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PATENT PROTECTION FOR HIGH TECHNOLOGY

Patent Exhaustion after Quanta

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Overview of Presentation

- Patent exhaustion – basic principles and cases
- Discussion of *Quanta Computer, Inc. v. LG Electronics, Inc.*, 553 U.S. ____ (2008)
 - U.S. Supreme Court case decided in June 2008
 - Clarified and expanded exhaustion doctrine
- *Post-Quanta strategies*

Patent Exhaustion Basics

- Exclusive right to an invention
 - Right to exclude others from
 - *making*,
 - *using*,
 - *offering to sell*, or
 - *selling* a patented invention
- Patent exhaustion involves how these individual rights (make, use & sell) can be enforced with respect to *subsequent use* of a patented article *after the first sale* of the article

Patent Exhaustion Basics

- Under the doctrine of patent exhaustion, an initial authorized sale of a patented item exhausts all patent rights to further uses or sales of that item
 - *Bloomer v. McQuewan*, 55 U.S. 539 (1853)
 - U.S. Supreme Court decision from 1853
- Referred to as the “First sale doctrine”
- For patent exhaustion to apply the initial sale must be *authorized*
- Under this doctrine, a patent holder’s patent rights are “exhausted” after the first sale of a patented article, meaning the patent holder has no remaining patent rights to enforce against subsequent users or sellers of the patented article

Patent Exhaustion Simple Examples

- Example 1:
 - A patent owner holds a patent on a bicycle
 - The patent owners licenses a manufacturer to *make* bicycles covered by the patent and *sell* them to consumers for private use, but not to businesses for commercial uses
 - This is a “field of use” limitation in the license
 - The manufacturer sells the bicycles to consumers as authorized
 - Here, the **first sale** of the bicycles by the manufacturer is **authorized** and **exhausts** all the patent owner’s rights under the bicycle patent, such that the patent owner cannot sue a consumer for *using* or reselling a bicycle purchased from the manufacturer

Patent Exhaustion Simple Examples

- Example 2:
 - Example 2 is the same as Example 1, except:
 - The manufacturer makes unauthorized sales of the bicycles to commercial concerns
 - Here, the **first sale** of the bicycles by the manufacturer is **NOT authorized** and the patent owner's rights are **NOT exhausted** under the bicycle patent
 - The manufacturer has violated the field of use limitation of the license
 - Accordingly, the patent owner CAN sue a consumer for *using* a bicycle covered by its patent

Questions Answered by Quanta:

- But:
 - *What if the Licensee makes and sells an incomplete product that does not include all the elements of the invention as claimed?*
 - *Is the claim or patent still exhausted?*
 - *What if a subsequent purchaser the incomplete product finishes the product in a manner that is covered by a method claim of the patent?*
 - *Is the method claim of the patent exhausted by the sale of the un-completed product, or can the patent holder enforce his method claim against the subsequent purchaser?*

Questions Answered by Quanta:

- But:
 - *What if the initial sale is unauthorized but the license specifically disclaims a license of the patent to subsequent purchasers of the incomplete product?*
 - *Does exhaustion apply if the initial sale is not authorized by license?*
 - *Does exhaustion still apply even if there is a disclaimer of a license given to the subsequent purchaser*

Quanta Says:

- Answer:
 - The sale of an incomplete (but licensed) product that *does not* include all the elements of the invention as claimed DOES EXHAUST the apparatus and method claims of the patent IF the incomplete products “embody” the patents, as evidenced by:
 - **The incomplete products substantially embody the essential features of the patented invention**
 - **The incomplete products have no substantial non-infringing use**
 - **The final steps to assemble a complete product involves nothing more than non-inventive steps combining the incomplete products with standard components**

Quanta Says:

- Answer:
 - The first sale must be authorized for exhaustion to apply
 - In the Quanta case the first sale was authorized
 - If the first sale is authorized, a disclaimer of a license given to the subsequent purchaser is of no consequence if the patent is exhausted upon sale of the incomplete product

Simplified Example of Applying Quanta

- Example 3:
 - Patent Owner’s “invention” is for an improved bicycle frame (i.e. the novelty of the invention lies in the design of the frame), but the patent *claims* the frame in several different embodiments, for example:
 - a claim to the frame itself,
 - a claim to a complete bicycle including the frame, and
 - a method claim to assembling the frame with standard bicycle components: wheels, handlebar, seat, sprockets, gears and chains
 - The Patent Owner licenses a Bicycle Parts Manufacturer under its patent to *make and sell* “licensed bicycle products”, which includes the right to make and sell products covered by any of the claims of the patent (frames or bicycles w/frame)

But what if its more complicated?

