensees must prove that the licensor possesses market power, is restricting competition, and is behaving unreasonably.<sup>14</sup>

Marvel focused its response on compliance with precedent and argued that since the Patent Act was drafted, Congress has carefully balanced two public interests: (1) promoting healthy competition and (2) encouraging invention. Over the past fifty years, Congress has not changed the *Brulotte* rule via amendments to the Patent Act, and there has been no special justification to overrule precedent. Even though Marvel found Kimble’s arguments for overruling the *Brulotte* rule—deferred royalties beyond the duration of patents allows for greater flexibility in royalty payments—persuasive, the authority to revise the rule resides with Congress, rather than the Court. Marvel also questioned Kimble’s claim that the public benefits from overturning the *Brulotte* rule and states that the *Brulotte* rule is clear, definite, easy to comply with, and easy to apply. Thus, in Marvel’s view, the Court should continue to follow the *Brulotte* principle in this and subsequent cases.<sup>15</sup>

Finally, the Supreme Court decided to maintain the original judgment with six votes against three. Justice Elena Kagan wrote the majority opinion for the Court rejecting Kimble’s appeal on the ground that courts must adhere to the principle of *stare decisis* and this case presents no special justifications for overturning the *Brulotte* rule. The Court said that even if relaxation of the *Brulotte* rule, in theory, promoted market competition, it was not in the facts under review and that such a decision was outside the scope of the Court’s jurisdiction. Rather, this was a decision regarding intellectual property policies to be reached by Congress, and any legislative amendments should be handled by Congress.<sup>16</sup>

An examination of the reasons provided by the Supreme Court leads to the following observations. First, the Supreme Court still has concerns over the restrictions to a licensee’s rights based on a contractual arrangement. As the ruling indicates, the Supreme Court determined in *Scott Paper Co. v. Marcalus Mfg. Co.*<sup>17</sup> that clauses which prohibit licensees from disputing the validity of the patent are invalid. Even if only the licenses in the licensing contracts are restricted, such clauses still hinder the public’s right to freely utilize public-domain knowledge and contradict a fundamental principle of patent policy: that once patents expire, the

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<sup>13</sup> See *Kimble v. Marvel Entertainment, LLC*, 135 S. Ct. 2401 (2015).

<sup>14</sup> *Id.* at 2408-09.

<sup>15</sup> *Id.* at 2409-11.

<sup>16</sup> *Id.* at 2412-14.

<sup>17</sup> See *Scott Paper Co. v. Marcalus Mfg. Co.*, 326 U.S. 249 (1945).

public should be able to freely access knowledge in public domain.<sup>18</sup> Meanwhile, the Supreme Court reiterated that the *Brulotte* rule does not prevent patent owners from achieving similar goals via commercial means other than royalties. For example, patent owners may establish joint ventures with licensees and such commercial arrangements are not subject to the duration of patents.<sup>19</sup> In sum, there should not be excess restrictions on licensors.

Secondly, the Supreme Court detailed the reasons why its decision was based on the principle of *stare decisis* and highlighted the importance of that principle in the establishment of the judicial system. The ruling quoted Justice Brandeis's famous statement that it is "more important that the applicable rule of law be settled than that it be settled right."<sup>20</sup> Unless there is special justification why the *Brulotte* rule should be overruled, its applicability should prevail even with the likelihood of errors.<sup>21</sup> Without special justification to be overruled by the Court, the first duty to rectify a possible error falls on the shoulder of legislators. However, several amendments to the Patent Act over the past five decades—including an amendment to Article 154 in relation to the *Brulotte* rule<sup>22</sup>—have not dealt with this issue. In fact, Congress voted against the proposal to reject the *Brulotte* rule in favor of the "rule of reason."<sup>23</sup> Despite extensive criticism of the *Brulotte* rule, the Supreme Court has to follow precedent. Should the Supreme Court decide to overturn the *Brulotte* rule, would that mean other similar rulings, such as the *Scott Paper* case, would also be rendered invalid?<sup>24</sup>

The Supreme Court indicated that the principle of *stare decisis* is particularly appropriate to cases concerning properties and contracts. This allows the concerned parties to make arrangements in relation to properties or contracts by referring to precedent. For example, there is no need to specify the number of years in the patent licensing agreement because the *Brulotte* rule dictates the maximum duration of any patent licensing agreement should be twenty years. If the *Brulotte* rule is overturned, disputes will arise for all contracts without specified licensing terms.<sup>25</sup> The Supreme Court also suggested that the principle of *stare decisis* allows flexibility

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<sup>18</sup> See *Kimble*, 135 S. Ct. at 2407-08.

