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 UNIVERSITY OF MASSACHUSETTS BIOLOGIC LABORATORIES AS AMICUS CURIAE IN SUPPORT OF PETITIONERS

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STATEMENT OF INTEREST

The University of Massachusetts Biologic Laboratories ("MassBiologics") is a public research laboratory established by the Massachusetts Legislature to carry out a public health mission.[1] As set forth in its enabling act, "the purpose of [MassBiologics] shall be the research, development and production of childhood vaccines and biologic products designed to reduce or prevent morbidity and mortality in the commonwealth, including but not limited to those products which may be of little or no interest to commercial manufacturers and are therefore otherwise substantially unavailable to the citizens of the commonwealth." Mass. Gen. Laws ch. 75, § 43.

Over the past several years, MassBiologics has been forced to litigate, at great expense, a licensee's challenge, under *Brulotte v. Thys Co.*, 379 U.S. 29 (1964), to the mutually-agreed royalty terms in a technology license agreement. The agreement was entered into as part of a research collaboration to develop therapeutic products for the prevention or treatment of respiratory syncytial virus ("RSV"), a cause of devastating illness in premature infants. Years after one of these products became a billion dollar drug, the licensee's business was sold to a

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[1] In accordance with Supreme Court Rule 37.6, MassBiologics states that this brief was not authored, in whole or in part, by counsel to a party, and that no monetary contribution to the preparation or submission of this brief was made by any person or entity other than MassBiologics or its counsel.

global pharmaceutical company. Thereafter, the licensee attempted to cut off all further royalty payments to MassBiologics. In the course of the litigation that ensued, the licensee pressed the argument that the agreement's royalty terms, *drafted by the licensee's own experienced patent attorney*, were unlawful per se under *Brulotte.* The licensee's attempt to renege on its financial commitments was rejected by a Maryland trial court, but not without considerable cost exacerbated by the continued vitality of *Brulotte* and the circuit courts of appeals' treatment of it as creating a rule of per se illegality.[2]

SUMMARY OF ARGUMENT

MassBiologics' experience belies Respondent's suggestion that the *Brulotte* rule "causes little (if any) interference with desirable licensing practices." Respondent's Cert. Br. at 24. MassBiologics has been forced, at considerable expense, to defend its rights under a procompetitive research collaboration agreement when its licensee, with the goal of maximizing profits by reducing or eliminating third party royalties, seized upon *Brulotte* as an excuse to undo promises made years ago. The licensee's *Brulotte* challenge has been pressed zealously even though the evidence established that no patent applications had been filed at the time of the

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[2] MassBiologics sought consent to file this brief from the counsel of record for all parties, pursuant to Supreme Court Rule 37.3(a). Counsel for all parties consented and copies of the letters of consent have been submitted with this brief.

agreement, the licensee's royalty bearing therapeutic product makes no use of the licensor's patents, and the licensor had no market power and exerted no patent leverage at the time the license was negotiated. MassBiologics' experience powerfully illustrates the harm that is caused by the continued vitality of *Brulotte*, exacerbated by lower federal courts' mistaken interpretation of that decision.

Contrary to what those lower courts have held, *Brulotte* does not impose an unyielding per se rule that is blind to the absence of patent leverage, the convenience of the parties, or other factors making the arrangement procompetitive. The *Brulotte* Court's analysis and the facts of that case do not support the rigid test that has been ascribed to it, nor do this Court's subsequent precedents.

If *Brulotte* does impose a categorical per se rule of illegality, it should be overruled and replaced with a flexible, rule of reason analysis. Legal and economic scholars agree that a per se rule invalidating post-expiration royalties is economically unsupportable and unwise. Nor can *Brulotte* be justified as an articulation of patent policy. *Brulotte* has become an outlier in this Court's jurisprudence, lacking any doctrinal foundation. Today, it serves only as an obstacle to technology transfer and a dangerous trap for the unwary. It is time for this Court to bring this area of law in line with the Court's modern jurisprudence and articulate a principle that is economically sound, flexible, and fair to both licensors and licensees.

ARGUMENT

I. MassBiologics' Experience Exemplifies the Harm Caused by the Circuit Courts of Appeals' Treatment of Post-Expiration Royalties as Unlawful Per Se under *Brulotte*

The *Brulotte* Court's reference, in dicta, to per se illegality, and the rigid application of *Brulotte* by the circuit courts of appeals, have inspired licensees to challenge reasonable patent license arrangements that fall well outside the type of agreement seen as problematic by this Court in *Brulotte.* Mr. Kimble's case provides an opportunity for this Court to ensure that procompetitive agreements, entered into between willing parties and containing royalty terms designed for the convenience of the parties, cannot be attacked after the fact, when a profit-driven licensee decides it no longer wants to keep its promises.

For the past several years, MassBiologics has been forced to defend against a licensee's *Brulotte* challenge to the enforceability of a royalty provision agreed upon as part of a joint development collaboration. The licensee has mounted this challenge even though the evidence established that (1) at the time of the agreement, no patents or patent applications existed; (2) there was no patent leverage, as a trial court expressly found; and (3) the licensee's continuing obligation to pay royalties on its billion dollar drug is not based upon any continuing use of the licensor's expired patents. The licensee, now a business unit of a multibillion-dollar global pharmaceutical company, is seeking to exploit

Brulotte as a way to escape its contractual obligations and enhance its profits at the expense of a small, budget-constrained state agency. MassBiologics' experience provides a real world illustration of the risks, costs, and uncertainties engendered by the continued vitality of *Brulotte* and the intermediate federal appellate courts' inflexible and incorrect interpretation of that decision.

