

**ACCA Presentation**

**Patent Exhaustion/First Sale Doctrine:  
Substantive Patent Law Limitation or  
Opt-Out Presumption**

November 9, 2007

- LG owns patents on systems and methods for receiving and transmitting data in computer systems
- Quanta builds computer systems by combining standard computer components (PC board, external memory) with microprocessors and chipsets purchased from Intel
- Quanta purchased microprocessors from Intel and was sued by LG for patent infringement notwithstanding an Intel/LG license agreement

- The License Agreement authorizes Intel to “make, use, sell (directly or indirectly), offer to sell, import and otherwise dispose of all Intel Licensed Products”
- Intel/LG agreed that the license did “not create any express or implied license under [LG’s] patents to computer system makers that combine Intel Integrated Circuits with other non-Intel components to manufacture motherboards, computer subsystems, and desktop, notebook and server computers”
- Recital provided: “WHEREAS Intel desires to acquire a license and a release *with respect to only Intel products* made for or by Intel *and not* for the products that computer system manufacturers make by combining Intel processors and chipsets with non-Intel components and materials”

- Recital provided: “WHEREAS LGE and Intel do not intend this Agreement or the Patent License . . . to give rise *to implied license rights* in computer system manufacturers under LGE’s patents in the instance where the computer system manufacturers combine Intel processors and/or chipsets with non-Intel components to produce mother boards, computer subsystems, and computer systems, such as desktop, notebook, and server computers”
- Agreement provided that Intel had to send notice to its customers stating that Intel had a “broad license” from LG and that “any Intel product that you purchase is licensed by [LG]” – however, the notice also stated that while the license covered Intel’s products, “it does not extend, expressly or by implication, to any product that you may make by combining an Intel product with any non-Intel product”

- Where is the dispute?
  - “Notwithstanding anything to the contrary in this Agreement, the parties agree that nothing herein shall in any way limit or alter the effect of patent exhaustion that would otherwise apply when a party hereto sells any of its Licensed Products.”
  
- What was intended by the Patent Exhaustion clause?
  - 15 years ago, Intel was involved in litigation with Cyrix, where Cyrix purchased chips from Intel’s licensee (TI)
  - Intel claimed that Cyrix’s microprocessors, when combined with external memory, infringed a claim Intel had on an un-licensed combination claim incorporating a licensed microprocessor
  - The District Court noted as follows: “If there are no commercially viable non-infringing uses for the claim 1 microprocessor, then the doctrine of patent exhaustion would preclude Intel from extracting a second monopoly profit” through assertion of claims combining the microprocessor with other standard system components (e.g., memory)

➤ **Quanta's Argument**

- Intel has a license under LG's patents to make, use and sell Intel Licensed Products
- Intel's microprocessors are Intel Licensed Products
- Intel's microprocessors were sold to Quanta under the authority of Intel's license from LG
- Intel's microprocessors have no reasonable use that would not infringe LG's combination and method patents
- As a matter of federal law, embodied in the patent exhaustion doctrine, a patentee's exclusive rights (e.g., rights to control future uses and sales) end at the first authorized sale of a patented good

➤ **LG's Argument**

- Intel has a license under LG's patents to make, use and sell Intel Licensed Products
- Intel's license rights were conditional (limited)
- Quanta was placed on notice that Intel's license did not cover the combination of Intel licensed products with non-licensed products
- Patent exhaustion can be avoided by contract where a patentee expressly limits the scope of a license by notifying the licensee's purchasers of specific use limitations

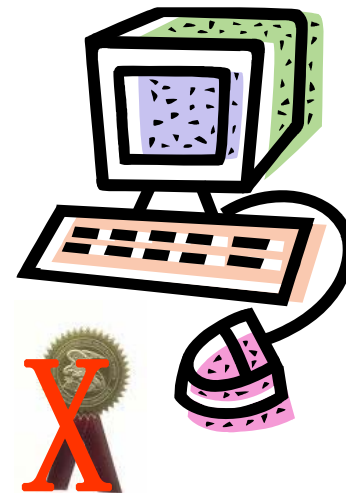
# What Is Patent Exhaustion?

- Patent exhaustion doctrine (*aka* first sale doctrine)
  - “[W]hen the patented machine rightfully passes from the patentee to the purchaser, or from any other person by him authorized to convey it, the machine is no longer within the limits of the monopoly.” *Bloomer v. Millinger*, 68 U.S. 340, 351 (1863)  
[See also *Bloomer v. McQuewan*, 55 U.S. 539 (1853) (exclusive rights to sell are exhausted upon the first valid sale of the article in commerce, whether by the patentee itself or by an authorized licensee)]

**Patentee/Licensee**



**Purchaser**



## ➤ Limited monopoly

- “The declared purpose of the patent law is to promote the progress of science and the useful arts *by granting to the inventor a limited monopoly*, the exercise of which will enable him to secure the financial rewards for his invention.” *U.S. v. Univis Lens Co.*, 316 U.S. 241, 250 (1942) (emphasis added).

