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The Supreme Court Reviews the Doctrine of Patent Exhaustion: *LG Electronics v. Quanta Computer*

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INTRODUCTION

For the past several years, the Supreme Court has been paying close attention to the patent laws and the effects those laws have on business relationships. There have been eight patent cases decided by the Supreme Court over the past five years; this trend shows no signs of stopping. The Court recently granted certiorari to Quanta Computer in a case that could potentially change the environment in which business is done. The case, *LG Electronics v. Quanta Computer*, was decided by the Court of Appeals for the Federal Circuit on July 7, 2006. The Court of Appeals ruled in favor of LG Electronics (LGE), overturning the ruling by the Northern District of California, which found that LGE's patents at issue in the case were exhausted. Since the Supreme Court has decided to take this case, they will have the opportunity to differentiate between two separate branches of the patent exhaustion doctrine that have evolved over nearly a century of patent jurisprudence. That last time the Court addressed patent exhaustion explicitly was in 1942.

This article will address the history of the patent exhaustion doctrine and how this line of cases evolved into the Supreme Court issue it is today. After the background for the case has

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been described, a discussion of where the case history and an application of how the Supreme Court should apply the exhaustion doctrine in this case will follow.

BACKGROUND

The Patent Exhaustion Doctrine

The patent exhaustion doctrine is derived from copyright law's first sale doctrine.[2] Both copyright and patent rights are provided for in Article I, Section 8, Clause 8, of the U.S. Constitution, which rewards those who put forth the effort to promote the progress of "Science" and "the useful Arts."[3] The promotion of Science and Arts is considered by many to be a cornerstone of the United States economy.[4] Today's industries that derive the majority of their income from technology based sales are in business because of the patent protections provided by the United States Constitution.

A patent grants the owner a monopoly right over the invention for its sale, production and use.[5] The owner of a patent may restrict or control the production, duplication and sale of the item which embodies the patented idea.[6] This monopoly right is where the value of the patent is vested. The monopoly is given for a period of twenty years for the purpose of driving invention and rewarding those who spend the time, effort and money in order to progress the state of Science.[7] For a significant period of time the United States Supreme Court and Court of Appeals

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[2] Adams v. Burke, 84 U.S. 453 (1873).

[3] U.S. CONST. art. I, § 8, cl. 8.

[4] RICHARD FLORIDA et al., THE UNIVERSITY AND THE CREATIVE ECONOMY (2006), http://creativeclass.com/rfcgdb/articles/University_andthe_Creative_Economy.pdf.

[5] United States v. Univis Lens Co., Inc., 316 U.S. 241, 250 (1942).

[6] *Id.*

[7] *Adams*, 84 U.S. at 456.

for the Federal Circuit expended efforts in solidifying this right and broadening the power of the patentee to further encourage inventiveness.[8]

As stated earlier, the doctrine of patent exhaustion came directly from the first sale doctrine, based in copyright law.[9] The first sale doctrine came about because publishers attempted to control what happened to books they published by demanding additional fees every time a book or publication exchanged hands.[10] This may have been good for the bottom line of the book publisher, but it strangled the dissemination of knowledge by placing the cost of buying even used books well out of the reach of the average citizen. This was understood to be against the common good and was then held to be illegal based on the first sale doctrine originally from the comon law of Old England.[11]

The first sale doctrine says that once a person has produced a work and then sold it, the producer of that work no longer has any rights in that product.[12] It was understood that the original publisher had at that point received sufficient compensation and benefit from her efforts. It is upon this framework that patent exhaustion was implemented by the United States.[13] Once the owner of an invention creates a product from that invention and sells it, she no longer has any

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[8] John W. Osborne, *A Coherent View of Patent Exhaustion: A Standard Based on Patentable Distinctiveness*, 20 SANTA CLARA COMPUTER & HIGH TECH. L.J. 643 (2004).

[9] *Adams*, 84 U.S. at 456.

[10] *Id.*

[11] *Id.*

[12] *Id.*

[13] *Id.*

rights in that product.[14] That product can be resold, repaired, modified or destroyed at the whim of whoever owns that product.[15]

These post-purchase processes have many benefits to the economy as a whole.[16] It allows for the resale of used goods at discount prices. It allows for the maintenance of the products which are already in the marketplace. It provides a trickle-down effect for those who cannot afford to purchase technologically superior products when they first come to market; they can now wait until those products are older and have been supplanted by more advanced technology. Without this doctrine, the original inventor would still have an interest in the sales of these older technologies and would still be able to demand a premium upon the market value at which they would otherwise sell.