<sup>19</sup> *Id.* at 2408.

<sup>20</sup> *Id.* at 2409.

<sup>21</sup> *Id.*

<sup>22</sup> 35 U.S.C. § 154 provides that:

(a) In General—(1) Contents.—Every patent shall contain a short title of the invention and a grant to the patentee, his heirs or assigns, of the right to exclude others from making, using, offering for sale, or selling the invention throughout the United States or importing the invention into the United States, and, if the invention is a process, of the right to exclude others from using, offering for sale or selling throughout the United States, or importing into the United States, products made by that process, referring to the specification for the particulars thereof. (2) Term.—Subject to the payment of fees under this title, such grant shall be for a term beginning on the date on which the patent issues and ending 20 years from the date on which the application for the patent was filed in the United States or, if the application contains a specific reference to an earlier filed application or applications under section 120, 121, or 365(c), from the date on which the earliest such application was filed.

<sup>23</sup> S. 1200, 100th Cong., 1st Sess., Tit II (1987).

<sup>24</sup> See *Kimble*, 135 S. Ct. at 2411.

<sup>25</sup> *Id.* at 2410.

for the Court to take into consideration the economic fluctuations and other factors in antitrust decisions.<sup>26</sup> However, this was a patent case—not an antitrust case—making an exception inappropriate.<sup>27</sup>

Finally, the Supreme Court pointed out the lack of empirical data to support Kimble’s arguments that the *Brulotte* rule prevents licensees from evenly distributing high royalties over a longer period of time, makes it impossible for patent owners and licensees to reach an agreement in the first place, and therefore discourages innovation and hurts the U.S. economy. In fact, Kimble’s argument happened to highlight the legislative nature of the policy-related contention, reinforcing that it should be dealt with by the Congress, not by the courts.<sup>28</sup>

Justice Alito, Justice Thomas, and Chief Justice Roberts had differing opinions. Justice Alito wrote the dissenting opinion arguing that the purpose of the principle of *stare decisis* is usually to prevent the misuse of jurisdictional power from reviewing a clear and non-controversial principle.<sup>29</sup> However, this was not the case here. Granting permission for patent owners to collect royalties after patent expiration does not expand the monopoly of patent owners or extend the patent duration. In fact, there is no provision in the Patent Act prohibiting royalty collections after patent expiration. Therefore, the *Brulotte* rule is not an interpretation of the laws, but the formation of an (erroneous) policy.<sup>30</sup> Consequently, *stare decisis* is not applicable to this case because the principle should not be used to require the Court to abide by a groundless and harmful precedent.<sup>31</sup> This is particularly true when so-called precedents are created by the courts, and are not interpretations of the laws passed by legislators. Courts should not impose the responsibility of correcting their own mistakes on Congress.<sup>32</sup>

The dissent opined that continued royalty payments beyond the duration of patents are sometimes preferred by both parties in the contracts because (1) neither party can be sure whether the patents can create economic value, and (2) it usually takes years to recover from the investments on innovation. Under these circumstances, deferred royalties provide economic benefits—particularly to colleges and teaching hospitals whose inventions do not immediately generate income. The *Brulotte* rule makes it difficult to devise economically reasonable contracts.<sup>33</sup> In this case, neither party was aware of the *Brulotte* rule at the time of contract execution, but both parties voluntarily reached the agreement of a 3% royalty. However, as soon as Marvel learned about the *Brulotte* rule, it immediately claimed the contract was invalid. As a matter of fact, the *Brulotte* rule only disrupts royalty arrangements.<sup>34</sup>

Finally, the majority opinion suggested that courts have great flexibility in *stare decisis* regarding antitrust cases. However, this distinction is not specific. This case is in fact an antitrust case disguised as a patent case, as the Supreme Court

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<sup>26</sup> *Id.* at 2412.