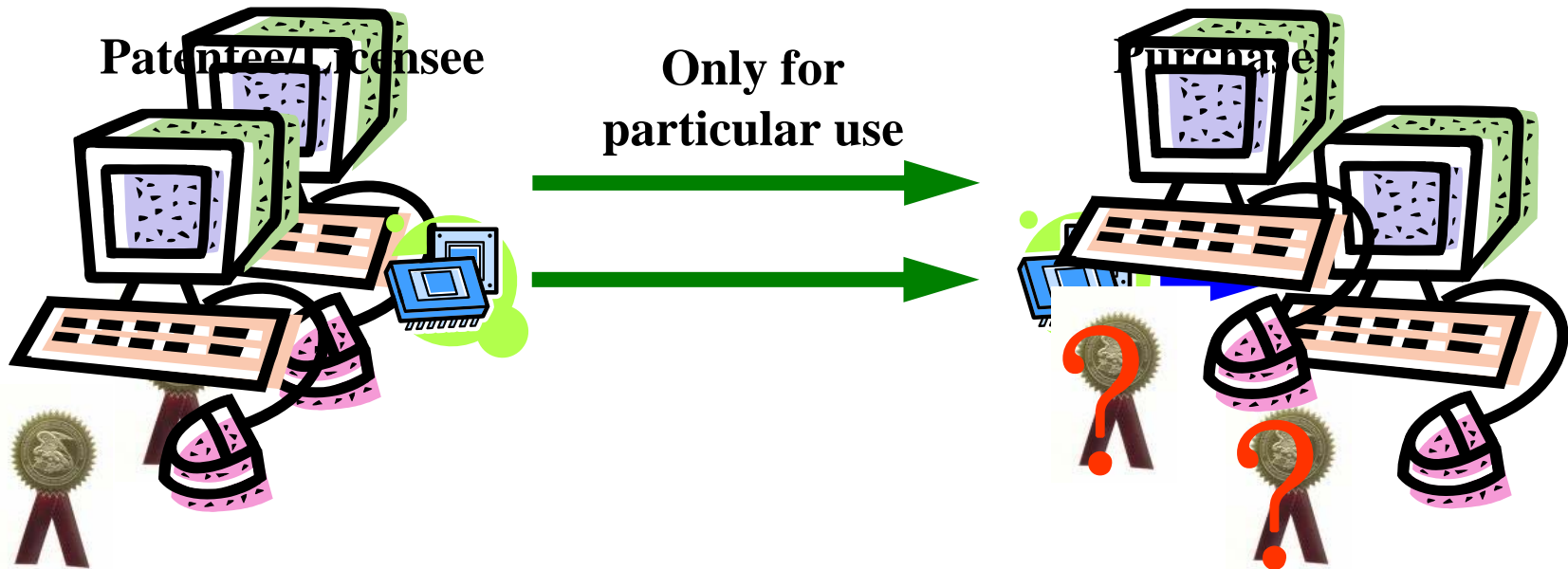
## ➤ One reward; no double dipping

- “They are entitled to *but one royalty for a patented machine*, and consequently when a patentee has himself constructed the machine and sold it, or authorized another to construct and sell it, or to construct and use and operate it, and the consideration has been paid to him for the right, he has then to that extent parted with his monopoly...” *Bloomer*, 68 U.S. at 351 (emphasis added).

# To What Types Of Sales Might The Doctrine Apply?

# Skadden

- Unconditional sale
- Conditional sale
- Patent license



# Conditional Sale: What Has The Supreme Court Held?

Skadden

## ➤ *Mitchell v. Hawley*, 83 U.S. 544 (1872)

- Licensee, who could only license patented machines for use during original patent term, licensed defendant to use patented machines.
- Patent term was extended for seven years and defendant continued to use machines during term extension.
- HELD: Injunction against defendant affirmed. *Id.* at 550-51.
- “[T]he instrument of conveyance from the patentee to him, which describes all the title he ever had, expressly stipulates that he shall not in any way or form dispose of, sell, or grant any license to use the said machines beyond the expiration of that term of the patent ...” *Id.* at 550.
- Notice to the defendant was not required. *Id.*

# Conditional Sale: What Has The Supreme Court Held?

Skadden

- *Adams v. Burke*, 84 U.S. 453 (1873)
  - Assignee authorized to make, sell and use patented coffin lids in Boston.
  - Assignee sold coffins with patented lids in Boston to undertaker, who resold coffins to his clients in another town.
  - HELD: No infringement claim against undertaker. *Id.* at 456-57.
  - “[T]he patentee or his assignee having in the act of sale received all the royalty or consideration which he claims for the use of his invention in that particular machine or instrument, it is open to the use of the purchaser without further restriction on account of the monopoly of the patentees.” *Id.* at 456.

