No. 13-720

IN THE

Supreme Court of the United States

STEPHEN KIMBLE, *et al.*,

Petitioners,

v.

MARVEL ENTERPRISES, INC.,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF OF THE ASSOCIATION OF THE BAR OF THE CITY OF NEW YORK AS *AMICUS CURIAE* IN SUPPORT OF NEITHER PARTY

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QUESTION PRESENTED

Whether this Court should overrule *Brulotte v. Thys Co.*, 379 U.S. 29 (1964).

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I. STATEMENT OF INTEREST OF *AMICUS CURIAE*

The Association of the Bar of the City of New York ("Association"), through its Committee on Patents and its Committee on Antitrust, submits this *amicus curiae* brief in response to the Court's December 12, 2014 Order granting the petition for certiorari of Stephen Kimble et al. ("Kimble" or "Petitioner") and setting forth the question presented above. The Association files this brief in accordance with Rule 37 of this Court, and supports the position of neither party.[1] The parties to the appeal have consented to the filing of this amicus brief.[2]

The Association is a private, non-profit organization of more than 24,000 members who are professionally involved in a broad range of law-related activities. Founded in 1870, the Association is one of the oldest bar associations in the United States. The Association seeks to promote reform in the law and to improve the administration of justice at the local, state, federal and international levels through its more than 160 standing and special committees. The Committee on Antitrust ("Antitrust Committee") and the Committee on Patents ("Patents Committee") are

1. With regard to the inquiries raised by Supreme Court Rule 37.6, no party's counsel authored this brief in whole or in part. No party or party's counsel or no person – other than the amicus curiae, its members, or its counsel – contributed money that was intended to fund the preparation or submission of this brief. Sup. Ct. R. 17.

2. Petitioners and Respondent consented in writing to the filing of this amicus curiae brief on January 14, 2015 and January 16, 2015, respectively.

long-established standing committees of the Association, and their membership reflects a wide range of corporate, private practice and academic experience in antitrust and patent law. The participating members of the Committees are dedicated to promoting the Association's objective of improving the administration of the antitrust and patent laws.

II. SUMMARY OF ARGUMENT

In *Brulotte v. Thys Co.*, this Court held under federal common law that "a patentee's use of a royalty agreement that projects beyond the expiration date of the patent is unlawful *per se*." *Brulotte v. Thys Co.*, 379 U.S. 29, 32 (1964). In light of this Court's other decisions concerning the intersection of the laws of antitrust and intellectual property, a patent owner's ability to accept royalties, even beyond the patent's expiration date, should be analyzed under the rule of reason rather than a rigid *per se* rule. The *per se* rule of *Brulotte* is based on the erroneous assumption that royalties paid after a patent's expiration somehow extend the patent right and thus extend a patent owner's presumed monopoly power over the applicable market. However, in reality the ability to schedule the timing of royalty payments after the expiration of a patent is generally procompetitive because it encourages innovation, increases the ability to license technology, and promotes overall economic activity. Furthermore, there is no evidence that post-termination royalty payments "always or almost always tend to restrict competition and decrease output" as required for *per se* condemnation to be applicable. *See Business Electronics Corp. v. Sharp Electronics Corp.*, 485 U.S. 717, 723 (1988). Therefore, a licensee seeking to avoid paying post-termination royalties should be required to prove under a rule of reason analysis that extending royalty payments beyond the patent term is unlawful under the antitrust laws.