<sup>27</sup> *Id.* at 2413.

<sup>28</sup> *Id.* at 2414-15.

<sup>29</sup> *Id.* at 2415.

<sup>30</sup> *Kimble*, 135 S. Ct. at 2415.

<sup>31</sup> *Id.* at 2415.

<sup>32</sup> *Id.* at 2418.

<sup>33</sup> *Id.* at 2416.

<sup>34</sup> *Id.* at 2417.

previously ruled that royalty collections beyond the duration of patents are bundling in nature and thus are unfair competition.<sup>35</sup>

### III. CASE ANALYSIS AND COMMENTS

#### *A. Prior Criticism from U.S. Academics on Brulotte Rule*

The *Brulotte* rule has been widely criticized by both academics and practitioners in the U.S. Judge Posner said in *Scheiber v. Dolby Laboratories*<sup>36</sup> that expired patents do not have any leveraged influence. Any possibility of exercising such influence—if royalty payments on expired patents were enabled—exists only because the licensees are at risk of patent infringement lawsuits whilst patents are still protected. The majority opinion in *Brulotte* believes that royalty collections on expired patents are unlawful because they essentially go beyond the intent of patent law to protect patents for a specified time period. This perspective is incorrect because, after a patent expires, anybody can use the patent at no risk of being accused of patent infringement. Therefore, the protection period already imposes a limitation on royalty rates and collections. Whether the royalties are collected at a high rate during a short period or at a low rate over a long period is simply an irrelevant, minor detail.<sup>37</sup>

Whilst the Court has not overturned the *Brulotte* rule, the scope of the rule's applicability has been narrowing. A few years after *Brulotte*, the Court said in *Zenith Radio Corp. v. Hazeltine Research*<sup>38</sup> that royalty collections on expired patents are not unlawful if the contracts are formed on the fact that patents are utilized within the patent term. Therefore, the allocation, in part or in all, of fixed payments beyond the duration of a patent does not violate the *Brulotte* rule, even though the leverage enjoyed by patent owners is no different, conceptually, than in *Brulotte*.

Other exceptions further erode the theoretical foundation of the *Brulotte* rule. Package licensing is a common approach that applies a single royalty rate to all the licensed patents. Even though the expiration dates of each patent in the package vary, the royalty rate does not reduce with the expiration of individual patents. Courts have held that this is acceptable under the *Brulotte* rule.<sup>39</sup>

The Court also acknowledges hybrid contracts as an exception to the *Brulotte* rule. If a licensing contract covers patents and non-patent rights, patent owners are allowed to continue collecting royalties for rights other than patents. For example, trade secrets and patents are often licensed together, and the owners may continue to charge royalties on trade secrets after associated patents expire.<sup>40</sup> In *Kimble*, Kimble brought his case based on the concept of hybrid contracts and argued that his contract with Marvel was an exception to the *Brulotte* rule. However, the Ninth

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<sup>35</sup> See *Brulotte*, 379 U.S. at 38-39.

<sup>36</sup> See *Scheiber v. Dolby Laboratories*, 293 F.3d 1014 (7th Cir. 2002).

<sup>37</sup> *Id.* at 1017-18.

<sup>38</sup> See *Zenith Radio Corp. v. Hazeltine Research*, 395 U.S. 100, 136 (1969).

<sup>39</sup> See *Hull v. Brunswick Corp.*, 704 F.2d 1195, 1202-03 (10th Cir. 1983).

<sup>40</sup> See *Meehan v. PPG Indus., Inc.*, 802 F.2d 881, 884-86 (7th Cir. 1986).

Circuit was unconvinced by Kimble's plea because the royalty rate did not drop after the expiration of the licensed patent.<sup>41</sup> If the contract were really a hybrid one, the royalty rate should drop because the royalty would only cover the rights other than expired patents.

