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Patent Exhaustion (Post Quanta)

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Doctrine of Patent Exhaustion

- Also known as the **First Sale Doctrine**.
- A single authorized and unconditional sale of a patented item terminates all patent rights to that item.
 - *Quanta Computer, Inc. v. LG Electronics*, 128 S.Ct. 2109, 2115-16 (2008).
- This Limits a patentee's monopoly over a patent.

Purpose of Patent Exhaustion

- To prevent patentees from controlling post-sale use of the patent and extracting double recoveries from downstream purchasers for infringement.
 - See, e.g., *Cyrix Corp. v. Intel Corp.*, 846 F. Supp. 522, 539 (E.D. Tex. 1994)

Rationale for Patent Exhaustion

- The exercise of patent rights should be cut off after the first sale of the patented goods because the sale provides every benefit of that monopoly which the patent law secures to the patentee.
 - *United States v. Univis Lens Co., Inc.*, 316 U.S. 241 (1942)

Rationale for Patent Exhaustion

- Without patent exhaustion, the patentee “could independently control the goods indefinitely, thereby giving him absolute control over the product market and leaving subsequent purchasers . . . subject to a patent infringement action.”
 - William A. Birdwell, *Exhaustion of Rights and Patent Licensing Market Restrictions*, 60 J. PAT. OFF. SOC'Y 203, 216, 229 (1978).

The *Univis* Exhaustion Rule

- What if the patentee sells **unpatented goods** to a purchaser, and that purchaser converts the product into a patent-protected product?
- Would the purchaser's **customers** of the patented goods be liable for infringement?
- The Supreme Court answered no in *Univis*.

The *Univis* Exhaustion Rule

- The Court in *Univis* established that the patent exhaustion doctrine also applies to the sale of uncompleted articles as long as they embody “essential features” of the patented invention.
 - *Univis*, 316 U.S. at 250-51.

Quanta Restatement of *Univis* Rule

- *Quanta Computer, Inc. v. LG Electronics* (“LGE”)
- U.S. Supreme Court case, decided June 9, 2008.
- Clarified the doctrine of patent exhaustion and expanded the *Univis* Exhaustion Rule.

Quanta Restatement of *Univis* Rule

- “The traditional bar on patent restrictions following the sale of an item applies when the item **sufficiently embodies** the patent—even if it does not completely practice the patent—such that **its only and intended use** is to be finished under the terms of the patent.”
 - *Quanta*, 128 S.Ct. at 2117.

Quanta - Background

- LGE licensed its patents to Intel under a **License Agreement** that authorized Intel to “make, use, and sell” processors and chipsets that practice LGE’s method patents.
- The License Agreement contains a limitation that no license is granted to any third party for the combination of Intel products with non-Intel components.

Quanta - Background

- In a separate **Master Agreement**, LGE required Intel to provide its customers written notice that the license does not extend to a product made by combining Intel products with non-Intel products.

Quanta - Background

- Quanta purchased the processors and chipsets from Intel, and Intel sent the notice as required by the Master Agreement.
- Despite the notice, Quanta manufactured computers using Intel products in combination with non-Intel memory and buses.

Quanta - Background

- LGE sued Quanta for infringement of LGE's method patents.
- Quanta responded that the license LGE granted to Intel resulted in **patent exhaustion**, barring any potential infringement actions against legitimate purchasers of Intel products.

Quanta - Issues

- Issue 1:
 - Whether doctrine of patent exhaustion applies to method claims (Held: Yes)
- Issue 2:
 - Whether Intel products substantially embodied LGE's patents (Held: Yes)
- Issue 3:
 - Whether Intel's sale to Quanta was authorized by LGE (Held: Yes)

Quanta – Analysis (Issue 1)

- LGE argued that patent exhaustion does not apply to method claims.
- **Court disagreed:** “[n]othing in this Court’s approach to patent exhaustion supports LGE’s argument that method patents cannot be exhausted.”
 - *Quanta*, 128 S.Ct. at 2117.

Quanta – Analysis (Issue 1)

- **Court's rationale:**
 - Precedent repeatedly held that method patents were exhausted by sale of item that embodied the method.
 - Eliminating method claims from reach of patent exhaustion would seriously undermine the doctrine.
 - Must not allow patentees to avoid exhaustion by simply drafting method claims rather than apparatus claims.

Quanta – Analysis (Issue 2)

- LGE next argued that sales of an incomplete article do not necessarily exhaust the patent in that article.
- **Court disagreed:** “The authorized sale of an article that substantially embodies a patent exhausts the patent holder’s rights.”
 - *Quanta*, 128 S.Ct. at 2122.

Quanta – Analysis (Issue 2)

- **Court's rationale:**
 - Intel's products “substantially embodied” the LGE patents because of **two factors**:
 - (1) Intel's products had no reasonable noninfringing use; and
 - (2) Intel's products included all the inventive aspects of the patented invention.

Quanta – Analysis (Issue 2)

- **Factor (1) – Intel’s products had no reasonable noninfringing use because:**
 - There is no other reasonable use for the Intel processors and chipsets other than incorporating them into computer systems.
 - A processor or chipset cannot function until connected to buses and memory.

Quanta – Analysis (Issue 2)

- **Factor (2) – Intel’s products included all the inventive aspects of LGE’s patented invention because:**
 - Only step needed to practice LGE’s patent is application of **common processes** (e.g., connected to buses) or addition of **standard parts** (e.g., memory).
 - Quanta was not required to make any creative or inventive decision when adding those parts.