III. ARGUMENT

A. A Patent Is Not An Automatic Grant Of Monopoly Power To The Patent Holder

In economics, a monopoly is defined formally as a market condition in which there is a single supplier of a product. In the textbook version of monopoly, a monopolist faces no competition from existing or potential rivals and thus has unfettered market or monopoly power. Market power refers to how much control a seller has over the price it charges for its output. The textbook monopolist has total control over the price of its output.[3] At the other end of the spectrum, individual firms in the textbook version of perfect competition have no control over the price of their output because "the market" sets the price. For this reason, economists often refer to firms in perfectly competitive markets as "price takers." These firms take market prices as given and have no unilateral influence over price.[4]

Most commerce, however, takes place in markets where competition is "imperfect," in the sense that sellers' products are differentiated, and therefore sellers have some control over their prices. Unlike a textbook "perfect" competitor, these firms can raise prices somewhat without losing all their customers, and they can lower prices

3. Hubbard & O'Brien, Economics 474,487 (2nd Ed.2008).

4. *Id.* at 379.

somewhat without being completely overrun by customer demand. Because product differentiation is so common in the economy, many firms possess some degree of market power. Economists are generally only concerned with market power to the extent it threatens competition by insulating the firm's pricing decisions from the restraining influence of competing firms. This restraint comes from existing rivals as well as potential new entrants into the firm's market.[5]

Under the Patent Statute, the government grants patent owners limited rights to exclude others for a term of years, in exchange for the patent owner's rights inuring to the benefit of the public and entering the public domain upon patent expiration. *See* 35 U.S.C. § 154. Specifically, the patentee may exclude others from making, using, offering for sale, selling, or importing the invention. *Id.* In *Brulotte*, this Court held that "extraction of royalties… after the patent has expired is an assertion of monopoly power in the post-expiration period when… the patent has entered the public domain." *Brulotte*, 379 U.S. at 33. This holding of *Brulotte* was premised on the assumption that patent ownership in and of itself confers monopoly power, which may then be unlawfully extended by the post-expiration payment of royalties. *See id*. at 33. This assumption – that a patent grants market power – found its origins in the doctrine of patent misuse. *See International Salt Co. v. U.S.*, 332 U.S. 392 (1947); *see also Morton Salt Co. v. G.S. Suppiger Co.*, 314 U.S. 488 (1942). But this notion has since been summarily overruled by *Illinois Tool Works Inc. v. Independent Ink, Inc.*, where this Court clarified – consistent with accepted economic doctrine –

5. *Id.* at 412-16.

that a patent does not necessarily confer market power on the patent owner. *See* 547 U.S. 28, 44 (2006).

In *Illinois Tool Works*, the petitioner sold printing systems, having two patented components and unpatented ink, conditioned on their customers' agreement that ink would be bought solely from the petitioner. *See id.* at 31-32. After a grant of summary judgment for the petitioner by the District Court (and a reversal by the Federal Circuit), this Court held that without specific proof of a patent-holder's market power, tying agreements – even including a "requirements tie," i.e., a tying arrangement involving the purchase of unpatented goods over a period of time – do not constitute *per se* patent misuse. *See id.* at 42-43.

Thus, while a patent confers certain limited rights, it does not in and of itself confer, or necessarily equate with, monopoly power on the patent holder.[6] The ability of consumers to switch to other closely substitutable product(s) constrains the price a supplier can charge for its product. Two products are substitutes on the demand side if an increase (or decrease) in the price of one causes an increase (or decrease) in the demand for the other, all other things being equal. Thus, a patent will not confer market power on the patent holder if the pricing of the patented product is constrained by the ability of consumers to

6. In fact, the only rights provided by the patent are the rights to exclude others from practicing the invention– a patent owner may itself not be able to produce and sell its patented invention, due to patents assigned to others. *See King Instruments Corp. v. Perego*, 65 F.3d 941, 949 (Fed. Cir. 1995).

switch to substitutable non-infringing products.[7] For example, the holder of a patent over a particular drug will not have market power if consumers are readily able to substitute non-infringing drugs (which may or may not be patented) to treat the same condition.

As a result, and as recognized by this Court in *Illinois Tool Works*, the ability of any firm, including a patent holder, to exercise market power depends on a number of economic factors that require a case-by-case analysis. *See* 547 U.S. at 44-45. For example, the ability of a patent holder to exercise market power may depend not only upon the existence of non-infringing demand substitutes, but also the ability of producers of those substitutes to produce and sell them in sufficient quantity to constrain the pricing of the patent holder. It can also depend on other factors such as costs of designing around the patent and strategic interactions among market participants.