There are, however, supporters of the *Brulotte* rule. Legal opinions from *amicus curiae* in favor of Marvel indicate that the number of patent applications did not fall after the *Brulotte* rule, and the statement that the *Brulotte* rule stifles innovation is not true. On the contrary, overturning the *Brulotte* rule may temper the willingness of corporations to enter into licensing agreements and lower the likelihood of technological transactions. In addition, the *Brulotte* rule is clear, feasible, and able to reduce litigation costs and other risks for companies.<sup>42</sup>

However, the majority of the practitioners in the U.S. are against the *Brulotte* rule.<sup>43</sup> Before the decision in *Kimble v. Marvel Entertainment*, the general expectation was for the Supreme Court to abolish or at least amend the *Brulotte* rule<sup>44</sup>. The decision most likely came out as a disappointment to many.

### *B. Applicability of the Brulotte Rule to Other Forms of Intellectual Property*

It is possible that the *Brulotte* rule is also applicable to copyrights. However, this author did not find any direct discussions of this issue among copyright cases. Generally, both copyrights and patents aim to encourage creation/innovation by granting a monopoly over a period of time as incentives. Both means are similar and hence legal principles such as the misuse of rights may be applicable to both under appropriate conditions.<sup>45</sup> As to why there is no direct application of the *Brulotte* rule to copyright cases, the author believes that it is perhaps due to a longer period of copyright protection; consequently, the collection term for copyright royalties is also longer, which leads to fewer similar contractual clauses compared with patent license agreements. In addition, most of the long, best-selling copyrightable works, such as Mickey Mouse, have yet to see their copyrights expire. Similar issues may occur after those copyrights expire.

The leading case regarding the misuse of copyrights is *Lasercomb America v. Reynolds*, where the right owner, Lasercomb America, demanded the licensee not to develop computer software or other technical products in the same field within 99 years post-licensing. The court opined that patents and copyrights stem from the

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<sup>41</sup> See *Kimble*, 727 F.3d at 864-65.

<sup>42</sup> Brief for Nautilus, Inc. as Amicus Curiae Supporting Respondent, *Kimble v. Marvel Enterprises, Inc.*, 135 S. Ct. 2401 (2015) (No. 13-720), 2015 WL 1057619.

<sup>43</sup> A total of 16 opinions were issued from *amicus curiae* on this case. Eleven opinions were in favor of Kimble, namely, against the *Brulotte* rule. The remaining five were not in favor of either party.

<sup>44</sup> See Jane Cooper, *Kimble v. Marvel: the End of the Brulotte Rule Restricting Royalties on Expired Patents?* (Jan. 6, 2015), <http://antitrust.weil.com/articles/kimble-v-marvel-the-end-of-the-brulotte-rule-restricting-royalties-on-expired-patents/> (last visited Dec. 1, 2015); Laura Seigle, *A Look at Oral Arguments in Kimble v. Marvel* (Apr. 2, 2015), <http://www.law360.com/articles/637404/a-look-at-oral-arguments-in-kimble-v-marvel> (last visited Dec. 1, 2015).

<sup>45</sup> See 2 RAYMOND T. NIMMER & JEFF C. DODD, MODERN LICENSING LAW 349 (2010).

same constitutional article to achieve similar purposes.<sup>46</sup> The prohibition on extension of control of inventions or creations beyond the statutory duration is applicable to both patents and copyrights.<sup>47</sup> Thus, whilst there is no directly related copyright case, it is common belief by scholars that the *Brulotte* rule is also applicable to copyrights.<sup>48</sup>

It is worth noting that most courts do not opine that the *Brulotte* rule is applicable to trade secrets. The famous *Listerine* case is a good example.<sup>49</sup> The plaintiff, Warner-Lambert Pharmaceutical Co., was a Delaware corporation that produced Listerine mouthwash and other products. In 1881, the predecessor of the company entered a licensing agreement with Dr. Lawrence for the Listerine formula. The contract specified the payment of royalty at \$20 (later reduced to \$6) for each gross Listerine product sold. The major ingredients of the formula have been manufactured and marketed by the plaintiff to this day. By the time the case was brought in 1959—and over the course of the 75 years since the contract was executed—the plaintiff (including its predecessor) had paid a total of over \$2.2 billion royalty to John J. Reynolds, Inc. (the beneficiary to Dr. Lawrence’s rights) and continued to pay more than \$1.5 million per year.<sup>50</sup>

