US Perspectives: US High Court Removes Economics From Patent Law

08/07/2015 BY STEVEN SEIDENBERG FOR INTELLECTUAL PROPERTY WATCH — LEAVE A COMMENT

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Economics be damned. So said the US Supreme Court on 22 June, when it reaffirmed a 50 year-old ruling that limits how patent owners can license their patents. The court conceded the limit does not make economic sense, but asserted that patent law has its own logic. That could change many aspects of patent law, according to experts.

The issue in *Kimble v. Marvel Enterprises* [pdf] was simple: After a patent's term has expired, can a patent owner still accrue royalties on the patented product?

"No," was the high court's answer back in 1964. The court in *Brulotte v. Thys Co.* found unenforceable a contract that required the purchasers of patented machines to pay royalties for using the machines – after the patents on the machines had expired. Demanding royalties after the patent had expired was an impermissible attempt to expand the patent right into the period when the patent had entered the public domain. This constituted patent misuse and was "unlawful per se," the Supreme Court held.

Enter Stephen Kimble, an inventor who, for some reason, wasn't a keen student of Supreme Court patent decisions. Kimble patented a toy glove that shoots pressurized foam string from users' wrists, so users can pretend to shoot webs like Spider-Man can. Kimble sold his patent to Marvel Enterprises the publisher of Spider-Man comics) for approximately half a million dollars plus a three percent royalty on toy web-shooters that use his patented technology. Both sides expected Marvel to pay the royalties for as long as it marketed these toys.

Then Marvel discovered the *Brulotte* decision. The company obtained a court ruling that it could stop paying royalties in 2010, when Kimble's patent expired. The 9th Circuit Court of Appeals grudgingly upheld [pdf] that decision.

Kimble appealed, asking the US Supreme Court to overrule *Brulotte*. Instead, the court reaffirmed that controversial ruling.

Beyond Free Markets

In the decades since the Supreme Court decided *Brulotte*, the decision has been widely criticized by economic experts. They assert that allowing post-patent royalties would enable patent licensees to pay a lower royalty rate over a longer period of time, which would bring a variety of economic benefits during the patent term: The consumer price of the patented item would fall, the patented item would be more competitive with alternatives, and more companies could afford to license the patent – promoting competition among the patent licensees. Even for the period after the patent term ends, allowing post-term royalties would bring an economic benefit (provided new competitors would face no significant barriers to entry): The licensee's continuing obligation to pay royalties would encourage other firms to begin making the item, because they could undercut the licensee on price.

Kimble presented these arguments to the Supreme Court, and the court conceded their validity. "A broad scholarly consensus supports Kimble's view of the competitive effects of post-expiration royalties, and we see no error in that shared analysis," the court wrote in *Kimble*.

But such economic and competition concerns are not the focus of patent law. "The patent laws — unlike the Sherman Act [the US antitrust statute] — do not aim to maximize competition," the court stated.

The main concern of patent law is to promote innovation, according to the court. And Congress has indicated how this goal is to be achieved. The Patent Act "draws a sharp line cutting off patent rights after a set number of years. And this Court has continued to draw from that legislative choice a broad policy favouring unrestricted use of an invention after its patent's expiration," the Supreme Court stated.

"The court quite rightly characterized patent law as focused on public domain concerns and innovation concerns, not market concerns," said Prof. Daryl Lim of the John Marshall Law School, in Chicago. Thus, he added, "the core concern of the court was to prevent the extension of patent rights beyond the patent term and to ensure that the subject matter of patents should be free for all to use after 20 years [i.e., when the patent term ends]."

This might not be the best way to promote innovation, the court admitted. But deciding how best to promote innovation was beyond the court's competence. "Truth be told, if forced to decide that issue, we would not know where or how to start," the court wrote. "Which is one good reason why that is not our job."

That is the job of Congress, according to the court. And Congress' conclusions on this matter are contained in the Patent Act.

Brulotte merely interpreted the Patent Act, the court declared in *Kimble*. And Congress has implicitly approved this interpretation. Congress repeatedly amended the Patent Act after *Brulotte*, but did not revise the statute in order to overturn *Brulotte*. Instead, Congress explicitly rejected language that would have allowed the accrual of post-term royalties.

Because of this, and because of *stare decisis*, the court declared in *Kimble* that it must continue to apply *Brulotte*'s interpretation of the Patent Act. "This is about statutory construction, not about economic justification," said Arthur S. Rose, a partner in the Orange County office of the law firm of Knobbe, Martens, Olson & Bear.

Away from Antitrust

Kimble's ramifications will not be limited to post-term royalties. The case has wider lessons for patent owners and the Federal Circuit (often called the nation's "patent court").

"The Supreme Court justices have sent a signal to the Federal Circuit that they are serious about not intermingling patent law and antitrust policy," said Lim.

That will upend Federal Circuit jurisprudence on patent misuse. Since 1985, the Federal Circuit has created a "whole body of patent misuse cases bringing together patent law and antitrust principles. The court was applying antitrust principles instead of *per se* rules," said Sean Gates, a partner in the Los Angeles office of Morrison & Foerster, a law firm. That case law will have to change.

For instance, in the seminal 1992 case of *Mallinckrodt, Inc. v. Medipart*, the Federal Circuit rejected a challenge to the post-sale restrictions Mallinckrodt put on its patented medical device. Mallinckrodt forbade purchasers from reusing the devices, thus forcing them to purchase new devices for every use. The Federal Circuit held such post-sale use restrictions are unlawful only if they are not "reasonably within the patent grant" and they create "an anticompetitive effect not justifiable under the rule of reason [the antitrust law's standard that is most lenient to alleged abusers of market dominance]."

Mallinckrodt's two-prong test, however, now conflicts with two recent Supreme Court rulings. "*Federal Trade Commission v. Actavis* [pdf] took care of former [prong], and *Kimble* takes care of latter," Lim said. The Federal Circuit may thus be forced to adopt a tougher stance against post-sale restraints.

Other aspects of patent law also are likely to be altered, including how damages are calculated for patent infringement. A patent owner is entitled to damages equal to a reasonable royalty, but what amount is reasonable? The courts used to answer that by applying a 15-factor test from *Georgia-Pacific Corp. v. United States Plywood Corp.* Now, courts sometimes modify that test because of competition concerns, according to Gates. "Courts have been looking at competition law principles to decide royalties," he said. That may no longer be acceptable.

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