For example, if an original manufacturer were to sell, for use in kitchen table construction, a circular wood slab that had been patented because of its superior design and stability, that manufacturer would be able to charge a premium for this product to all assemblers who join the circular tops with bases and legs to form a finished table. The assembler would enter into a sales agreement with the manufacturer to assemble these tables and buy all the manufacturer's table tops. However, as part of the assembler's business he may also sell the table tops he could not assemble himself. The exhaustion doctrine states, basically, that the original sale from manufacturer to assembler exhausted the manufacturer's rights in the table tops and therefore the manufacturer cannot demand an additional fee from the assembler for the

[14] *Adams*, 84 U.S. at 456.

[15] *Univis*, 316 U.S. at 250.

[16] Osborne, *supra* note 7, at 650.

next sale. If there were no exhaustion doctrine, the manufacturer would be able to effectively "double-dip" and receive double compensation for the patent on the table top.

This makes sense if you consider that the manufacturer of the table tops cannot be certain, at the time he sells the table tops to the assembler, whether the assembler will eventually sell the table top as part of a whole table or as just the top. He would not be able to say with certainty that the assembler would sell a given top as a top or as part of a table. Therefore the manufacturer would demand the most he could get from the assembler from that first sale, not knowing whether there would ever be another chance to receive another payment. Therefore, if you then allow the manufacturer to demand payment from the secondary assembler the manufacturer is getting twice the value from the patent and expanding the patent rights which were given in the United States Constitution and interpreted by the United States Supreme Court. This expansion is not allowed.[17]

This is generally what LG Electronics is attempting to do to Quanta Computer and other secondary assemblers. This also should not be allowed. This note will articulate the principles behind patent exhaustion which are at issue in this case. It will also demonstrate why LGE should not succeed on the merits of the case.

The Beginning of the Patent Exhaustion Doctrine

The exhaustion doctrine was first applied to patents by the Supreme Court in 1873, in *Adams v. Burke*.[18] In *Adams*, the Court found that a secondary purchaser was not bound by restrictions placed on the original sale from the patentee to the retailer.[19] The Court held for the

[17] *Univis*, 316 U.S. at 250.

[18] *Adams*, 84 U.S. at 456.

[19] *Id.*

first time that patent rights are exhausted after the first sale of the product and the patentee may not exercise rights over subsequent purchasers regardless of the initial conditions for sale.[20]

The basic principle of patent exhaustion is that once a patentee receives valuable consideration for a product which embodies a patent, the patentee loses the ability to sue subsequent purchasers of that product for patent infringement; the patent rights are exhausted for that product.[21] For example, let's say you own a technology patent which enables an engine to run at a greatly increased efficiency and you license the right to use the technology to Company X through a license agreement. Company X now makes its automobiles incorporating your technology and sells cars to end users. Patent exhaustion says that you may not sue any party who buys a car from Company X or any party who sells Company X products that include your invention. Your patent rights are exhausted because you have already received compensation for your efforts.

Since *Burke* in 1873, patent exhaustion has evolved into two separate realms of thought. The first is that patents, which are insufficient by themselves to constitute a saleable product, are considered unfinished and the purchaser of the patent has an implied right to create a saleable product through combination of the invention and other products.[22] Meaning that if a product has only one use and that is to be combined with another patented product if this combination is also patented, the combination will not constitute infringement. The second is that the sale of a patented product is conditional on restrictions, which are reasonable within the reward of the

[20] *Adams*, 84 U.S. at 456.

[21] *Id.*

[22] *Univis,* 316 U.S. at 250.

patent.[23] This means that the exhaustion doctrine is secondary to restrictive contract terms, which are included with the sale.[24] A licensee may dictate which claims in the patent are to be applicable to the sale and therefore which one will be exhausted after the sale.[25]

The Development of the Definite Patent Monopoly

The exhaustion doctrine began with the *Adams* case and was further developed in *United States v. Univis Lens Co.* and later in *Cyrix Corp. v. Intel Corp.*[26] In 1942, the *Univis* Court decision expanded the patent exhaustion doctrine and formed the modern day controlling precedent for exhaustion.[27] The Court restricted Univis's rights to contract out of the exhaustion doctrine, finding that this violated provisions in the Sherman Anti-Trust Act.[28] The Sherman Act made it unlawful to restrain trade or commerce between the states through contract or conspiracy.[29] The Court took the opportunity presented in *Univis* to clarify the exhaustion doctrine.

Univis owned patents which described an eye glass lens blank and the process to finish the blank into a finished lens ready to wear in eye glasses.[30] Univis was selling lens blanks to distributors, finishers and retailers. Then Univis demanded that those who were reselling the

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[23] Mallinckrodt, Inc. v. Medipart, Inc., 976 F. 2d 700, 701 (Fed. Cir. 1992).

[24] *Id.*

[25] *Id.*

[26] Cyrix Corp. v. Intel Corp., 846 F. Supp. 522, 540 (E.D. Tex. 1994), *aff'd without op.*, 42 F.3d 1411 (Fed. Cir. 1994).

[27] Osborne, *supra* note 7, at 650.