- Example 3 continued:
 - However, the license expressly states that the manufacturer is NOT authorized to sub-license purchasers of such licensed bicycle products to combine them with bicycle parts made by other manufacturers
 - The licensed manufacturer makes bicycle frames under the licensed patent and sells the bicycle frames to a third party bicycle assembler – **this sale is authorized and proper under the license agreement**
 - The third party assembler combines the bicycle frames with bicycle parts obtained from other *unlicensed manufacturers* (i.e. *manufacturers not licensed by the patent holder*) and produces assembled bicycles for sale

But what if its more complicated?

- Example 3 continued:
 - QUESTION: Can the patent owner sue the third party assembler for patent infringement?
 - ANSWER UNDER QUANTA: **NO**
 - Because the frame substantially embodies all of the inventive aspects disclosed in the patent, has no substantial non-infringing uses, and the *combining* of the frame with standard bicycle parts is *not inventive*, sale of the frame exhausts ALL claims of the patent, including claims to the assembled bicycle and the method of assembling the bicycle
 - Prior to Quanta – at least the claims to assembling the bicycle would not be exhausted, allowing the patent holder to sue the third party assembler

Let's Now Look at the *Quanta* Case

- Here, LG Electronics is the patent holder and more than one patent is involved (although the principles of the *Quanta* case apply equally well to cases involving only one patent)
 - Computer chip component-related patents
 - Microprocessors and chipsets
 - Involved efficient processing of “read” and “write” instructions
- LG had licensed Intel under a License Agreement:
Intel authorized to “make, use, sell (directly or indirectly), offer to sell, import or otherwise dispose of” Licensed Products

The *Quanta* Case

- LG-Intel License also stated that:

No license “is granted by either party hereto... to any third party for the combination... of Licensed Products... with... components... from sources other than a party hereto”

The *Quanta* Case

- Under a separate Master Agreement:

Intel was to give written notice to customers that the license “does not extend, expressly or by implication, to any product that you make by combining an Intel product with any non-Intel product”

The *Quanta* Case

- LG sought to prevent Intel's customers (Quanta) from combining Intel microprocessors and chipsets with non-Intel parts
 - They argued this required a separate license from LG
- Quanta Computer- world's largest manufacturer of notebooks
 - Purchased Intel microprocessors and chipsets
 - Received notice that license does not extend to combinations with non-Intel products
 - Combined Intel microprocessors and chipsets with non-Intel memory and busses

The *Quanta* Case

- The District Court
 - Ruling on summary judgment
 - No reasonable non-infringing use for Intel microprocessors and chipsets
 - Patent rights on device claims exhausted
 - But, exhaustion doctrine does not apply to method claims

The *Quanta* Case

- The Federal Circuit
 - Affirmed that **exhaustion doctrine does not apply to method claims**
 - License to Intel **did not authorize** Intel to sell microprocessors and chipsets for use in combination with non-Intel parts
 - Patent rights on device claims **not exhausted**

The *Quanta* Case

- The United States Supreme Court
 - Decided June 9, 2008
 - Opinion authored by Justice Clarence Thomas
 - Court unanimous in its holding

The Supreme Court's Decision

- Exhaustion applies to method claims
- The Intel products “embody” the LG patents
- Sale to Quanta was an “authorized sale”
- Quanta does not need a license from LG under the respective patents

The Supreme Court's Decision

- Method claims
 - LG argued method claims cannot be exhausted
 - Method claims are not linked to a tangible article
 - Linked to a process
 - Right to use method can only be transferred by contract
 - Quanta argued method claims can be exhausted
 - Methods held exhausted in earlier cases
 - If method claims exempt, have absurd result
 - Patent owner could avoid exhaustion by simply inserting method claims

The Supreme Court's Decision

- Method claims
 - Court held method claims can be exhausted
 - Methods may be embodied in a product
 - Consistent with precedents
 - *Bhyl Gasoline Corp. v. United States* (1940), sale of a motor fuel produced under one patent exhausted another patent for a method of using the fuel in combustion motors
 - *United States v. Univis Lens* (1942), found exhaustion of method claims by sales of lens blanks for grinding multi-focal lenses
 - Avoids absurd result:
 - If methods exempt from exhaustion, then Intel customers liable even when they combine Intel microprocessors and chipsets with Intel parts