# Conditional Sale: What Has The Supreme Court Held?

Skadden

- *Hobbie v. Jennison*, 149 U.S. 355 (1893)
  - Michigan assignee sold patented pipes in Michigan to a contractor for use in Connecticut.
  - HELD: No infringement claim against the assignee. *Id.* at 362-63.
  - “[T]he sale was a complete one [in Michigan]; and ... neither the actual use of the pipes in Connecticut, nor a knowledge on the part of the defendant that they were intended to be used there, can make him liable.” *Id.* at 363.
  
- *Keeler v. Standard Folding-Bed Co.*, 157 U.S. 659 (1895)
  - Michigan assignee sold patented beds in Michigan to defendants, who resold beds in Massachusetts.
  - HELD: No infringement claim against defendants. *Id.* at 666-67.
  - “[O]ne who buys patented articles of manufacture from one authorized to sell them becomes possessed of an absolute property in such articles, unrestricted in time or place.” *Id.* at 666.

## Conditional Sale: What Has The Supreme Court Held?

Skadden

- *General Talking Pictures Corp. v. Western Electric Co.*, 305 U.S. 124 (1938)
  - Licensee sold patented amplifiers for use in motion picture industry in violation of license, which limited make/sell rights to non-commercial radio uses.
  - Licensee affixed notice of license restrictions to amplifiers.
  - HELD: Infringement ruling affirmed. *Id.* at 126-27.
  - Sales were not authorized and the amplifiers did not “pass[] into the hands of a purchaser in the ordinary channels of trade” because “the [license] restriction was legal and the amplifiers were made and sold outside the scope of the license.” *Id.* at 127.
  - “[T]he effect is precisely the same as if no license whatsoever had been granted to [the licensee].” *Id.* at 127.

## Conditional Sale: What Has The Federal Circuit Held?

Skadden

- *Mallinckrodt, Inc. v. Medipart, Inc.*, 976 F.2d 700 (Fed. Cir. 1992)
  - Patentee sold patented medical device with a “single use only” notice.
  - Hospitals sent used devices to defendant to be reconditioned for reuse.
  - HELD: Patentee’s reuse restriction was not *per se* unenforceable under the patent law. *Id.* at 708-09.
  - “*Adams v. Burke* and its kindred cases do not stand for the proposition that no restriction or condition may be placed upon the sale of a patented article.” *Id.* at 708.
  - “The appropriate criterion is whether [the] restriction is reasonably within the patent grant, or whether the patentee has ventured beyond the patent grant and into behavior having an anticompetitive effect not justifiable under the rule of reason. ... Should the restriction be found to be reasonably within the patent grant, i.e., that it relates to subject matter within the scope of the patent claims, that ends the inquiry.” *Id.*

## Conditional Sale: What Has The Federal Circuit Held?

Skadden

- *B. Braun Medical, Inc. v. Abbott Laboratories*, 124 F.3d 1419 (Fed. Cir. 1997)
  - Challenge to patent misuse jury instruction, which stated that “a patent holder is not allowed to place restrictions on customers which prohibit resale of the patented product, or allow the customer to resell the patented product only in connection with certain products.”
  - HELD: Instruction was erroneous. *Id.* at 1426.
  - “[Patent exhaustion] does not apply to an expressly conditional sale or license. In such a transaction, it is more reasonable to infer that the parties negotiated a price that reflects only the value of the ‘use’ rights conferred by the patentee. ... Such express conditions, however, are contractual in nature and are subject to antitrust, patent, contract, and any other applicable law, as well as equitable considerations such as patent misuse.” *Id.*

## Conditional Sale: What Has The Federal Circuit Held?

Skadden

- *Monsanto Co. v. Scruggs*, 459 F.3d 1328 (Fed. Cir. 2006)
  - Licensed sellers of patentee's seeds only authorized to sell seeds to growers who agreed to use seeds for a single commercial crop only.
  - Defendant bought seeds without agreeing to the use restriction and retained and used new-generation seeds.
  - HELD: Patent exhaustion doctrine did not apply. *Id.* at 1335-36.
  - “The first sale/patent exhaustion doctrine establishes that the unrestricted first sale by a patentee of his patented article exhausts his patent rights in the article. ... The doctrine of patent exhaustion is inapplicable in this case. There was no unrestricted sale because the use of the seeds by seed growers was conditioned on obtaining a license from Monsanto.” *Id.*
  - “The fact that a patented technology can replicate itself does not give a purchaser the right to use replicated copies of the technology.” *Id.*