[28] *Univis*, 314 U.S. at 250.

[29] Sherman Anti-Trust Act, 15 U.S.C. § 1 (1890).

[30] *Univis*, 316 U.S. at 247.

finished lenses to do so at a Univis-set price.[31] The United States brought suit against Univis under the newly passed Sherman Act.[32]

The Court held that if a patentee sells an article which is "unfinished," the seller's patent rights are exhausted with respect to the article sold.[33] The Court defined "unfinished" as a patent which is meant to be finished by the purchaser in conformity [with] the patent;" or it is unfinished "because it embodies the essential features of the patented invention."[34] For the exhaustion doctrine to apply to a patented article, the product originally sold must embody the essential features of the remaining patented uses or refinements.[35]

Because the lens blanks incorporated the essential features of the patents, they were said to have no other noninfringing use.[36] The Court found that the blanks had absolutely no utility without utilizing Univis' process to grind and polish them into a finished lens as described in the patent.[37] The Court found that selling a product which is only capable of one use, to practice the patent in question, is the same relinquishment of the monopoly as if you had sold it fit for its intended use, the seller, therefore, has exhausted his rights of monopoly for that product.[38]

Also articulated in *Univis* was the concept that the seller of the product and the purchaser of the product must be authorized. If one or both parties are unauthorized, then there is

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[31] *Univis*, 316 U.S. at 244.

[32] *Id.*. at 242-43.

[33] *Id.* at 251.

[34] *Id.* at 251.

[35] Univis, 316 U.S. at 250.

[36] *Id.* at 249.

[37] *Id.* at 249

[38] *Id.* at 249

contributory infringement.[39] Because Univis was licensing the right to produce the lens blanks and the finishing of the lenses, the Court further found that a sale by a licensee constituted the same transaction, for exhaustion purposes, as a sale directly by the patentee.[40] Therefore, Univis could not control the sales of the products, whether blanks or finished lenses, through infringement suits or contract with licensees.[41] Since this decision in 1942, sellers of patented articles cannot claim additional rights against the purchasers of those articles by selling them incomplete.[42] No matter what point in the manufacturing chain the purchaser buys a product, it is the same if he bought the product at the end of the chain as it is if he bought it at the beginning.[43]

Univis is Reaffirmed by the Federal Circuit in 1994

In 1994, on facts very similar to those in *Univis* and in *LGE*, the Court of Appeals for the Federal Circuit found patent exhaustion was present and further embedded the exhaustion doctrine in modern patent law and business practice.[44] In *Cyrix*, Cyrix Corporation contracted with Texas Instruments to produce microprocessors.[45] Cyrix then used these microprocessors, together with components from other manufacturers, to assemble personal computers which were then sold to consumer end-users.[46] The microprocessors which Texas Instruments manufactured

[39] Univis, 316 U.S. at 249.

[40] *Univis*, 316 U.S. at 251.

[41] *Id.* at 249.

[42] *Id.* at 251.

[43] *Id.* at 249.

[44] *Cyrix*, 846 F. Supp. at 540.

[45] *Id.* at 541.

[46] *Id.* at 538.

for Cyrix were built using patented technologies licensed from Intel Corporation.[47] However, the Intel patents which covered the microprocessor manufacturing process also included the combination with external memory modules.[48] These modules were necessary for the microprocessor to function; the microprocessors would not work without memory attached to them.[49] This combination claim in Intel's patent was at issue in the suit.[50] Cyrix originally sought a declaratory judgment against Intel for non-infringement based on the defenses of implied license and patent exhaustion.[51] Intel countersued for patent infringement.[52]

The Eastern District Court of Texas thought the analogous relationship between the facts presented in this case and those in *Univis* to be obvious and followed that result.[53] Because the microprocessors in the Intel patents were useless without additional memory, just like the lens blanks and finishing process in *Univis*, they embodied the essential features of the completed invention.[54] Therefore, the unfinished microprocessors were sold as if they had been sold completed with memory.[55] Thus, Intel's patent rights against Cyrix's assembly of the microprocessors purchased from Texas Instruments with memory were exhausted.[56]

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[47] *Cyrix*, 846 F. Supp. at 541.

[48] *Id*.

[49] *Cyrix*, 846 F. Supp. at 541.

[50] *Id*.

[51] *Id.* at 524.

[52] *Id*.

[53] *Id.* at 540 (citing United States v. Univis Lens Co., 316 U.S. 241 (1942)).

[54] *Cyrix*, 846 F. Supp. at 537, 540.

[55] *Id*.

[56] *Id.* at 541.