Recognizing this economic reality, Congress amended the Patent Statute to eliminate the market power presumption in certain patent misuse cases:

> (d) No patent owner otherwise entitled to relief for infringement or contributory infringement

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7. U.S. Dep't of Justice & Fed. Trade Comm'n, *Antitrust Enforcement and Intellectual Property Rights: Promoting Innovation and Competition* 2, 22 (2007), available at http://www.usdoj.gov/atr/public/hearings/ip/222655.pdf ("Although some intellectual property rights may create monopolies, intellectual property rights do not necessarily (and indeed only rarely) create monopolies because consumers may be able to substitute other technologies or products for the protected technologies or products.").

> of a patent shall be denied relief or deemed guilty of misuse or illegal extension of the patent right by reason of his having done one or more of the following: ... (5) conditioned the license of any rights to the patent or the sale of the patented product on the acquisition of a license to rights in another patent or purchase of a separate product, *unless, in view of the circumstances, the patent owner has market power in the relevant market for the patent or patented product on which the license or sale is conditioned.*

35 U.S.C. § 271(d)(5) (as amended, 1988) (emphasis added). This amended statute makes clear that Congress did not intend that merely tying a patent to another patent or product would constitute patent misuse absent market power, and this Court's decision in *Illinois Tool Works* further cemented the underlying rationale.

Thus, the rule in *Brulotte* was founded on the erroneous premise that a patent inherently conveys market power – a premise that was later abrogated by this Court in *Illinois Tool Works*. This Court should therefore overrule the *per se* rule of *Brulotte* and adopt the more flexible and pragmatic rule of reason approach.

B. Royalty Payments Scheduled Post Patent Expiration Do Not Extend the Patent Monopoly

A patent owner's right to exclude others expires at the time of patent expiration. Once a patent expires, others are free to incorporate the formerly patent-protected technology into their products without consent of the patent holder. Patent expiration can and does induce the entry of rivals offering substitute products in the market. In the pharmaceutical industry, for example, once the brand-name drug's patent(s) expire, new firms rapidly enter the market and offer consumers generic equivalents of the brand-name drug.[8]

While the strength of the patent can depend on the duration of patent protection ("patent length") along with the scope of patent protection ("patent breadth") conferred by U.S. patent policy,[9] it does <u>not</u> depend on the duration of royalty payments ("payment length"). This is because patent length is not affected by payment length.[10] More generally, increasing payment length does not increase the strength of patent protection (i.e., patent length and patent breadth).[11] Given the foregoing, allowing licensees to pay post-expiration royalties cannot, by itself, "enlarge the monopoly of the patent" (as determined by the court in *Brulotte*).

8. Henry G. Grabowski & Margaret Kyle, *Generic Competition and Market Exclusivity Periods in Pharmaceuticals*, 28 Managerial & Decision Econ. 491 (2007).

9. Hugo A. Hopenhayn & Matthew F. Mitchell, *Innovation Variety and Patent Breadth*, 32 RAND J. Econ. 152 (2001); Richard Gilbert & Carl Shapiro, *Optimal Patent Length and Breadth*, 21 RAND J. Econ. 106 (1990).

10. Richard Gilbert & Carl Shapiro, *Antitrust Issues in the Licensing of Intellectual Property: The Nine No-No's Meet the Nineties*, Brookings Papers on Econ. Activity, Microeconomics 283, 322 (1997).