A. The RSV Consortium

In 1989, the licensee, MedImmune LLC – then a small, fledgling startup – and two non-profit entities came together to form the "RSV Consortium." Their goal was to develop and commercialize antibody technology for the prevention and treatment of RSV. The parties recognized a significant unmet public health need in RSV as well as a commercial opportunity, and they formed their consortium to solve it, hopefully for the benefit of them all and for countless premature infants and other vulnerable patients who might otherwise suffer from RSV infections. The three parties decided that each of them would take the lead on a separate antibody project in the hopes that at least one would yield a product that MedImmune could commercialize and sell.

In addition to MedImmune, the other two members of the RSV Consortium were the Massachusetts Health Research Institute ("MHRI"), whose scientists pioneered the early development of antibody-based treatments for RSV, and the Henry M. Jackson Foundation for the Advancement of Military Medicine ("HJF"), a Bethesda-based

research institution whose scientists likewise were working on treatments for RSV. As part of the formation of the consortium, MHRI and HJF entered into license agreements with MedImmune that gave MedImmune access to their RSV research. Most of MHRI's rights under its contract (the "RSV Agreement") were later assigned to MassBiologics.[3]

The agreements were drafted by an experienced outside patent attorney for MedImmune.[4] Although MHRI did not have any patents or even patent applications at the time the agreement was negotiated, MedImmune's proposal included a license grant covering any future MHRI patents within the RSV antibody field. The agreement also granted MedImmune a license to MHRI's trade secrets and manufacturing know-how in the RSV field. MHRI agreed to share with MedImmune MHRI's existing and future technology in the RSV

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[3] In 2002, MHRI, MedImmune, and MassBiologics entered into an Assignment Agreement by which MHRI assigned the RSV Agreement, with MedImmune's consent, to MassBiologics. MHRI retained a portion of the royalty stream under the agreement.

[4] MHRI, the original licensor, did not have outside counsel. The agreement was negotiated on its behalf by its president, himself an attorney, but he had no intellectual property expertise or experience. There was no evidence that he was aware of the *Brulotte* decision.

antibody field, and it agreed not to compete against MedImmune's RSV antibody products.[5]

MedImmune proposed to pay MHRI and HJF each a modest 3% royalty on any anti-RSV antibody product sold by MedImmune. The royalty proposal, as accepted by MHRI and HJF, provided that MedImmune would pay this royalty regardless of which of the three entities contributed the technology incorporated into a commercialized product. In other words, consistent with the RSV Consortium's "all for one, one for all" nature, the parties agreed that if any of them could develop an anti-RSV antibody product, all would be rewarded. This arrangement maximized the RSV Consortium's chance of success because it incentivized each party to support all of the projects pursued by each of the Consortium's members. And it also spread the risk associated with focusing exclusively on any one project.

MedImmune's proposal gave MedImmune the flexibility it needed while providing fair compensation to MHRI and HJF for their development efforts. At the time the agreement was signed, MedImmune was a small, cash-strapped start-up that was not in a position to make substantial upfront or early milestone payments to MHRI or HJF as part of their compensation. MedImmune's proposal allowed it to delay compensation until it had successfully

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[5] In a separate agreement, MHRI also agreed to carry out specified RSV research funded by MedImmune.

commercialized an anti-RSV antibody product. By its terms, the proposed license agreement and MedImmune's royalty obligations continued unless and until a party terminated the agreement under conditions specified in its termination provisions.[6]

MedImmune's proposal did not include an increased royalty rate in the event that MHRI should later obtain patents on its licensed technology, nor did it provide for a reduced royalty rate to take effect upon the expiration of any such patents. In fact, it did not tie the royalty to the use of any licensed patent or other technology. On the contrary, as noted above, the royalty obligation was deliberately uncoupled from any technology contributed by any of the parties. Again, the agreement aimed to incentivize the parties to work together by ensuring that they all would share in

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[6] Under Massachusetts state contract law, agreements of indefinite duration, particularly those that contain express termination provisions, are valid and enforceable. *See, e.g.*, *BPR Grp. Ltd. P'ship v. Bendetson*, 906 N.E.2d 956, 964 (Mass. 2009); *Edmund D. Hewins, Inc., v. Marlboro Cotton Mills*, 136 N.E. 159, 160 (Mass. 1922); *G.M. Abodeely Ins. Agency, Inc. v. Commerce Ins. Co.*, 669 N.E.2d 787, 789-90 (Mass. App. Ct. 1996); *see also Aronson v. Quick Point Pencil Co.*, 440 U.S. 257, 261, 264-65 (1979) (enforcing parties' agreement to royalty of indefinite duration and observing that "[c]ommercial agreements traditionally are the domain of state law. State law is not displaced merely because the contract relates to intellectual property which may or may not be patentable...."). At trial, the Maryland state court held that under the RSV Agreement, MedImmune was obligated to continue paying royalties to MassBiologics as long as MedImmune manufactured or sold its Synagis® product.

any future commercial success regardless of which of the three ultimately developed a successful product. As the trial court would later find, the agreement was more akin to a co-development agreement than a traditional patent license agreement.

The RSV Consortium was a medical and commercial success beyond the hopes and dreams of its three members. Its first FDA-approved product, Respigam®, was a polyclonal antibody product developed by MHRI after substantial effort by its scientists. Respigam® provided revenue, a market presence, and other benefits to MedImmune during a critical period of its early growth. Some years later, MedImmune, with input from MHRI and HJF, developed Synagis®, a monoclonal antibody-based anti-RSV product that, by agreement of the parties, replaced Respigam®. Synagis® became a blockbuster drug, providing billions of dollars in revenue to MedImmune. Today, MedImmune's royalty payments to MassBiologics are based entirely on MedImmune's sales of Synagis®, which MedImmune itself patented and which does not use any of MHRI's patents. The royalties amount to about half of MassBiologics' annual budget and help to fund its public health mission.