Also similar to *Univis*, Texas Instruments was an authorized seller of products, which incorporated Intel's patents.[57] Further, Cyrix was an authorized buyer.[58] The only portion of the transaction which was not authorized by Intel, the licensor, was Cyrix's combination of the microprocessors with memory to form a finished personal computer.[59] Analogous to Univis's restriction of the selling price of the finished lenses, Intel's restriction on subsequent sales went beyond the monopoly grant of a patent.[60] Intel was thus implicitly attempting to extend its monopoly and was found displaying anti-competitive behavior.[61] The district court's ruling was affirmed by the Federal Circuit, without opinion, later in 1994.

Back to the car engine example, your patented technology is unfinished unless it is combined with an engine which allows your technology to function for its intended purpose. The claims of your patent specify that it is to be joined with a motor engine. Since your technology is considered unfinished without an engine, you do not have rights over anyone who purchases your article from your licensee, Company X, and then uses it on an engine.

However, There are Restrictions

As previously stated in *Univis*, the Supreme Court placed a requirement that the sale be from an authorized seller to an authorized buyer for the doctrine of patent exhaustion to apply to the sale.[62] The sale must also be unconditional.[63] How far a seller may take this conditional

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[57] *Id*.

[58] *Id.* at 534.

[59] *Id.* at 539.

[60] *Cyrix*, 846 F. Supp. at 540.

[61] *Id.*

[62] *Univis*, 316 U.S. at 249.

sales idea beyond that which is allowed by either patent or contract doctrines has been tested and challenged by many in the courts.[64] The bounds set by the Federal Circuit are that sale may have limitations imposed upon on them, but those limitations may not be outside the bundle of rights included in the patent.[65]

The unconditional sale of a patented article exhausts the patentee's rights.[66] The strongest argument that this result is logical and equitable is that the first sale of a patented good provides "adequate financial reward to stimulate invention."[67] To hold otherwise would allow the patent holder to control the market indefinitely, giving the patentee "absolute control over the product market."[68] Having one entity in control of a market is a monopoly and monopolies are supposed to be un-American.

A patentee may avoid the unconditional sales effect of automatic exhaustion by placing "clear, explicit and otherwise lawful" conditions upon the sale of the patented article.[69] The United States Supreme Court has described the ability of patentees and licensors to use conditional sales to expressly restrict a licensee's right to sell the licensed product.[70] However,

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[63] Osborne, *supra* note 7, at 658.

[64] *Id.*

[65] *Id*.

[66] Mitchell v. Hawley, 83 U.S. 544, 588 (1872); Braun Medical, Inc. v. Abbott Labs, Inc., 124 F.3d 1419, 1426 (Fed. Cir. 1997).

[67] W. Birdwell, *Exhaustion of Rights and Patent Licensing Market Restrictions*, 60 J. PAT. OFF. SOC'Y 203, 216, 229 (1978).

[68] *Id.* at 216.

[69] Osborne, *supra* note 7, at 658.

[70] General Talking Pictures Corp. v. Western Electric Co., 305 U.S. 124 (1938). (*General Pictures I*)

for conditions expressly written into a license agreement to be found valid they must also be made known to the purchaser at the time of the purchase.[71]

In *General Talking Pictures*, patentees were found to have patent rights in products sold by licensees when those licensees / sellers and subsequent purchasers were aware of the explicit restrictions in the license.[72] The patentee in this case had given non-exclusive licenses to various companies in the industry.[73] One of these non-exclusive licensees held a license whose terms were explicit; manufacture and sale of vacuum tubes was only allowable for radio functionalities, specifically excluded were sales for the use in talking picture machines for cinemas.[74] The licensee, however, ignored the provisions and knowingly sold vacuum tubes to a company whose sole purpose in purchasing them was to use them in the assembly of talking picture machines for cinemas.[75] Also, the licensee complied with the term in the license agreement which stated that the tubes, when sold, must be affixed with a decal which states that these tubes are only to be used in radio transmission or reception devices – no motion picture machines.[76] Further, the buyer of these tubes had actual knowledge before and after purchase that these tubes were only licensed for use in radio devices and the manufacturer did not hold a license for the sale which they entered.[77]

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[71] *GeneralPictures I*, 305 U.S. at 124.

[72] General Talking Pictures v. Western Electric Co.,, 304 U.S. 175, 179 (1938). (*General Pictures II*)

[73] *General Pictures II*, 304 U.S. at 179-80.

[74] *Id.* at *180.*

[75] *General Pictures I*, 305 U.S. at 125.

[76] *Id.*

[77] *General Pictures I*, 305 U.S. at 129.