As late as 1949, the Listerine formula in question had been completely in the public domain and had even once been published on the National Formulary and Journal of the American Medical Association. The fact that the formula was public knowledge could not be attributable to negligence by the plaintiff or by its predecessor.<sup>51</sup>

According to the contract, as long as Lambert or its successor(s) produces or markets the formula, it has the obligation to continue to pay the royalty. The obligation for royalty payments would cease only when the formula in question was no longer produced or marketed. The plaintiff indicated that the contract was vague, particularly regarding the effective term of the contract. The plaintiff argued that, regardless of the wording used in the contract, the court should measure the duration of royalty payment obligations and interpret the contract on the basis of the trade secrets embodied in the Listerine formula. The plaintiff quoted federal cases concerning the licensing agreements of patents and copyrights, and argued that in the absence of specific wording to express the true intentions of the parties involved at the time of contract execution, the court should determine the term of the contract according to the legal duration of the rights concerned.<sup>52</sup>

However, the court disagreed with the plaintiff. It is the court’s opinion that the contract in contention does not carry the same characteristics of a patent or copyright license. A copyright or patent contract is structured by both parties on the basis of

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<sup>46</sup> *Lasercomb America, Inc. v. Reynolds*, 911 F.2d 970, 975 (4th Cir. 1990).

<sup>47</sup> See *Lasercomb America*, 911 F.2d at 970. The court overruled the decision by the lower court on the basis of the rule of reason and argued that misuse of copyrights does not necessarily constitute a violation of antitrust laws.

<sup>48</sup> See ROBERT MERGES ET AL., *INTELLECTUAL PROPERTY IN THE NEW TECHNOLOGICAL AGE* 94-95 (3rd ed. 2003).

<sup>49</sup> See *Warner-Lambert Pharmaceutical Co. v. John J. Reynolds, Inc.*, 178 F Supp. 655 (S.D.N.Y 1959).

<sup>50</sup> *Id.* at 657.

<sup>51</sup> *Id.* at 659.

<sup>52</sup> *Id.* at 658-660.

the monopoly period granted by copyright laws or patent laws. The legislators devise this monopoly period to protect the rights owner during the monopoly period, so that the rights owners are willing to release the patentable/copyrightable work to the public. However, there is no similar public policy concern in the scope of trade secrets. Therefore, both parties can freely determine the details and clauses of the contract regarding trade secrets on the basis of their interests.<sup>53</sup>

According to the court's opinion, third parties who discover the secret formula can of course use it but obligations to pay a royalty for the trade secret in a licensing agreement are not waived simply because of the trade secret was discovered by a third party. As the licensor in the contract is not obligated to safeguard the licensed trade secret, it is a risk to be borne by the licensee. In a nutshell, the court opined that there was no reason or necessity for the contract to be amended.<sup>54</sup> The judgment was against the plaintiff and the court demanded the plaintiff to continue making royalty payments until the plaintiff no longer produced or marketed the formula in question.

This was a highly contentious case. The RESTATEMENT (THIRD) OF UNFAIR COMPETITION states that the contractual restriction on the use of knowledge in public domains constitutes unfair limitations on trade.<sup>55</sup> The public's access to public-domain knowledge represents a public interest. A contractual clause that requires royalty payments after the disclosure of trade secrets cannot prevent the contracting party from disputing the validity of the trade secrets concerned.<sup>56</sup> However, the U.S. Court of Appeals for the Federal Circuit ("CAFC") and most other courts support the decision in *Listerine*. CAFC believes that the issue of patents does not put an end to the confidentiality obligations in the contract, even if the disclosed patented knowledge is the underlying reason for the confidentiality clauses.<sup>57</sup> The Court of Appeals for the Seventh Circuit further held that the court has no right to review the reasonability of confidentiality clauses even if the whole employment contract should be subject to the test of reasonability.<sup>58</sup>