11. *Id.*

Whether a patented product enjoys any amount of market power is a separate question, to be determined by economic factors that include the technological contribution of the patent and the substitutability of other products for the patented one.[12] Given the foregoing, there is no reason to believe that permitting post-expiration royalties would on their own give rise to any economic market power. Moreover, regardless of the law on post-expiration royalties, rational licensees would not, in economic terms, be expected to pay more to acquire a license simply because they have the ability to pay royalties over a longer period of time. There is no reason to believe that these licensees would agree to pay more than the value of the patent simply because they are paying over a longer period. Indeed, as further addressed below, giving potential licensees the flexibility to pay royalties over a longer period may well prove beneficial to the licensee.[13]

12. Suzanne Scotchmer, Innovation and Incentives 86-87 (2004).

13. Gilbert & Shapiro, *supra* note 10, at 322 (Given that the use of post-expiration royalties will not confer additional monopoly power on the patent holder, it may be optimal to have such payments be *per se* legal. However, the rule of reason provides the court with the flexibility to deal with unforeseen circumstances that may require individual analysis).

C. Post-Expiration Royalties Encourage Innovation, Increase Economic Efficiency, And Promote Competition By Expanding The Range Of Potential Licensees.

The Patent Statute provides for the expiration of patent rights with the expiration of the patent term, and *Brulotte* holds that the expiration of the patent right also extinguishes contracting parties' obligation to pay or right to receive royalties for exploiting the patent. *See Brulotte*, 379 U.S. at 33-34. *Brulotte* concludes that a patent owner's use of a royalty agreement that projects beyond the expiration date of the patent is *per se* an unlawful extension of a monopoly that hurts competition in free markets. *See Brulotte*, 379 U.S. at 32-33.

However, there is no evidence that post-expiration royalties have any harmful impact on competition in markets. In reality, giving contracting parties the latitude to structure their payment options over a longer period actually promotes economic activity and competition. In particular, permitting licensees to pay royalties after patent expiration enables a patent holder to grant licenses to licensees that would prefer to stagger royalties over a longer period and might not otherwise have sufficient funds to pay.[14] Greater freedom in licensing can lead to more licenses, which, in turn, can encourage innovation, increase economic efficiency, and promote competition. The following example illustrates how moving from the *per se* rule of *Brulotte* to the rule of reason can facilitate innovation through the earlier use of patented technology, increase efficiency by facilitating the use of superior technology, and promote entry into the market. Suppose:

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14. Gilbert & Shapiro, *supra* note 10, at 322.

A. Licensor holds Patent X;

B. Patent X expires 2 years from today;

C. Licensor is willing to license Patent X if it receives $150 in total royalties; and

D. Licensee would like to license Patent X today in order to develop a new product but is liquidity-constrained and can only pay $50 per year.

Under *Brulotte*, a license agreement between the Licensor and Licensee in this example is not feasible because Licensee can only pay $100 to Licensor ($50 in Year 1 and $50 in Year 2). No license would be consummated, and as a result Licensee would either have to wait 2 years to incorporate the patented technology into its product or pursue a (possibly inferior) non-infringing alternative. If, however, post-expiration royalty payments were allowed, a license agreement would be consummated as the Licensee can pay royalties not exceeding $50 over more than 2 years (e.g., $50 per year for 3 years or $25 per year for 6 years) that add up to $150 for a license for Patent X today rather than two years hence.

As illustrated in this example, enabling a licensee to spread its royalty payments over a longer period can facilitate the consummation of license agreements that might not otherwise be feasible in nascent industries or for new entrant licensees. Such flexibility, in turn, encourages innovation through the earlier use of patented technology; and increases economic efficiency by avoiding costs associated with the would-be licensee's pursuing possibly inferior non-infringing alternatives.[15] This ability to stagger payments also may lead to an increase in the number of entrants (e.g., by liquidity-constrained firms) into certain markets, which promotes competition.