The Court found that the licensee/manufacturer knowingly sold the vacuum tubes outside the scope of the otherwise valid license agreement.[78] Furthermore, the purchaser knowingly purchased products outside the scope of the product license.[79] Therefore, both the licensee/manufacturer and the purchaser were found to be contributory infringers and liable to the patentee/licensor.[80]

In coming to this conclusion the Court held that "the owner of a patent may grant licenses to manufacture, use, or sell upon conditions not inconsistent with the scope of the monopoly."[81] Also, because the tubes had multiple uses, there was no attempt on the part of the patentee/licensor to "extend the scope of the monopoly beyond that contemplated by the patent statute."[82] These holdings establish that the exhaustion doctrine applies only to implied restrictions on purchased goods.[83] Goods which are sold with known, explicit restrictions which are otherwise lawful are outside the realm of patent exhaustion.[84]

Federal Circuit Establishes Restrictive Sales are Acceptable

The Federal Circuit further established in 1992 that express restrictions preclude exhaustion, assuming there is no violation of other applicable laws such as antitrust or patent misuse.[85] The *Mallinckrodt* decision took factors other than antitrust and patent misuse into

[78] *General Pictures I*, 305 U.S. at 129.

[79] *Id* at 126.

[80] *Id.*

[81] *General Pictures II*, 304 U.S. at 181.

[82] *Id.*

[83] Osborne *supra* note 7, at 660.

[84] *Id.* at 658.

[85] *Id.* at 660; Mallinckrodt, Inc. v. Medipart, Inc., 976 F. 2d. 700 (Fed. Cir. 1992).

consideration when deciding Mallinckrodt's patent rights had been exhausted. The Federal Circuit analyzed the restriction, questioning whether or not it was reasonably within the rights of a patentee or if "the patentee had ventured beyond the patent grant and into behavior having an anticompetitive effect not justifiable under the rule of reason."[86]

Mallinckrodt, Inc. was a manufacturer of medical devices which it sold directly to end-users, in this case, hospitals and doctors.[87] Mallinckrodt was the owner of the patents which protected its proprietary medical device products.[88] Mallinckrodt included in the packaging of these products explicit notices that the sale of the product was condition upon "single use only."[89] The end users of the Mallinckrodt products sent the products to Medipart, Inc. for servicing after they had used them.[90] This servicing enabled the devices to be used again, for more than "single use."[91] Mallinckrodt brought suit against Medipart on the claims that it induced infringement on the part of the hospitals and that it was itself infringing.[92]

The Federal Circuit did not rule on whether the included notice of "single use only" was sufficient or there were deficiencies, or whether the second notice mailed by Mallinckrodt was sufficient notice.[93] The court held that according to precedent, the patentee has the right to

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[86] *Mallinckrodt*, 976 F.2d at 708.

[87] *Mallinckrodt*, 976 F.2d at 701.

[88] *Id.*

[89] *Id.*

[90] *Id.*

[91] *Id.*

[92] *Mallinckrodt*, 976 F.2d at 706.

[93] *Id.* at 705.

restrict sales of the product so long as those restrictions are within other rules of law.[94] Furthermore, as long as that restriction is reasonably within the patent grant, then the patent is not exhausted and the inquiry ends[95] Reasonably within the patent grant was defined as "relat[ed] to the subject matter within the scope of the patent claims."[96]

The lawful express restriction doctrine was reaffirmed by the Federal Circuit in 1997 by *Braun Medical, Inc. v. Abbot Labs, Inc.*[97] The theory behind patent exhaustion is that the patentee is deemed to have bargained for and received the full value of the goods sold, the Federal Circuit removed expressly conditional sales from this doctrine.[98] Following the logic behind the theory of exhaustion doctrine, the Court found it reasonable to conclude that if both parties in the transaction were aware of the express restriction, that the price bargained for would reflect the incomplete rights included in the product.[99] The Court further stated that because of the contractual nature of such conditional sales, they "are subject to antitrust, patent, contract and any other applicable law, as well as equitable considerations such as patent misuse."[100] Therefore, restrictions that violate any of these laws are unenforceable.[101] However, those

[94] *Mallinckrodt*, 976 F.2d at 708.

[95] *Id.* .

[96] *Id.*

[97] B. Braun Med., Inc. v. Abbott Labs, Inc., 124 F.3d 1419, 1426 (Fed. Cir. 1997).

[98] *Braun Med., Inc.*, 124 F.3d at 1426.

[99] *Id.*

[100] *Id.*

[101] *Id.*

agreements that are in accord with all applicable laws entitle the patentee/licensor to remedies of "either patent infringement or breach of contract."[102]

In *Braun Medical*, the district court based its finding of non-exhaustion on the circumstances of the sale, which were: "(1) purchasers, including end-users, are on notice of the single-use condition; (2) purchasers have an opportunity to reject the condition; and (3) the Prebate is offered at a special price that reflects an exchange for a single-use condition."[103] These conditions, generally, are recurrent in analysis of exhaustion applications of the Federal Circuit and Supreme Court.