The RSV Consortium exemplifies the innovation and social and economic good that can result from flexible, long-term contractual arrangements. MHRI's willingness to forego front-loaded monetary benefits and accept a low royalty rate in exchange for the prospect of a long-term, continuing royalty stream on future commercial products gave MedImmune the room to thrive and invest in its

early growth and development. The agreement also created incentives for the parties to collaborate with each other and share their research without concern that the financial rewards would be skewed according to which Consortium member contributed the ultimately successful technology, which Consortium member managed to secure patents, or when such patents were secured. MedImmune, its collaborators, the economy, patients, the public health, and society benefited from the flexibility and efficiency of the royalty agreement. It was procompetitive in every sense of the word.

B. MassBiologics' Licensee Brings a *Brulotte* Challenge Seeking to Avoid Its Promise to Share in the RSV Consortium's Success

After Synagis® achieved blockbuster status, MedImmune undertook a business strategy aimed at reducing or eliminating its third party royalty obligations. MedImmune had needed to obtain royalty-bearing licenses of many different proprietary technologies to develop Synagis®. Since 2002, MedImmune has sued at least seven of its licensors claiming that it was not required to pay royalties under those agreements under various legal theories. *E.g.*, *MedImmune, Inc. v. Genentech, Inc.*, 549 U.S. 118 (2007).

MedImmune's lawsuit challenging the RSV Agreement was among them. In 2011, without warning, MedImmune filed a complaint asking a Maryland state court to declare that MedImmune's royalty obligations had ended. *MedImmune, LLC v. Henry M. Jackson Foundation for the Advancement*

of Military Medicine, Inc., et al., Circuit Court for Montgomery County, Maryland, Civil No. 351304. The complaint said nothing about *Brulotte*, did not allege per se illegality of the RSV Agreement, and asserted no cause of action under federal law. Later in the course of the litigation, however, MedImmune contrived the idea that its royalty obligations could be challenged on the theory that the royalty arrangement proposed by MedImmune in 1989 was unlawful per se under *Brulotte*. Eventually, this theory came to dominate MedImmune's litigation strategy.

In support of its *Brulotte* theory, MedImmune seized on the fact that several years after execution of the RSV Agreement, MHRI received a patent covering the now-discontinued Respigam® product. Citing the circuit court of appeals' expansive interpretation of *Brulotte*, MedImmune urged that, as a matter of federal law, all of its royalty obligations based on sales of Synagis® terminated upon the expiration of MHRI's patents covering *Respigam*®, even though MedImmune has not sold Respigam® after MHRI's patents expired and even though MedImmune's sales of Synagis® do not involve any use of MHRI's patents. There was no evidence that MHRI possessed or attempted to exert any patent leverage in the negotiation.

C. The State Trial Court Rejects a Rigid Interpretation of *Brulotte* and Determines that It Does Not Apply to the Facts and Circumstances of the RSV Agreement

The Maryland trial court rejected MedImmune's *Brulotte* theory. After hearing testimony laying out the negotiating history of the RSV Agreement, the court found no evidence that MHRI had exerted any leverage based upon the potential issuance of MHRI patents. As noted, no patents or even patent applications existed at the time of the agreement, and the evidence established that it was MedImmune, not MHRI, that later insisted on applying for patents in MHRI's name. More generally, the Maryland court concluded that the agreement was in the nature of a co-development agreement quite unlike the agreement before this Court in *Brulotte*.

In its decision, the Maryland court analyzed *Brulotte* and this Court's subsequent decisions and concluded that *Brulotte* should not be read to impose an inflexible per se rule on any agreement containing a patent license, but rather indicated only that under certain factual circumstances, not present in the negotiation of the RSV Agreement, patent owners could not use patent leverage to require post-expiration royalties in exchange for the continued use of a licensed patent.

D. MassBiologics' Licensee Presses *Brulotte* on Appeal

MedImmune has appealed the trial court's ruling to Maryland's intermediate appellate court, and the latter court's ruling is under advisement. MedImmune's appeal attempts to exploit the Ninth Circuit's decision in Mr. Kimble's case and other circuit court decisions misapplying *Brulotte* to support its *Brulotte* challenge. MedImmune asserts, for example, that the effect of *Brulotte* is to make all of its royalty obligations unlawful per se from and after the date when MHRI's Respigam® patents expired in 2012, even though MedImmune's current royalty payments are based entirely on sales of Synagis®, the manufacture and sale of which involve no use of MHRI patents. Indeed, MedImmune presses its arguments even though its royalty obligations under the agreement do not arise from its use of *any* licensed technology, but rather as a result of the parties' agreement that MedImmune would pay a royalty on sales of all antibody products it sold in the RSV field, regardless of whether it uses licensed technology, in order to incentivize and reward collaborative research.

MedImmune also claims that the Maryland trial court's express factual finding – not challenged on appeal – that MHRI exerted no patent leverage in negotiating the agreement is irrelevant under *Brulotte*'s alleged "per se rule," and that *Brulotte* also makes it irrelevant that no patent applications existed at the time of the parties' agreement. According to MedImmune, even though it drafted the financial terms of the parties' agreement and

benefited from the flexible arrangements the parties negotiated, including a low royalty rate on sales of a therapeutic medicine, it now is free to escape its commitments and enjoy a windfall merely because the agreement did not include a "step-down" of the royalty rate after the expiration of any MHRI patents that might later issue, whether MedImmune used them or not.