The Supreme Court's Decision

- Do the Intel products “embody” the LG patents?
 - Quanta argued
 - Sale of an incomplete product can exhaust patent
 - *United States v. Univis Lens*
 - If sale of incomplete product avoids exhaustion, have absurd result
 - Patent owners could authorize the sale of items that are complete except for one minor step

The Supreme Court's Decision

- Do the Intel products “embody” the LG patents?
 - LG argued
 - The Intel microprocessors and chipsets are individual elements of LG’s patented combination
 - Cannot ascribe to one element the status of the invention itself
 - The *Aro* case warns that no element of a combination patent is equivalent to the invention

The Supreme Court's Decision

- Do the Intel products “embody” the LG patents?
 - Court held Intel products “embody” the patents
 - The Intel products have no substantial non-infringing use
 - The object of Intel’s sale was to allow Quanta to make computers that practice the LG patents
 - The **final steps to combine** Intel microprocessors and chipsets with memory and busses **not inventive**
 - “The sale of a device that practices patent A does not, by virtue of practicing patent A, exhaust patent B”
 - “**But**, if the device practices patent A *while substantially embodying* patent B, its relationship to patent A does not prevent exhaustion of patent B”

The Supreme Court's Decision

- Exhaustion applies to method claims
- The Intel products “embody” the LG patents
- Sale to Quanta was an “authorized sale”

What is an “Authorized Sale”?

- Exhaustion is triggered **only** by a patent holder’s authorized sale.
- LG argued its license did not authorized Intel to sell components to Quanta without restrictions
 - License agreement disclaimed third party licenses
 - Master Agreement required notice to Intel customers

What is an “Authorized Sale”?

- Court held sale to Quanta without restrictions was authorized
 - The license grant clause does not restrict Intel’s right to sell to purchasers who intend to combine with non-Intel parts
 - The term disclaiming third-party license is of no effect because Quanta does not rely on implied license
 - Doctrine of exhaustion is no different from implied license
 - Quanta received notice
 - No breach of the Master Agreement
- “Intel’s authority to sell its products... was not conditioned on... Quanta’s decision to abide by LGE’s directions in that notice”

Simple Strategy to avoid impact of Quanta

- How could LG have done?
 - Nothing in the License Agreement restricted Intel’s right to sell its microprocessors and chipsets to purchasers who intended to combine them with non-Intel parts. It broadly permitted Intel to “make, use, [or] sell” products free of [LG’s] patent claims

Quanta Computer v. LG Electronics
 - LG could have limited grant clause to restrict Intel’s right to sell only to purchasers who will not combine with non-Intel parts
 - Of course, Intel would likely have resisted this license clause

Practical Implications of *Quanta*

- Supreme Court left open the enforceability of post-sale limitations on use of a patented item
 - *Mallinckrodt v. Medipart* not overruled
- Thus, field of use restrictions on sales may help avoid *Quanta* exhaustion
- Include as part of license grant
- In the LG case, such field of use restriction could have limited Intel's uses to the sale of parts used in combination with other parts manufactured by Intel
- Again, Intel would have likely resisted such a term

The Grey Areas of *Quanta*

- In the *Quanta* case and in the Example 3 hypothetical, it is stated as fact that the parts being sold substantially or nearly entirely “embody” the patented technology – i.e. the assembly step is not in itself inventive
- What if this is not the case?
 - For example, assume the method claim is novel and inventive in its own right – i.e. the method of assembly is independently inventive from the patented apparatus
 - *Quanta* then should seemingly not apply to that claim
 - Or, in Example 3 assume one of the other bicycle parts described in the patent, for example the seat, is patentable in its own right, independently of the frame.
 - If that patent is not licensed, then it is not exhausted simply by sale of the frame

Practical Implications of *Quanta*

- Does a litigation settlement give rise to patent exhaustion with respect to the defendant's customers?
 - Look to language of the agreement and/or covenant not to sue
 - *Transcore v. Electronic Transaction Consultants* 2008 U.S. Dist. LEXIS 41812 (N.D. Tex. May 22, 2008)

Thank you for your participation.

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