Acceptable Restrictions Summary

It is now well established that product sales and patent licenses may be restricted, however the restrictions may not disclaim the patent exhaustion doctrine altogether.[104] Considering the ability of licensors/patentees to restrict sales that are reasonably within the patent grant, as long as that restriction does not violate other applicable laws and the economic theory behind this ability, it can be said that as long as the total license fees received from the rights given does not exceed that which would be received had those rights been bargained for altogether, those restrictions are within the patent rights.[105] Further, it is also established that when a combination claim within a patent is "separate and distinct" from that of the component, excluding one from the other in the form of restrictions is acceptable.[106] However, for claims or

[102] *Id.*

[103] *Braun Med., Inc.,* 124 F.3d at 1426.

[104] Osborne, *supra* note 7, at 662.

[105] *Id.* at 662-663.

[106] *Id.* at 663.

patents to be qualified as "separate and distinct" they must not include the essential feature of each other and one may not have only one use which is that of the other.[107]

Misuse

For restrictions to be considered misuse of the patent right, let's turn our attention back to *Mallinckrodt*. The restriction at question was a single use restriction.[108] The sale of the Mallinckrodt product did not involve a combination or method claim exhaustion so this example will be clear for its application of the misuse doctrine. Mallinckrodt did not attempt to restrict the hospitals or doctors from using the device in its intended purpose nor did they attempt to extend the patent monopoly unlawfully.[109] Just as in *Braun Medical*, one of the reasons this restriction was upheld was that the license fee received by Mallinckrodt was based upon a single use of the product.[110] It follows that if Mallinckrodt had intended the device to have multiple uses, the bargained for price would have been proportionally higher.[111] Further, if the Mallinckrodt device had only one use and that use embodied the essential features of the device, then the exhaustion doctrine would have applied under *Univis Lens*.[112]

Mallinckrodt's device that was sold was covered under the asserted claim in that patent.[113] Mallinckrodt did not attempt to broaden the scope of the claim in the issued patent through clever drafting of license terms, the "only issue was whether a use restriction was

[107] *Cyrix*, 846 F. Supp. at 537.

[108] *Mallinckrodt*, 976 F.2d at 700.

[109] Osborne, *supra* note 7 at 663.

[110] *Id.*

[111] *Id.*

[112] *Id.*

[113] *Mallinckrodt*, 976 F.2d at 710.

allowable."[114] It was not misuse to include a restriction of "single use only" on the sale of the device because the right to use is one of the rights included in the bundle with a granted patent.[115] Further, the restriction that Mallinckrodt placed on the device's use did not expand the scope of the patent to cover something which was not covered by the original patent grant.[116] If it had, the patent grant would not have been allowed since this is clearly not within the bundle of rights that comes with a patent grant.[117] Mallinckrodt could also have excluded the device purchaser from combining their device with some other devices to create a new, separate and distinct device with other uses.[118] This would be allowed because this combination would be separate and distinct from the product and the product would not have only one use, which would be that combination.[119] If Mallinckrodt's device had only one use and that was to combine it with another product to make it useful to the purchaser that "would constitute impermissible broadening of patent scope, and thus, misuse."[120]

DISCUSSION

Background on the LG Electronics Cases

LG Electronics (LGE) is the owner of six patents which describe subcomponents in computer devices, which necessarily qualifies them as unfinished products.[121] The named

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[114] Osborne, *supra* note 7 at 664.

[115] *Id.*

[116] *Id.*

[117] *Id.*

[118] Osborne, *supra* note 113, at 664.

[119] *Id.*

[120] *Id.*

[121] *LG Elec., Inc. v. Asustek Computer, Inc.*, 248 F. Supp.2d 912, 914 (N.D. Cal. 2003).

defendants (Quanta Computer et al.) purchase products from Intel; these products incorporate LGE's patents which are licensed to Intel.[122] Under LGE's license with Intel, Intel is authorized to combine the LGE patents with their own or anyone else's patents and then sell them without limitation.[123] However, under this LGE-Intel license, purchasers of Intel's products which incorporate LGE patents are not authorized to combine the products with other non-Intel products.[124] Intel sold products to the defendants which incorporated LGE patents.[125] LGE notified Intel that its customers where in violation of the LGE-Intel license.[126] Intel then notified Quanta and its other customers that they were not permitted to use Intel's products in combination with any other products.[127]

The defendants' business is to combine computer components and sell these finished products to end users.[128] LGE asserts that the defendants infringe LGE's patents because this combination is included in LGE's patents, that the defendants are not licensed by LGE to practice this combination under the LGE-Intel license, and that the defendants had been given notice of this limitation by Intel.[129] The defendants assert the patent exhaustion defense and

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[122] *Id.*

[123] *Id.*

[124] *Id.*

[125] *Asustek*, 248 F. Supp.2d at 914.