This paper posits that trade secrets are indeed different from patents and copyrights. Patent laws and copyright laws aim to encourage inventions and creations by granting a monopoly period as incentives.<sup>59</sup> However, trade secret laws are not meant to create more trade secrets, as the confidentiality of trade secrets disallows others from enjoying the benefits generated by trade secrets. In brief, the public interest element or policy consideration is not an integral part of trade secrets and, hence, it is understandable why U.S. courts adopt a different approach in dealing with trade secret licensing clauses (as opposed to the clauses associated with patent and copyright licensing).

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<sup>53</sup> *Id.* at 665.

<sup>54</sup> *Id.*

<sup>55</sup> See RESTATEMENT (THIRD) OF UNFAIR COMPETITION §41, Comment (d) (1995).

<sup>56</sup> *Id.* at 430.

<sup>57</sup> See *Celeritas Technologies v. Rockwell Intl. Corp.*, 150 F.3d 1354 (Fed. Cir. 1998).

<sup>58</sup> See *IDX Systems v. Epic Systems*, 285 F.3d 581 (7th Cir. 2002).

<sup>59</sup> See U.S. CONST. art. 1, § 8, cl. 8 (stating that "[t]he Congress shall have power to lay and collect taxes, duties, imposts and excises, to pay the debts and provide for the common defense and general welfare of the United States; but all duties, imposts and excises shall be uniform throughout the United States . . . To promote the progress of science and useful arts, by securing for limited times to authors and inventors the exclusive right to their respective writings and discoveries . . .").

However, this does not imply a lack of controversy concerning the opinion that royalty payments should continue pursuant to the signed licensing contracts even if confidentiality is lost. If secrecy is lost, anybody—including the competitors of the licensee—can use the knowledge freely but the licensee must still pay royalties.<sup>60</sup> This causes unfair competition and hence reduces both the willingness of any licensee to enter a licensing contract with trade secret owners and the ensuing likelihood of licensing transactions. Therefore, there is still commonality regarding the reasonability of royalty collections in trade secrets after the loss of confidentiality for similar clauses in patents and copyrights.

Trademark rights can be extended, and theoretically speaking, can exist forever; so there have been no similar issues or relevant court decisions regarding royalty collection after the expiration of trademark rights.

### C. Opinions from the Author

The biggest reason for the Supreme Court ruling against *Kimble* was the principle of *stare decisis*. According to the Supreme Court, the *Brulotte* rule may not be able to keep up with the needs of modern society, but there was no special justification to overturn it. Hence, the Court ruled against *Kimble* using the *Brulotte* rule.

Nonetheless, there are two types of precedents to be followed by courts under *stare decisis*. One type is binding precedent in which subordinate courts adhere to the decisions from superior courts in the same jurisdiction. The other type is persuasive precedent which courts in different jurisdictions may adhere to because the precedent makes a valid point, even though the court is not necessarily bound.<sup>61</sup> Whilst the *Brulotte* rule was established by the Supreme Court, the problem associated with subordination and super-ordination does not exist. Although the same court is subject to its own binding precedents,<sup>62</sup> there is more leeway to revisit its own prior decisions. The *stare decisis* principle is meant to maintain the stability of laws so that the public can predict the outcome of their actions and make reasonable commercial arrangements accordingly. If the rule in question is no longer suitable, the decision to adhere to the rule should not be considered merely to ensure the stability of laws at the expense of the reasonability of laws.

As Justice Alito said in his dissenting opinion, *stare decisis* does not ask us to abide by a groundless and harmless precedent. The Supreme Court of New Jersey also indicated that “[t]he doctrine of *stare decisis* neither renders the court impotent to correct their past errors, nor requires them to adhere blindly to rules that have lost their reasons for being. The common law will be sapped of its life blood if *stare decisis* were to become a god instead of a guide.”<sup>63</sup> In this case, the Supreme Court

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<sup>60</sup> See MERGES, *supra* note 48, at 94.