MassBiologics rejects these overreaching contentions but, unfortunately, the continued vitality of the circuit court of appeals decisions, which those courts themselves have criticized, has forced MassBiologics to divert its limited resources to defending the enforceability of the RSV Agreement. The use of per se terminology in dictum in *Brulotte* and the expansive interpretation of *Brulotte* by several lower federal courts incentivize licensees to challenge the enforceability of mutually-agreed-upon royalty terms without regard to the reasonableness of those terms, the importance or lack of importance of any licensed patent rights, the certainty or strength of any patents, the absence of market power provided by the patents, the lack of any patent leverage or coercion, or the procompetitive or other beneficial effects of the agreement.

This Court should correct the improper application of *Brulotte* by the circuit courts of appeals and ensure that its holding in this case does not result in procompetitive agreements, like the RSV Agreement, becoming subject to attack simply because they relate to long-term business

relationships that eventually lead both to issued patents and royalty-bearing sales.

II. *Brulotte*, and This Court's Subsequent Decisions, Do Not Support an Inflexible Per Se Test

The circumstances of *Brulotte* and this Court's subsequent precedent illuminate this Court's holding in that case, and make clear that this Court did not intend to create the inflexible and far reaching rule that has been laid at its feet. The *Brulotte* Court worried that the post-expiration royalties in that case were the result of an unequal "bargaining position" deriving from the licensor's patent. 379 U.S at 32. What most of the circuit courts of appeals have overlooked is that many additional indicia of coercion beyond a post-expiration royalty appeared in the *Brulotte* contract, and they all played a role in this Court's conclusion that the royalty was unenforceable after expiration of the patent.

The Thys Company's contract for the sale of its hop picking machines did not merely require payments for the use of the patents after they had expired. Rather, the agreement also included strict limitations forbidding the licensee from moving the machines out of the territory or even assigning them to others after the patents had expired. *Id.* at 31-32. These use and transfer restrictions, operating together with the royalty provision, are what caused this Court to conclude that it was "unable" to conjecture what the bargaining power of the parties might have been absent patent leverage. Indeed, this Court referred to the post-expiration royalty as

"peculiarly significant" only because of these "other provisions in the license agreements." *Id.* at 31.

After having identified these additional, and unusual, post-expiration restrictions on the licensees' ability to use or alienate the machine, the Court consistently referred to the restrictions in the *Brulotte* license in the plural. For example, the Court concluded that "[t]hose restrictions… and their applicability to the post-expiration period is a telltale sign that the licensor was using the licenses to project its monopoly beyond the patent period." *Id.* at 32.

If the *Brulotte* Court truly meant to create a categorical, per se rule invalidating any promise to pay a post-expiration royalty based on use of the patent regardless of any other circumstances, this Court's discussion and consideration of the additional restrictions in the *Brulotte* license would have been superfluous, because the royalty provision alone would have been determinative. But that was not the analysis underlying the *Brulotte* holding; to the contrary, the Court deemed those additional factors equally important in considering the legality of the post-expiration royalty. *Id.* at 31. The Court also emphasized the licensor's use of patent "leverage" to project royalty payments beyond the life of the patent, *see id.* at 32, 33, further indicating that the existence of market power and patent leverage mattered. Clearly, the Court viewed the agreement as a whole as coercive and anticompetitive. Its one-time invocation of "unlawful per se" terminology drawn from antitrust law was dictum, unnecessary to the holding.

The circuit courts of appeals, in applying *Brulotte*, have largely ignored *Brulotte*'s actual facts, its analysis, its holding, and the importance of other restrictions beyond the post-expiration royalty that contributed to the Court's conclusion that the licensor in *Brulotte* exerted coercive patent leverage. Indeed, among the intermediate appellate courts, only the Ninth Circuit, the court from which this case is before this Court on certiorari, has delved into *Brulotte*'s facts and analysis in an effort to determine how that case should correctly be applied. As that court explained in *Zila, Inc. v. Tinnell*, 502 F.3d 1014 (9th Cir. 2007), which is the precedent applied below to decide Mr. Kimble's case:

> *Brulotte* indicates that it is because of post-patent-expiration contractual restrictions *other* than royalties that the Thys Company could not collect the royalties after the patents expired…. It is only "in view of [these] *other* provisions of the license agreements" that the Court found the unchanging royalty rate to be "peculiarly significant." The Court emphasized that the presence of "*[t]hose* restrictions," rather than the royalty alone, in the "post-expiration period [was] a telltale sign that the licensor was using the licenses to project its monopoly beyond the patent period."

Id. at 1021 (alterations in original) (quoting *Brulotte*, 379 U.S. at 29, 31-32). The Ninth Circuit concluded that, were it "writing on a clean slate," it would decide Zila's case based on this interpretation of the Court's reasoning in *Brulotte*; however, the Ninth

Circuit instead decided, in deference to its sister circuits, that it would join them in "ignor[ing] the relevance of the restrictions on use" in the *Brulotte* Court's analysis. *Id.* at 1022.[7]

Reading *Brulotte* to articulate an inflexible per se rule that ignores lack of market power, leverage, or coercion and requires only the existence of a post-expiration royalty also flies in the face of this Court's subsequent decisions examining *Brulotte*. Those cases demonstrate that dicta in *Brulotte* should not be read to impose per se illegality no matter the circumstances, the nature of the contract, or the absence of patent leverage. If *Brulotte* really did impose a strict per se rule – where all evidence bearing on the exercise of patent leverage was irrelevant – then any and all royalties extending beyond the life of a patent would be invalid. But, in *Aronson v. Quick Point Pencil Co.*, 440 U.S. 257 (1979), this Court upheld the enforceability of a license to a patent application and other intellectual property that imposed a royalty of indefinite