[126] *Id.*

[127] *Id.*

[128] *Id.*

[129] *Asustek*, 248 F. Supp.2d at 914.

presently continue to combine the products without an LGE license.[130] LGE has filed suit against Intel's customers alleging patent infringement.[131]

In the Northern District of California case, the district court found that the combination/apparatus claims were exhausted because Intel was an authorized, licensed seller of the products and the defendants were authorized buyers.[132] The court found that the microprocessors which Intel sold to the defendants had no other noninfringing use than to be joined with other components to form a computer.[133] Further, the court found that microprocessor embodied the essential elements of the combination claims in the other patents which LGE alleged the defendants were infringing upon.[134] Because there was no other significant use for the microprocessors and they embodied the essential elements of the combination claims, the district held the combination patents to be exhausted based on the precedents of *Univis Lens*.[135]

Further, it was additionally assumed that, based on the transaction and license agreement entered into between LGE and Intel, LGE had received compensation for the all of the rights given by the patents.[136] This analysis was very similar to that in *Univis*. *Univis* was reaching beyond the rights given by the patent grant, expanding its monopoly control over that which is

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[130] *Id.* at 918.

[131] *Id.*

[132] *Id.* at 917.

[133] *Asustek*, 248 F. Supp.2d at 917.

[134] *Id.*

[135] *Id.* at 921.

[136] *Asustek*, 248 F. Supp.2d at 915.

not given by a patent.[137] The court in *LGE* determined that the products which Intel sold under license from LGE had no other use than to be combined with other products.[138] This combination patent was held by LGE and this is the infringement right which was alleged over the defendants.[139] Because this was the only use which those products could be put to, it was assumed that, just like in *Univis*, if one sells a product which has only one use and is patented by the company as well, that right is said to have been exhausted by the sale because it must have been know by that company that there would be no other uses for it, and therefore, it would bargain for that right in the initial sale.[140]

How the Courts Have Applied the Exhaustion Doctrine in the *LGE* Cases

In the two opinions issued from the Northern District Court of California, the court agreed with the defendants and ruled in their favor.[141] The court held that patent exhaustion applied and *Cyrix* controlled the outcome.[142] LGE's patents, embodied by Intel's products, must be combined with other patented products in order to achieve a complete and working computer.[143] Thus, LGE may not force third-party manufacturers to pay additional license fees on products for which they have already paid.[144]

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[137] *Asustek*, 248 F. Supp.2d at 916.

[138] *Id.* at 917.

[139] *Id.* at 916.

[140] *Id.* at 917.

[141] *Id.* at 914.

[142] *Asustek*, 248 F. Supp.2d at 918.

[143] *Id.* at 917.

[144] *Asustek*, 248 F. Supp. 2d at 918.

However, the Court of Appeals for the Federal Circuit ("CAFC") disagreed with the district court and overturned the decision.[145] The CAFC was more convinced by LGE's argument that there was an explicit restrictive condition in the license between LGE and Intel.[146] The court further found the notice letter from Intel to the defendants served to bolster LGE's position.[147] The CAFC said that, because the sales of these products were conditional, the doctrine of patent exhaustion does not apply and the defendants are infringing.[148] It is this ruling that Quanta Computer has appealed and the Supreme Court has agreed to hear.[149]

APPLICATION

How the Supreme Court Should Apply the Exhaustion Doctrine

I. Patent exhaustion applied to the LGE-Intel license and to the Intel to Quanta transaction.

Did the doctrine apply to the license agreement transaction between LGE and Intel? Or did the transaction between Intel and Quanta trigger exhaustion? These questions will be integral to the decision of this case.

A. The exhaustion doctrine applied to the transaction between LGE and Intel.

There is no precedent which controls the determination of whether or not a license agreement is considered a sale for the purposes of patent exhaustion. The exhaustion doctrine applies to any unrestricted sale that is between an authorized seller and an authorized buyer.[150]

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[145] LG Electronics, Inc. v. Bizcom Computer, Inc., 453 F.3d 1364, 1369 (Fed. Cir. 2006).

[146] *Bizcom*, 453 F.3d at 1370.

[147] *Id.*

[148] *Id.*

[149] *Id.* at 1368.

[150] *Univis*, 316 U.S. at 250.

A sale is defined as a "transfer of property for money or credit."[151] The cornerstone of property is the right to exclude others.[152] The right to exclude is considered the most important right in the "bundle of rights" included with any property interest.[153]

The license agreement was an unrestricted sale. The transaction that occurred between LGE and Intel was for money and the right to use each others' patents. There was a transfer of rights involved in this transaction; LGE gave Intel the unrestricted right to use, sell and manufacture microprocessors using LGE technology. The rights to use, sell and manufacture are the complete bundle of rights in a patent.[154] Once the agreement was signed, Intel could use any LGE patent for any purpose, to manufacture products and sell those products to any entity. LGE had sold all the rights of a patent in the bundle to Intel for valuable consideration when they entered into the license agreement. Therefore, there was an unrestricted sale and patent exhaustion applies to this transaction. Thus, the right of exclusion for any product made using patents involved in this license agreement has been exhausted.