# Component Sale: What Has The Supreme Court Held?

Skadden

- *U.S. v. Univis Lens Co.*, 316 U.S. 241 (1942)
  - Holder of patent on eyeglass lenses licensed manufacturer to make and sell lens blanks, which purchasers ground and finished to produce patented eyeglass lenses.
  - Patentee required purchasers to sell completed lenses at fixed prices.
  - “[E]ach blank embodies essential features of the patented device and is without utility until it is ground and polished as the finished lens of the patent.” *Id.* at 249.
  - HELD: Patent exhaustion applied so as to preclude patentee’s price restrictions. *Id.* at 250-52.

# Component Sale: What Has The Supreme Court Held?

Skadden

- *U.S. v. Univis Lens Co.*, 316 U.S. 241 (1942)
  - “An incident to the purchase of any article, whether patented or unpatented, is the right to use and sell it, and upon familiar principles the authorized sale of an article which is capable of use only in practicing the patent is a relinquishment of the patent monopoly with respect to the article sold.” *Id.* at 249.
  - “[W]here one has sold an uncompleted article which, because it embodies essential features of his patented invention, is within the protection of his patent, and has destined the article to be finished by the purchaser in conformity to the patent, he has sold his invention so far as it is or may be embodied in that particular article.” *Id.* at 250-51.
  - “The reward he was demanded and received is for the article and the invention which it embodies and which his vendee is to practice upon it.” *Id.* at 251.

# Component Sale: What Has The Federal Circuit Held?

Skadden

- *Met-Coil Systems Corp. v. Korner's Unlimited, Inc.*, 803 F.2d 684 (Fed. Cir. 1986)
  - Holder of patent on apparatus and method for connecting metal ducts sold machine for forming integral flanges, which were essential part of patented duct connecting system.
  - Defendant sold patentee's customers corner pieces for use with patentee's integral flanges.
  - HELD: Summary judgment of noninfringement based on *Univis* affirmed. *Id.* at 686-87.
  - “A patent owner's unrestricted sales of a machine useful only in performing the claimed process and producing the claimed product plainly indicate that the grant of a license should be inferred.” *Id.* (internal quotations omitted).
  - Court rejected patentee's argument that implied license was disclaimed because patentee gave notice to customers *after* machines were sold. *Id.*

## Component Sale: What Has The Federal Circuit Held?

Skadden

- *Anton/Bauer, Inc. v. PAG, Ltd.*, 329 F.3d 1323 (Fed. Cir. 2003)
  - Holder of patent on battery-pack combination comprising female and male plates sold female plates to customers without restriction.
  - Female plates had no non-infringing uses.
  - Defendant made and sold male-plate portion of patented combination.
  - HELD: Reversed preliminary injunction against defendant. *Id.* at 1353.
  - Relying on *Univis*, the Court held that patentee's unrestricted sale of female plate granted implied license to customers to practice patented combination. *Id.* at 1351.
  - “The sale of the unpatented female plate by [patentee] is a complete transfer of the ownership of the plate. In effect, the sale extinguishes [its] right to control the use of the plate, because the plate can only be used in the patented combination and the combination must be completed by the purchaser.” *Id.*

- *Reverse the Federal Circuit and re-affirm Univis Lens*
  - *KSR & eBay* decisions exhibit a trend toward reigning in patents
  - Given the presence of the exhaustion doctrine since 1853 and Congress' re-enactment of the patent laws in 1952 without alteration in this regard, the current Patent Act incorporates the Court's judicial interpretations on patent exhaustion [*see, e.g., Merrill Lynch v. Dabit*, 547 U.S. 71 (2006)] and thus patent exhaustion remains a substantive limit on the patentee's rights
  
- *Affirm the Federal Circuit based on strict construction*
  - Patent exhaustion was a judicial creation that has no literal support in the Patent Act
  - If the Patent Act permits a patentee to completely prohibit someone from selling, it necessarily allows a patentee to allow sales only in certain instances

## ➤ Patent prosecution

- If you invent a novel component of a larger system, separately claim both the component and the component's use in a system
- Include method/process claims using the novel component by itself and its use in a system

## ➤ Licensing

- Carefully scrutinize the grant clause: while the recital indicated LG's intent that the license was for "only" Intel products, the grant clause in the license was not so limited
- Carve out system claims from the license grant if you choose to license a manufacturer that is supplying only a part of the combination
- Carefully select which entity you license when the manufacturing process involves multiple vertical suppliers (e.g., decide where you want to collect in the chain – the component level or the system level)