<sup>61</sup> See BLACK’S LAW DICTIONARY 491, 590 (1996).

<sup>62</sup> The binding of precedents can be classified into vertical and horizontal. Vertical binding refers to the binding power of the decisions from a superordinate court over a subordinate court. Horizontal binding refers to the binding power of the decisions from the court of the same hierarchical level over a court of the same level. See FREDERICK SCHAUER, THINKING LIKE A LAWYER: A NEW INTRODUCTION TO LEGAL REASONING, 36-37 and 41-44 (2009).

<sup>63</sup> See *Fox v. Snow*, 6 N.J. 12, 23 (1950).

acknowledged the fact that the *Brulotte* rule may hinder innovations or obstruct competition in some circumstances, but passed to Congress the opportunity and the power to correct this rule. On the surface it looked like due respect to the legislative rights of Congress. However, the *Brulotte* rule is not part of the patent laws; it is merely a principle created by the Court in the *Brulotte* case. The insistence that the application of the patent laws cannot be changed other than via amendments by Congress affects the principle of separation of powers. Because the *Brulotte* rule was created by judges, and the courts insisted on compliance with it, it will remain a part of U.S. patent laws until Congressional amendment. In this light, the apparent respect for the legislative power of Congress cannot be said to be fitting.

The collection of royalties from expired patents presents pros and cons to innovation and competition. A general approach is not suitable and thorough analysis is required for different cases. Therefore, the legality of such royalty collection should be based on the rule of reason. According to Judge Posner, the protection periods impose a limitation on patent owners regarding royalty collections. Whether the royalties are collected at a high rate during a short period or at a low rate over a long period is an irrelevant, minor detail. However, the author contends that these two methods of royalty collection are not irrelevant, minor details and indeed affect the rights of the parties involved. If possible, patent owners would hope to collect sufficient amounts of royalties in a short period of time, in order to play it safe. On the other hand, the licensees are unwilling to pay a large sum of royalties before the success of product commercialization. An extension of the time horizon in royalty payments should be to the advantage of the licensee. Therefore, the time period for royalty payments matters for the parties involved and the laws should respect commercial considerations and choices, taking a free-hand approach unless there is a misuse of rights or a hindrance to competition.

Furthermore, patent owners usually wish to collect royalties within a short window and licensees tend to wish for an extended period for royalty payments; unlike the reasoning of the *Brulotte* rule, the restriction over the royalty payments within the duration of patents is likely to disadvantage, not advantage, a licensee.

Some might argue that the collection of royalties on expired patents causes unfair competition because only licensees have to pay for royalties, but other competitors don't. In fact, the licensees have secured lead time to market by producing the patented products whilst competitors are unable to do so. If first-mover advantages remain, the licensees may still be able to compete. Despite a large number of generic drugs, many pharmaceutical companies continue to enjoy market shares for the drugs of expired patents. If there is no profit left on the table, then licensees just cease production. What is not preferred by courts is when the licensee asks for a lower royalty rate over an extended period and then attempts to suspend royalty payments, according to the *Brulotte* rule, once patents have expired. This was the general picture for *Kimble v. Marvel Entertainment*. Marvel enjoyed the benefit of a lower royalty rate within the patent term, but wanted to stop royalty payments once the patent had expired.

The Supreme Court indicated that the *Brulotte* rule is particularly applicable to cases relating to properties and contracts because property arrangements and contractual clauses can be arranged according to precedents. For example, there is no need to specify the number of years in a patent licensing agreement because the *Brulotte* rule dictates the maximum number of years for patent licensing to be twenty

years. If the *Brulotte* rule is overturned, disputes shall arise from contracts without the number of licensing years detailed. It is true that the stability of laws should be maintained for property and contract cases so that the parties involved can predict court decisions in order to take commercial actions accordingly. However, under the *Brulotte* rule, patent owners will not be able to collect royalties once patents expire. Thus, under the *Brulotte* rule, for licensing contracts inked without a specified number of years, the true intention of the contracting parties is understood to be that the royalty payment period should be equal to the patent period. If the *Brulotte* rule is overturned, such contracts shall, as in the *Listerine* case, be contracts without definite expiration dates. Then, as long as the licensee continues to produce and market the licensed formula, it shall have the obligation to pay royalties. If the issue can be dealt with by contract interpretation, there is no concern over the issue regarding stability of the laws.