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[7] By contrast, in *Cordance Corp. v. Amazon.com Inc.*, 727 F. Supp. 2d 310, 335-37 (D. Del. 2010) the district court interpreted *Brulotte* in light of its facts and the principles underlying the doctrine of patent misuse. The court concluded that *Brulotte* did not restrict a court's ability to consider the circumstances of a license agreement, stating that "the existence of post-expiration royalty obligations… does not dictate that a court find patent misuse *per se*." *Id.* at 33. Rather, the court explained, "what courts must be wary of – what the doctrine of patent misuse aims to guard against – are coercive attempts to use a patent monopoly as leverage." *Id.* at 335.

duration. *Id.* at 265. The Court cited the agreement's step-down in the royalty rate if no patent issued as evidence that there was no use of patent leverage in negotiating the contract. *Id.*[8]

Aronson's holding makes clear that *Brulotte* did not impose a formalistic per se rule divorced from the underlying circumstances surrounding the contract negotiation. The *Aronson* Court recognized that a pending patent application gives the applicant "some additional bargaining power" in negotiating a royalty agreement. *Id.* But the Court took care to note that "the amount of leverage arising from a patent application depends on how likely the parties consider it to be that a valid patent will issue." *Id.* The Court concluded that, under the circumstances, Ms. Aronson and her licensee "assigned a substantial likelihood to that contingency." *Id.* These observations would be meaningless if evidence bearing on patent leverage was irrelevant to

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[8] Notably, in *Aronson*, the agreement provided for an initial 5% royalty rate while the licensor's patent application was pending, subject to a reduction to 2.5% if no patent issued within five years. 440 U.S. at 259. Although this provision imposed a higher royalty for licensed patent rights ***before*** any patent term began – and thus could be said to enlarge the period of patent monopoly beyond the statutory term to cover the pre-issuance period – the Court did not suggest that this aspect of the royalty requirement implicated any per se illegality. In this respect as well, *Aronson* shows that for more than thirty years this Court has declined to treat *Brulotte* as a rule of per se illegality. *Aronson* also belies any suggestion that patent policy alone motivated the Court's analysis.

agreements for post-expiration royalties under *Brulotte*.

The federal circuit courts of appeals have largely ignored these aspects of *Aronson*. They have, instead, interpreted *Aronson* as simply creating an exception to *Brulotte*'s supposed per se rule – a safe harbor, in effect – that immunizes a license from a *Brulotte* challenge as long as the royalty rate is subject to a post-expiration step-down. But, if there is one exception to *Brulotte*'s supposed per se rule, then why should not there be others? If a step-down was compelling evidence that the licensor lacked sufficient leverage to coerce the post-expiration royalty, then why should not other evidence to that effect also be considered?

This Court's decision in *Zenith Radio Corp. v. Hazeltine Research, Inc.*, 395 U.S. 100 (1969) similarly contradicts the interpretation of *Brulotte* as a rule of per se illegality. In *Zenith*, this Court discussed *Brulotte* in the context of licenses requiring payment of royalties on the sale of both patented and unpatented products. The Court distinguished *Brulotte* as arising in a "particularized context." *Id.* at 136.

The Court further explained that "[i]f convenience of the parties rather than patent power dictates the total-sales royalty provision, there [is] no misuse of the patents and no forbidden conditions attached to the license." *Id.* at 138. The Court agreed that the mere existence of a royalty provision that arguably could extend the scope of the patent was not enough to invalidate the royalty. As the

Court explained, "[n]o such inference follows from a mere license provision measuring royalties by the licensee's total sales even if, as things work out, only some or none of the merchandise employs the patented idea or process, or even if it was foreseeable that some undetermined portion would not contain the invention." *Id.* This is because it was possible that "the licensee as well as the patentee would find it more convenient and efficient from several standpoints to base royalties on total sales than to face the burden of figuring royalties based on actual use." *Id.*

Thus, the central question for the Court in *Zenith* was not rote application of some categorical per se rule, but, rather, an issue of fact: whether the licensor in fact had "used its patent leverage to coerce a promise to pay royalties on radios not practicing the learning of the patent." *Id.*

Zenith teaches that where the royalty provisions were entered into to suit the parties' convenience, and not as a result of the coercive use of patent power, the license should be enforced. The Court's balanced analysis in that case demonstrates the error of those who woodenly insist that dicta in *Brulotte* should be applied in all circumstances irrespective of the nature of the agreement, the background facts, economic reality, or the parties' intentions.

As Mr. Kimble's case and other similar cases show, the circuit courts of appeals have failed to self-correct their overly broad application of *Brulotte*. *See* United States Certiorari Br. at 20 (recognizing

that "lower courts or contracting parties may sometimes misunderstand *Brulotte's* narrow scope"). If the Court does not overrule *Brulotte* outright, it should provide direction to trial and appellate courts, and licensing parties, as to *Brulotte*'s narrow holding to correct the mischief that its misreading by other courts as a rule of per se illegality has engendered.

III. The Court Should Reject Any Per Se Rule and Adopt a Flexible, Rule of Reason Analysis

If this Court concludes that *Brulotte* does impose on patent licenses a categorical per se proscription against post-expiration royalties for use of a patented invention, it should be overruled and replaced with a case-by-case, rule of reason analysis.

A. A Per Se Application of *Brulotte* Is Economically Irrational and Inconsistent with This Court's More Recent Jurisprudence

As this Court recently reemphasized in the context of patent settlement agreements, the "abandonment of the 'rule of reason' in favor of presumptive rules… is appropriate only where an observer with even a rudimentary understanding of economics could conclude that the arrangements in question would have an anticompetitive effect on customers and markets." *FTC v. Actavis, Inc.*, 133 S. Ct. 2223, 2237 (2013) (quoting *California Dental Ass'n v. FTC*, 526 U.S. 756, 770 (1999)).

