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Supreme Court Applies the Doctrine of Patent Exhaustion to Licensed Sale, Freeing Purchaser from Infringement Liability Notwithstanding Violation of License Limitation

Summary

On June 9, 2008, the United States Supreme Court followed what it termed the "150-year-old" doctrine of patent exhaustion and applied it to *authorized* sales by a manufacturing licensee of products that do not infringe, but embody the patented inventive concept and are capable of use only in practicing the patent. The Supreme Court held that a purchaser who had received notice of and violated a license restriction against combination with components from third-party sources was free of infringement liability. *Quanta Computer, Inc. v. LG Electronics, Inc.*, No. 06-937, 2008 U.S. LEXIS 4702 (June 9, 2008). The Supreme Court left standing the principle from *General Talking Pictures Corp. v. Western Elec. Co.*, 304 U.S. 175 (1938), *aff'd on reh'g*, 305 U.S. 124 (1938), that patent exhaustion does not apply to an *un*authorized sale by a manufacturing licensee outside the limited field of its license. Considered in the context of the recent Supreme Court rulings concerning patents, this decision continues the Supreme Court's tendency to limit patent protection.

The route open for patentees to control resale by a manufacturing licensee is via a limited field license, preferably with notice to purchasers, so that any sale outside that field is unauthorized, as in *General Talking Pictures*. This approach may also permit separate tiers of limited licenses to downstream purchasers/users not expressly or impliedly covered by the manufacturing license.

Facts

In *Quanta*, LG Electronics, Inc. ("LGE") licensed computer technology patents to Intel Corporation ("Intel") authorizing Intel to "make, use, sell (directly or indirectly), offer to sell, import or otherwise dispose of" its own products ("License Agreement"). *Quanta Computer, Inc.* 2008 U.S. LEXIS 4702, at *3. The Licensing Agreement also provided that no license "is granted by either party hereto . . . to any third party for the combination by a third party of Licensed Products of either party with items, components, or the like acquired . . . from sources other than a party hereto, or for the use, import, offer for sale or sale of such combination."[1] *Id.* In a separate agreement, Intel agreed to give written notice to its own customers to inform them that "any Intel product that [customers] purchase is licensed by LGE and thus does not infringe any patent held by LGE," but that license "does not extend, expressly or by implication to any product that [customers] make by combining any Intel product with any non-Intel product." *Id.* at **3-4.

Petitioners, Quanta, a group of computer manufacturers, purchased microprocessors and chipsets from Intel and received the required notice. *Id.* at *4. Quanta then manufactured computers using the Intel parts in combination with non-Intel memory and buses in ways that practiced the LGE patents. *Id.* LGE sued Quanta for infringing its patents by incorporating the Intel chipsets and microprocessors with non-Intel memory and buses in computers they manufactured.

[1] The License Agreement also provided that it does not alter the usual rules of patent exhaustion. *Id.*

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The Court of Appeals Decision

The Federal Circuit held that the limitation against third-party components conditioned Intel's sales and the sale did not exhaust the licensed patents. *LG Electronics, Inc. v. Bizcom Electronics, Inc.*, 453 F.3d 1364 (Fed. Cir. 2006). In particular, the Federal Circuit held that "the 'exhaustion doctrine . . . does not apply to an expressly conditioned sale or license' . . . so LGE's rights in asserting infringement of its system claims were not exhausted." *Id.* at 1370.

The Supreme Court Decision

The Supreme Court rejected LGE's argument that "method patents cannot be exhausted." *Quanta Computer, Inc.* 2008 U.S. LEXIS 4702, at *5. The Court was concerned that freeing method patents of exhaustion would allow infringement suits against downstream purchasers of a related patented system. *Id.* at *6.

The Court then addressed the extent to which a product must be covered by a patent for the patent to be exhausted by the sale. *Id.* The Court followed *United States v. Univis Lens Co.*, 316 U.S. 241 (1942). First, as in *Univis*, "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.

Second, like in *Univis*, "the Intel Products constitute a material part of the patented invention and all but completely practice the patent." *Quanta Computer, Inc.* 2008 U.S. LEXIS 4702, at *7. Moreover, the incomplete product "substantially embodie[d] the patent" because the only additional step necessary to practice the patent is to apply "common processes" or add "standard parts." *Id.* "Everything inventive about each patent [was] embodied in the Intel Products." *Id.*

LGE argued that there was no authorized sale because the License Agreement did not permit Intel to sell its products for use in combination with non-Intel products that practice the LGE patents. *Id.* at **6-8. LGE relied on *General Talking Pictures Corp. v. Western Elec. Co.*, 304 U.S. 175 (1938), *aff'd on reh'g*, 305 U.S. 124 (1938), which allowed a patent infringement suit against a purchaser of a patented amplifier from a manufacturing licensee; the field of the license was limited to home radio use, the purchase was for commercial use and the purchaser had received notice of the license restriction. As recounted in *Quanta*, "the Court held that exhaustion did not apply because the manufacturer had no authority to sell the amplifiers for commercial use, and the manufacturer 'could not convey to petitioner what both knew it was not authorized to sell.'" *Quanta Computer, Inc.* 2008 U.S. LEXIS 4702, at *8 (*citing General Talking Pictures* supra, at 181).

In *Quanta*, the License Agreement permitted Intel to "'make, use, [or] sell' products free of LGE's patent claims." *Id.* LGE did require Intel to give notice to its customers that LGE had not licensed its patents to those customers, but neither party contended that Intel breached that agreement. *Id.* Accordingly, "Intel's authority to sell its products embodying the LGE patents was not conditioned on the notice or on Quanta's decision to abide by LGE's directions in that notice." *Id.* at **8-9. In sum, "[b]ecause Intel was authorized to sell its products to Quanta, the doctrine of patent exhaustion prevent[ed] LGE from further asserting its patent rights with respect to the patents substantially embodied by those products." *Id.* at *9.

The Court viewed the License Agreement disclaimer of licenses to third parties to practice the patents by combining licensed products with non-Intel parts as an implied license issue. *Id*. at *9. It found that the question of whether third parties received an implied license was irrelevant because Quanta asserted its right to practice the patents based on the doctrine of patent exhaustion, not implied license. *Id*.

The Supreme Court left unresolved the question of whether contract damages might be available to LGE even though exhaustion operated to eliminate patent infringement damages, because LGE's complaint did not include a breach-of-contract claim. *Id*. at *9, n.7.

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