The author believes that the primary dispute of this case is over the misuse of patents—the issue the Court should address. The misuse of rights is a legal concept developed by the chancery court of the United States as a defense mechanism for infringement cases. It cannot be used as the source for either a cause of action or claim for damages.<sup>64</sup> Most courts believe that this concept is closely related with antitrust laws,<sup>65</sup> as evaluation of an action should be the same in antitrust and misuse cases. However, some courts argue that this concept stems from property law, and is not necessarily linked with antitrust and competition.<sup>66</sup> Regardless of the connection with antitrust law, courts generally hold that, to constitute misuse, the rights owner runs counter to public interests.<sup>67</sup>

Nonetheless, different cases deal with the issue of whether the exercise of rights in violation of public interests is deemed unlawful. The Supreme Court determined the contractual clauses to be invalid in *Kimble v. Marvel Entertainment* as they were considered illegal *per se*. However, in the similar case of *Zenith Radio Corporation v. Hazeltine Research, Inc.*, regarding misuse of patent rights, the Supreme Court did not evaluate the behavior of patent owners with the same doctrine. Rather, the Court emphasized that all relevant facts should be taken into account in the determination of the legality of the action in question<sup>68</sup> (i.e., under the rule of reason and considering all relevant conditions).

As mentioned previously, the clause regarding royalty collection after patent expiration can lower upfront royalty payments and hence encourages licensing transaction and protects innovations. However, if patent owners boast significant market power but cannot collect higher royalties during the patent period, licensees will be forced to commit to royalty payments after a patent's expiration. As a result, only licensees will need to pay for royalties after expiration. This does not necessarily benefit the public interest or meet with the spirit of public policy regarding the promotion of innovation. In sum, there are pros and cons in royalty collection after patent expiration and the rule of reason should be applied to take into

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<sup>64</sup> See NIMMER, *supra* note 45, at 319.

<sup>65</sup> See Mark Lemley, *The Economic Irrationality of the Patent Misuse Doctrine*, 78 CAL. L. REV. 1599, 1608-1614, 1628-1632 (1990).

<sup>66</sup> See NIMMER, *supra* note 45, at 321.

<sup>67</sup> See *Morton Salt Co. v. G.S. Suppiger Co.*, 314 U.S. 488, 492 (1942).

<sup>68</sup> See *Zenith Radio Corp.*, 395 U.S. at 100. In this case, the patent owner demanded royalties for the related products produced by the licensee but not on the patents in question.

account all the relevant facts in order to reach a fair conclusion. As scholars point out, the key issue is not whether the exercise of rights by patent owners breaches the boundary, but whether the valuations by both parties are tilted by the market power of patent owners, or affected by a series of actions not compliant with the rule of reason, and whether unreasonable suppression exists in each case.<sup>69</sup>

#### IV. CONCLUSION

It is a pity that the Supreme Court has been avoiding a revisit to the *Brulotte* rule that has been around, and under fire, for years. As in the *Listerine* case, in relation to trade secrets whereby continued royalty collection is not necessarily deemed lawful, the consideration of market power and all other factors under the rule of reason should be a more appropriate approach. This allows a thorough evaluation of pros and cons associated with continued royalty collection.

The dispute regarding the continued collection of royalties has not been settled with the decision by the Supreme Court. In fact, the controversy remains in the United States in relation to the validity of continued royalty collection as the Supreme Court also mentioned in its judgment the unreasonable aspects of the *Brulotte* rule. It will be interesting to see whether a similar clause that prohibits disputes over patent validity will be overruled as well if the *Brulotte* rule is overturned in the future.

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<sup>69</sup> See NIMMER, *supra* note 45, at 345.