Patent licenses allowing for post-expiration royalties do not meet this test: they can be

economically beneficial and have a procompetitive effect. As the government acknowledged in its brief in the certiorari phase of this case, "licensing arrangements that extend patent royalties beyond a patent term may sometimes be economically efficient." United States Certiorari Br. at. 14.

For example, the suggestion that post-expiration royalties are inefficient because they burden licensees ignores economic realities. In practice, it can equally be the *licensee* who prefers to spread the licensor's compensation over a longer period based upon sales that accrue post-expiration, so that the licensee does not bear all the risk of a failed product, or so that the licensee can negotiate a lower royalty rate for a longer period of time. *See* Harold See & Frank M. Caprio, *The Trouble with Brulotte: the Patent Royalty Term and Patent Monopoly Extension,* 1990 Utah L. Rev. 813, 851 (1990) ("Given the choice between a lump sum payment of $100,000 or royalty payments that will vary directly with the return to the licensee, but with an expected value of $100,000, risk averse licensees will select the latter."); *see also Scheiber v. Dolby Labs., Inc.*, 293 F.3d 1014, 1016 (7th Cir. 2002) (evidence established that it was the licensee who proposed that royalties continue post-expiration, in exchange for lower royalty rate, to reduce licensee's annual payments).

Similarly, in the case of MassBiologics' RSV Agreement with MedImmune, it was MedImmune that proposed a low 3% royalty rate on all future sales, including sales made after the expiration of any licensed patents that might later issue to MHRI.

Consider the hypothetical inventor who only wishes to ensure a lifetime income stream from his valuable invention. A licensee agrees to spread its royalty payments over the life of the inventor, but does not want to take the risk required by fixed annual payments knowing that the patented product may not succeed. It therefore proposes to grant the inventor an annual lifetime royalty based upon a percentage of product sales that accrue each year. The parties carefully set a royalty rate so that the expected value of those annual payments is about $100,000 per year based on their estimated sales projections. According to Respondent's position, because this license requires payments based upon post-expiration accrual and use, the accommodation by the licensor is strictly prohibited by *Brulotte*. This is true even if the arrangement is the parties' preferred mechanism for addressing the possibility that the product will be a commercial failure.[9]

Under Respondent and the government's logic, however, if the inventor instead rejects the licensee's proposal and insists that the licensee pay a fixed $100,000 annual payment, the agreement would survive because, in that case, the royalty is not tied to post-expiration accrual or use. Similarly, the parties might instead require the licensee to make a single upfront payment exactly equal to the expected present value of the inventor's desired $100,000

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[9] As this example shows, a post-expiration royalty is not necessarily better for the licensor; such an arrangement could benefit the licensee if the future sales are less than the parties initially projected.

annuity stream or, alternatively, the licensee could give the inventor equity in the licensee's business expected to provide about $100,000 annually in preferred dividend payments. Neither of these transactions would run afoul of *Brulotte* either, under even the most extreme interpretations of that case, because they do not require post-expiration royalties at all.[10]

What is the principled basis for finding that these agreements pass muster, while one that protects the risk-averse licensee against the risk of product failure (and gives the licensor additional benefits in the event the product succeeds) does not? Arbitrarily pronouncing some business transactions unlawful merely because they use sales that accrue post-expiration as a metric to compensate the patent owner for licensing the patent during its term is irrational, explained only by empty formalism and unwarranted reliance on discarded theories of competition law.

The mistaken assumption that apparently underlies a rigid per se application of *Brulotte* is that an agreement to pay post-expiration royalties means that the licensor has extended the term of the patent. Yet, as courts and commentators have recognized, a post-expiration royalty provision does not and cannot lengthen the period of exclusive

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[10] Some, like MedImmune, have taken the extreme position that *Brulotte* proscribes any post-expiration payment whatsoever, even if not based on post-expiration use of the licensor's patent.

rights conferred by a patent. By statute, all patents are of limited term, and will expire in accordance with law, after which the entire public, including the licensee, will be free to practice the patented invention. A patentee, therefore, has only its rights during the patent term to sell – no more, no less – and prospective licensees know this at the time they negotiate a patent license. As one commentator has explained,

> When the patent term ends, the exclusive right to make, use or sell the licensed invention also ends. Because the invention is available to the world, the license in fact ceases to have value. Presumably, licensees know this when they enter into a licensing agreement. If the licensing agreement calls for royalty payments beyond the patent term, the parties base those payments on the licensees' assessment of the value of the license *during the patent period*. These payments, therefore, do not represent an extension in time of the patent monopoly.

See & Caprio, *supra*, at 814; *see also* Louis Altman, *Is There an Afterlife? The Effect of Patent or Copyright Expiration on License Agreements*, 64 J. Pat. & Trademark Off. Soc'y 297, 302 (1982) ("[L]icensees will not normally be willing to pay a royalty, after patent expiration, for what their competitors can obtain without charge.... They only pay what they must in order to use the invention during the time when the patent would otherwise bar their way.").