Furthermore, by increasing the potential payoffs to both the patent holder and licensee, the ability to agree to post-expiration royalties encourages both pioneering and follow-on innovations.[16] Licensing generally benefits both licensors and licensees as it increases the use of existing knowledge, which can be used by licensees to enter new markets or produce new products. Among other reasons, patents are licensed in order to:

- produce proprietary products efficiently;
- let others use the intellectual property as inputs to subsequent innovations; and
- resolve blocking rights or enable development of complementary innovations.[17]

These reasons are procompetitive as they encourage patent holders to permit, rather than exclude others, from efficient uses of the patent holder's intellectual property and associated technology. For example, a firm that

15. U.S. Dep't of Justice & Fed. Trade Comm'n, *supra* note 7, at 117-118; Scotchmer, *supra* note 12, at 161-169; Dennis W. Carlton & Jeffrey M. Perloff, Modern Industrial Organization 692-698 (2nd ed. 1994).

16. *See* Scotchmer, *supra* note 12, at 132-163.

17. *Id.*

develops a new product is not necessarily the most efficient firm to produce it. Licensing can increase efficiency by having the product made by one or more other firms with lower manufacturing costs.[18]

Furthermore, extending the period over which royalties may be payable generally serves to promote economic efficiency by reducing the degree of "deadweight loss,"[19] i.e., the loss in economic efficiency that results from non-optimal market conditions. Improving efficiency also leads to an increase in the reward from a patent and enables inventors to capture more fully the value of their patented technology, a result that will lead to a more efficient level of innovation.[20]

From an economic perspective, policies that increase the use of knowledge through mechanisms, such as licensing, encourage innovation and competition.[21] For example, in industries in which early-stage development costs and uncertainty as to research and development success are high (e.g., emerging industries), payment of post-expiration royalties can reduce the barriers to entry by making a license (to enter the market) more affordable. This "extended-payment" option can induce more entities to enter the market. Similarly, the use

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18. *Id.*

19. *See, e.g.*, Gilbert & Shapiro, *supra* note 10; Stephen Law, *Inter-temporal Tie-ins: A Case for Tying Intellectual Property Through Licensing*, 11 Int'l J. Econ. of Bus. 3 (2004).

20. U.S. Dep't of Justice & Fed. Trade Comm'n, *supra* note 7, at 118; Law, *supra* note 19, at 4.

21. Scotchmer, *supra* note 12, at 132-168.

of post-expiration royalties can facilitate risk-sharing between a patent holder and licensee that can also lead to more consummated license agreements.[22]

In summary, *Brulotte* limits the flexibility of a licensor and licensee to negotiate efficient payment arrangements, which causes economically inferior payment structures and prevents some licenses from being consummated at all. Parties licensing a single technology are often forced to use inefficient mechanisms to prevent related intellectual property royalties from becoming unenforceable when the term of a corresponding patent expires.[23] In this regard, this Court in reviewing the holding of *Brulotte* should consider that a change from a *per se* rule of to a rule of reason has the potential to increase social welfare by encouraging innovation, increasing efficiency, and promoting competition.

22. For example, the use of post-expiration royalties can allow the patent holder to share the risk inherent in the licensee's business by agreeing to accept royalties that are conditional on the licensee achieving long-term success.

23. Eric J. Marandett & Sophie F. Wang, *Trade Secrets in Life Sciences: Challenges and Opportunities in a Collaborative and Mobile Environment*, 87 Pat. Trademark & Copyright J. (BNA) 89 (2013).

IV. CONCLUSION

For the reasons set forth above, current economic thought and this Court's own recent jurisprudence support overruling the *Brulotte* holding that a royalty agreement that extends beyond the expiration of the patent term is unlawful *per se*. Worthy of close attention are the arguments made that (1) the *per se* rule of *Brulotte* is based on the erroneous assumption that royalties paid after a patent's expiration somehow extend the patent right and thus extend a patent owner's monopoly power over the applicable market; (2) that the contracting parties' ability to pay royalties after the expiration of a patent can encourage innovation, increase economic activity, and promote competition; and (3) that licensees seeking to avoid payment of post-expiration royalties should have to prove under a rule of reason analysis that extending royalty payments is anticompetitive under the antitrust laws. Changing the existing *per se* rule of *Brulotte* to a rule of reason would serve to provide more freedom in the market for knowledge, and such a change can only improve social welfare.

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