Quanta – Analysis (Issue 3)

- Finally, LGE argued that the license was conditional and the sale was not authorized.
 - Note: Doctrine of patent exhaustion applies only if the sale is authorized and unconditional.
- **Court disagreed:** “Nothing in the License Agreement restricts Intel’s right to sell its microprocessors and chipsets to purchasers who intend to combine them with non-Intel parts.”
- *Quanta*, 128 S.Ct. at 2121.

Quanta – Analysis (Issue 3)

- **Court's rationale:**
 - The broad language of the License Agreement (allowing Intel to “make, use, and sell” products that practice LGE patents) constitutes authorization.
 - Although License Agreement disclaimed any license to third parties, the question of exhaustion turns only on Intel's own license (no condition in the License Agreement limited Intel's authority to sell its products).

Quanta – Analysis (Issue 2)

- **Court's rationale (continued):**
 - The Master Agreement was a separate and distinct agreement that had no effect on the license.

Quanta – Conclusion

- “Because Intel was authorized to sell its products to Quanta, the doctrine of patent exhaustion prevents LGE from further asserting its patent rights with respect to the patents substantially embodied by those products.”
 - *Quanta*, 128 S.Ct. at 2122.

Quanta – Implications

- The Supreme Court clarified the reach of the patent exhaustion doctrine in two respects:
 - (1) Patent exhaustion applies to **method patents**; and
 - (2) Authorized sale of an article that “**substantially embodies**” a patent or embodies essential features of the patent exhausts the patent rights to that article.

Quanta – Implications

- Doctrine of patent exhaustion cannot be circumvented by simply drafting method claims rather than apparatus claims.
- Doctrine of patent exhaustion cannot be circumvented by selling incomplete articles so long as the articles “substantially embody” the patent.

Quanta – Unresolved Questions

- *Quanta* left some questions unanswered:
 - (1) At what point does a product “substantially embody” a patent?
 - (2) *Quanta* chose not to resolve contractual issues.
 - (3) Modern Biotechnology presents a novel issue in post-*Quanta* patent exhaustion.

Quanta – Unresolved Question 1

- The Court in *Quanta* found two factors to conclude Intel's products "substantially embodied" LGE's patents:
 - (1) No reasonable noninfringing use; and
 - (2) Included all the inventive aspects of the patent.

Quanta – Unresolved Question 1

- However, the Court did not explain whether these two factors are both necessary or whether other factors could be considered.
- The question is open for future litigation.

Quanta – Unresolved Question

2

- *Quanta* chose not to resolve contractual issues.
- “LGE’s complaint does not include a breach-of-contract claim, and we express no opinion on whether contract damages might be available even though exhaustion operates to eliminate patent damages.”
- *Quanta*, 128 S.Ct. at n.7

Quanta – Unresolved Question 2

- Court leaves unanswered what contractual restrictions a patentee may place on purchasers.
- This question is also open for future litigation.

Quanta – Unresolved Question

3

- Modern Biotechnology presents a novel issue in post-*Quanta* patent exhaustion.
- “When a self-replicating living invention is sold, does the purchaser have a right to reproduce that invention to make . . . copies?”
 - Harold C. Wegner, *Post-Quanta, Post-Sale Patentee Controls*, 7 J. MARSHALL REV. INTELL. PROP. L. 682, 695 (2008).

Quanta – Unresolved Question

3

- In *Monsanto Co. v. Scruggs*, 459 F.3d. 1328 (Fed. Cir. 2006), the Federal Circuit held that the doctrine of patent exhaustion **does not apply** to seed patents.
- “Applying the first sale doctrine to subsequent generations of self-replicating technology would eviscerate the rights of the patent holder.” *Scruggs*, 459 F.3d at 1336.

Quanta – Unresolved Question

3

- Court's rationale in *Scruggs* was that new seeds grown from the original batch had never been sold, and without the actual sale there can be no patent exhaustion.
- However, would the Federal Circuit's ruling hold up at the Supreme Court in light of the new standards set by *Quanta*?

Quanta – Unresolved Question

3

- Analyzing seed patents in light of *Quanta*:
 - Do first generation seeds sold to farmers have “any reasonable non-infringing use” besides being planted to grow crops?
 - Do first generation seeds include “all the inventive aspects of the patented methods?”
 - Does the farmer perform any “additional, inventive steps besides watering and fertilizing?”

Quanta – Unresolved Question

3

- These questions may be answered in *Monsanto Co. v. David*, 516 F.3d 1009 (Fed. Cir. 2008), *petition for cert. filed*, 77 U.S.L.W. 3100 (U.S. Aug. 12, 2008) (No. 08-187).
 - *David* involved a farmer found liable for planting Monsanto's soybean seeds.
 - However, if Supreme Court denies *certiorari*, the questions could remain open.

Quanta - Licensing Implications

- How might licensors be able to avoid patent exhaustion after *Quanta*?
 - (1) Create clear contractual conditions or obligations to restrict the licensee's rights in the license from licensor to licensee.
 - For example, impose direct restrictions on licensee's ability to make, use, or sell.
 - (2) Describe in the license possible alternative “reasonable uses” for the article.

See Richard P. Gilly & Mark S. Walker, *Supreme Court's Quanta Decision Clarifies the Reach of Patent Exhaustion* 20 No. 9 IPTLJ 1, 7 (2008)

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Thank you.

Any Questions?