To put it another way, a rational patent licensee will pay no more for a license than the value it can derive from the patents during their term. If there is any presumptive rule to be applied, it should be that royalty terms of a patent license, regardless of how they are structured, represent nothing more than compensation for the value of the patented invention during its term. *See* Note, *An Economic Analysis of Royalty Terms in Patent Licenses*, 67 Minn. L. Rev. 1198, 1219 (1983) ("Since the postexpiration license is useless to the licensee, he or she will simply regard it as part of the price for the preexpiration license. Accordingly, a rational licensee would not pay more for a license requiring royalty payments after the expiration of the underlying patent than for one which terminated upon expiration of the patent."); See & Caprio, *supra*, at 851 ("If royalties are calculated on post-patent term sales, the calculation is simply a risk-shifting credit arrangement between patentee and licensee. The arrangement can be no more than that, because the patentee at that time has nothing else to sell."). A per se application of *Brulotte* turns economics on its head: it not only presumes that all licensees who agree to a post-expiration royalty are irrational, it also forecloses the factfinder from determining otherwise.

B. Patent Policy Does Not Justify a Per Se Rule

Respondent and the government argue that this Court's antipathy to per se rules in the competition law context is inapposite because, they claim, *Brulotte* is based on patent policy. They do not

identify any provision of the patent statute that bars post-expiration royalties in exchange for the grant of a license. *See* 1 Herbert Hovenkamp, et al., *IP and Antitrust* § 23.2a (Supp. 2009) (noting that the patent statute "nowhere condemns" a contract providing for patent royalties on post-expiration use). And they mistakenly assume that the choice between patent and competition policy is binary, and mutually exclusive. Not so. As this Court recently explained in *Actavis*, "it would be incongruous to determine antitrust legality [of a patent settlement agreement] by measuring the [agreement's] anticompetitive effects solely against patent law policy, rather than by measuring them against procompetitive antitrust policies as well." 133 S. Ct. 2223, 2231 (2013). As the Court noted, "rather than measure the length or amount of a restriction solely against the length of the patent's term," a court should instead conduct a more flexible inquiry into the economics of the transaction. The Court further admonished, "[w]hether a particular restraint lies beyond the limits of the patent monopoly is a *conclusion* that flows from that analysis and not… its starting point." *Id.* at 2231-32 (emphasis in original).

Per se application of *Brulotte* wrongly assumes that a patent by itself confers coercive market power on a patentee. This Court has since unanimously overruled the presumption that a patent confers market power in the relevant market. *Ill. Tool Works Inc. v. Indep. Ink, Inc.*, 547 U.S. 28, 31, 39-47 (2006); *see also* 35 U.S.C. § 271(d)(5) (eliminating any presumption of market power in tying patent). As this Court explained in *Actavis*, in rejecting a

categorical rule for evaluating reverse payment patent settlement agreements, the legality of such an agreement presents numerous "complexities" and "depends upon its size, its scale in relation to the payor's anticipated future litigation costs, its independence from other services for which it might represent payment, and the lack of any other convincing justification" and "may also vary as among industries." 133 S. Ct. at 2237. Patent license agreements – of which patent settlement agreements are a subset – are no less complex, and they are just as poor a fit for categorical rules.

The manner in which *Brulotte* has been applied in the context of "hybrid licenses" covering both patented and non-patented technology also shows how disconnected it has become from the goals that Respondent and the government claim justify it. The circuit courts of appeals have enforced post-expiration royalty provisions in such licenses when the license reduces the royalty rate upon patent expiration, as in *Aronson*. But this arrangement – which supposedly disproves the existence of patent leverage – is often contrived for no reason other than to escape *Brulotte.* In common practice, the parties simply insert an arbitrary stepped down royalty rate, in effect creating a *Brulotte* safe harbor. Courts seem to accept the step-down figure without inquiry into whether the differential truly reflects the relative value of patent and nonpatent rights. Yet, if a licensor has sufficient leverage to obtain a post-expiration patent royalty without a step-down, it likely also has the leverage to extract a minimally

reduced post-expiration royalty that still greatly exceeds the value of the nonpatent rights.[11] Thus, because a per se rule ignores evidence of leverage and the economics of the transaction, it does little to stop a licensor who actually has market power and knows of the step-down safe harbor from doing what Respondent and the government wish to prevent.

Equally possible is that the nonpatent rights have as much or greater value than the patent rights; for example, they may include licensed trade secrets that independently block the licensee's product from commercialization even without a patent. Yet if the agreement also confers a license even to one patent application – no matter how weak, easy to design around, or unlikely to issue as a patent at the time of negotiation – avoidance of *Brulotte*'s alleged per se rule can force the risk-averse licensor to accept a lower post-expiration royalty for its trade secrets simply to show that the

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[11] In the *MedImmune* litigation, MedImmune's expert espoused the view that the royalty provision in the RSV Agreement would have satisfied *Brulotte* if the royalty rate had *increased* when MHRI's patents issued and then returned to 3% when they expired. Ironically, under this scenario, the licensee would have ended up paying more in royalties than is required by the actual royalty provision it challenges. This reasoning makes no sense. The fact that the license does not require a higher royalty rate in the event a patent should later issue only underscores the absence of market power conferred by the licensor's prospect of a patent and the absence of any patent leverage in the negotiations. The testimony of MedImmune's expert highlights the absurd lengths to which practitioners today will go to employ *Aronson* as a *Brulotte* safe harbor, without regard to economic justification or common sense.

entire royalty has not been tainted by the concomitant grant of patent rights.

Requiring a royalty step-down upon patent expiration in these circumstances is unfair, economically inefficient, and subverts, rather than supports, patent policy. Indeed, if the licensor has valuable trade secrets, it may be better off filing no patents at all, and thus disclosing nothing of its invention to the public. In that event, patent law achieves exactly the opposite of what it is supposed to do by discouraging public disclosure of inventions and the sharing of technology.