B. The exhaustion doctrine applied to the sale between Intel and Quanta

The exhaustion doctrine applies to any unrestricted sale that is between an authorized seller and an authorized buyer.[155] In *Cyrix*, the Supreme Court applied the exhaustion doctrine to the transaction between Texas Instruments (TI) and Cyrix because TI was authorized to sell

[151] Random House Unabridged Dictionary, *available at*: http://dictionary.reference.com/browse/sale (last visited March 17, 2008).

[152] Kaiser Aetna v. United States, 444 U.S. 164, 176 (1979).

[153] *Id.*

[154] *Univis*, 316 U.S. at 250.

[155] *Cyrix,* 846 F. Supp. at 538.

products with Intel patents to any entity.[156] Therefore, the Court found that TI was an authorized seller and Cyrix was an authorized buyer.[157]

Here, the agreement between LGE and Intel authorized Intel to sell products incorporating LGE patents to any entity. Therefore, Intel is an authorized seller and Quanta is an authorized buyer. Thus, patent exhaustion applies to the sale from Intel to Quanta and there is no patent infringement by Quanta of LGE patents.

II. LGE cannot assert patent rights over Intel products sold to third party assemblers.

The LGE patents encompassed in Intel's microprocessors embody the essential features of a computer system, are unfinished products, and have only one practical use. Therefore, the combination of the microprocessors in a computer system is not an infringement of patent rights. Further, allowing LGE to assert rights over a third party in the supply chain is an unlawful restriction of trade and cannot be allowed. Finally, LGE received valuable consideration for its patents already and therefore cannot reach through trade channels and extract additional profits.

A. The microprocessors are unfinished products; they have only one practical use and they embody the essential features of the finished computer system.

In *Univis,* the Supreme Court held that, if a patentee sells an article that is "uncompleted," the seller's patent rights are exhausted with respect to the article sold.[158] The Court described an "uncompleted article" as one that "embodies the essential features of the patented invention" and is meant "… to be finished by the purchaser in conformity to the

[156] *Cyrix,* 846 F. Supp. at 540.

[157] *Id.*

[158] *Univis*, 316 U.S. at 251.

patent."[159] For the exhaustion doctrine to apply to a patented article, the product originally sold must embody the essential features of the remaining patented uses or refinements.[160]

Here, in the Quanta case, Intel sold microprocessors which have no use but to be combined with other computer components as a computer. This combination of the microprocessors is in conformity with the claims in the LGE patents. Further, the microprocessor embodies the essential features of the combination – the formation of a computer. A computer is incomplete without the microprocessor and other components. Therefore, by definition, the microprocessor is an uncompleted article under *Univis*. Thus, LGE's patent rights are exhausted.

B. Allowing LGE to assert rights over Quanta and other secondary purchasers of products embodying their patents is a restriction of trade and a violation of the Sherman Anti-Trust Act.

First, in 1873, the Court in *Adams* found that a secondary purchaser was not bound by restrictions placed on the original sale from the patentee to the retailer.[161] Then in 1890, under the Sherman Anti-Trust Act, "every contract, combination … or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal."[162] In 1942, in *Univis*, the Court found that attempting to control the entire manufacturing chain of a product by claiming additional patent rights against purchasers of components for that product further down the chain was a restraint of trade under the Sherman Act and therefore illegal.[163]

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[159] *Univis*, 316 U.S. at 251.

[160] *Id.*

[161] *Adams*, 84 U.S. at 456.

[162] Sherman Anti-Trust Act, 15 U.S.C. § 1 (1890).

[163] *Univis,* 316 U.S. at 250-251.

Quanta is not bound by restrictions placed on the LGE-Intel sale. As in *Adams*, Quanta is a secondary purchaser of a product and therefore not bound by restrictions placed on the sale between LGE and Intel. Thus, the terms in the LGE-Intel license do not bind Quanta and LGE cannot assert them against Quanta.

Under established precedent in *Univis*, the action of attempting to exert control of an entire manufacturing chain by attempting to exert rights over purchasers of components further down the chain is illegal. Here, LGE is attempting to force Quanta to pay additional royalties on products it has already paid a full price for to Intel. In *Univis,* Univis Lens Corporation was attempting to force resellers of their finished lenses to sell them at a price set by Univis. The Court found that this practice restricted trade and violated the Sherman Anti-Trust Act, thus being illegal. LGE is applying the same underhanded strategy here. By forcing Quanta to pay an additional royalty it will be increasing the price to consumers and restricting trade. Therefore, LGE cannot exert its patent rights over Quanta and other secondary purchasers of its products.

CONCLUSION

Based on the existing precedent on patent exhaustion and the facts presented in the *Quanta* case, the Supreme Court should rule in favor of Quanta and find LGE's patents exhausted.