If per se application of *Brulotte* were justified purely by patent policy, one would expect similar categorical rules in other circumstances where licenses required payment for activities outside the four corners of the patent grant. Yet, exactly the opposite is true. In other contexts, this Court has rejected categorical rules. For example, in *Automatic Radio Manufacturing Co. v. Hazeltine Research, Inc.*, this Court refused to invalidate an agreement licensing a patent pool in which a licensee agreed to pay royalties on an entire group of patents, even after some had expired and even if the licensee did not practice any of the patents at all. 339 U.S. 827 (1950), *overruled on other grounds by Lear, Inc. v. Adkins*, 395 U.S. 653, 836 (1969). This Court held that per se illegality was inappropriate, because "[s]ound business judgment could indicate that such payment represents the most convenient method of fixing the business value of the privileges granted by the licensing agreement." *Id.* at 834.

Similarly, in *Zenith Radio Corp. v. Hazeltine Research, Inc.*, 395 U.S. 100 (1969) this Court explained that parties could agree to a license in which all articles sold by the licensee were subject to a royalty even though only some, or perhaps none, of those products might actually infringe that patent. *Id.* at 138. The total sales royalty was permissible so long as the royalty provision was entered into for the convenience of the parties, rather than as a product of coercion. *Id.* In so holding, this Court again rejected an argument that the total sales royalty provision should be unlawful per se.

Notably, in *Brulotte* itself, a key underpinning of the Court's reasoning was that a provision requiring "royalty payments beyond the life of the patent" was analogous to "an effort to enlarge the monopoly of the patent" by tying use of the patented article to the purchase of unpatented ones. 379 U.S. at 33. But since then, in *Illinois Tool*, the Court rejected per se illegality for patent tying arrangements, agreeing that "[m]any tying arrangements, even those involving patents…, are fully consistent with a free, competitive market." 547 U.S. at 45.

Zenith, *Automatic Radio*, and *Illinois Tool* make clear that there is not, as both Respondent and the government have argued, a monolithic patent policy justifying per se invalidation of any royalty arrangement extending beyond the patent grant, without consideration of the convenience of the parties, the absence of market power, patent leverage, anticompetitive effects, or the presence of procompetitive justifications. To the contrary, this Court's patent law cases apply just as flexible an

inquiry as conducted by this Court in its modern antitrust jurisprudence.

C. A Per Se Application of *Brulotte* Creates a Dangerous and Unjust Trap for the Unwary

The economic irrationality of a per se application of *Brulotte* is compounded by the draconian punishment – unenforceability of the entire post-expiration royalty, including amounts that may indisputably reflect the value of nonpatent rights – that the lower courts impose on the unwitting licensor who omits an arbitrary step-down upon patent expiration. This, as in Mr. Kimble's case, can occur no matter how obviously valuable the nonpatent rights were or how little value the parties ascribed to the patents. In the case of MassBiologics, there was no evidence that MHRI's negotiator knew anything about *Brulotte* when he accepted MedImmune's proposed royalty structure. The circuit courts of appeals' categorical refusal to evaluate the economics of the transaction simply because patents are involved not only defies logic and reason but also can result in manifest injustice.

As Respondent has conceded and the above discussion shows, patent attorneys familiar with *Brulotte* can circumvent its strictures through careful drafting, such as including an arbitrary royalty rate step-down. But then, what is the point of *Brulotte*? Large companies with actual market power and the willingness to exert it can force licensees to accept carefully structured agreements that benefit patent owners but slip past *Brulotte*. By

contrast, small and unsophisticated inventors, who cannot afford savvy, high-priced patent attorneys and may be unaware of *Brulotte*, are punished for their failure to insert just the right incantations into their license agreements to take them outside of *Brulotte*. This serves no purpose other than creating a dangerous trap for the unwary and an incentive for a licensee later to break its contractual promises in order to exploit what is now, in effect, a hyper-technicality with no doctrinal foundation.

This is no hypothetical, as *Scheiber v. Dolby Laboratories, Inc.* shows. In that case, Peter Scheiber, an individual musician turned inventor, agreed to license to Dolby his surround sound invention in settlement of a lawsuit. 293 F.3d 1014, 1016 (7th Cir. 2002). In negotiations, it was Dolby the licensee, not Scheiber, who proposed spreading royalty payments beyond the term of the patents, in exchange for a reduced royalty, in order to make the annual payment more palatable to Dolby itself. Scheiber agreed. *Id.* Years later, after having enjoyed the benefit of the reduced royalty rate it obtained through its promise for a longer payment term, Dolby seized on *Brulotte* as the basis for refusing to pay upon the patent's expiration. *Id.* The Seventh Circuit reluctantly agreed, and struck down the post-expiration royalty in its entirety.

Proponents of *Brulotte* argue that a bright line rule is easier to police. But prohibiting courts from evaluating the facts and circumstances results in obvious unfairness, as both Mr. Scheiber's and Mr. Kimble's cases show. It punishes licensors who, unaware of *Brulotte*'s proscriptions, agree to a lower

royalty rate in exchange for a longer period of payments, simply because they did not include an arbitrary step-down in the royalty rate post-expiration to assure immunity from *Brulotte*'s alleged grasp. It grants an unjust windfall to licensees when they avoid payment of agreed-upon post-expiration royalties after having earlier received, in exchange, lower royalty rates or other concessions, such as omission of up-front payments and milestones. This injustice is a great price to pay for the administrative convenience allegedly provided by a bright line rule, particularly when flexible analyses informed by the rule of reason work so well elsewhere.

CONCLUSION

For the foregoing reasons, MassBiologics respectfully requests that the Court reverse the decision below and hold that patent royalty provisions extending beyond the term of a licensed patent are not per se unlawful.

Respectfully submitted,

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