



INTELLECTUAL PROPERTY PRACTICE

**SUPREME COURT CLARIFIES PATENT LICENSING
AND THE EXHAUSTION OF PATENT RIGHTS**

On June 9, 2008, the Supreme Court announced a decision addressing the scope of the doctrine of patent exhaustion, also known as the “first sale” doctrine. In *Quanta Computer, Inc. v. LG Electronics, Inc.*, No. 06-937, 553 U.S. ---- (2008), a unanimous Supreme Court held that a sale, authorized by the patent holder, of an article that substantially embodies the patent prevents the patent holder from using patent law to control subsequent use of the article. The Court also held that the “first sale” doctrine applies equally to method claims.

BACKGROUND

The “first sale” doctrine provides that the initial authorized sale of a patented item terminates the patent holder’s right to exclude others from using that item. In practice, where a patent holder licenses its invention to a manufacturer, the first sale doctrine prevents the patent holder from later bringing patent infringement claims against a third party who purchases the patented item from that manufacturer. The Quanta Computer decision addresses a patent holder’s attempt to preserve its right to bring infringement claims against third parties who obtain a subset of a patented invention from a licensed manufacturer, yet then use that subset in combination with *unlicensed* components to practice the patent holder’s invention.

LG Electronics, Inc. (“LGE”) licensed a portfolio of computer technology patents to Intel so that Intel could “make, use, sell (directly or indirectly), offer to sell, import or otherwise dispose of” Intel’s own products. However, the license stated that it did not grant to any third party a license to combine products produced by Intel with components from unlicensed sources. In other words, a third party who purchased products made by Intel under the license would be protected from an infringement suit so long as it used solely Intel (or LGE) components to practice the LGE patents. On the other hand, the license purported not to protect a third party who combined Intel components with components from unlicensed sources to practice the LGE patents. LGE’s agreement with Intel required Intel to give its customers notice of this license limitation, and by all accounts Intel did so.

Quanta Computer, Inc. and others (“Quanta”) purchased microprocessors and chipsets produced by Intel under the license, but manufactured computers using those Intel parts in combination with computer memory and data buses from unlicensed sources. The finished products operated such that they practiced the LGE patents. LGE sued Quanta for infringing the licensed patents, arguing that the Intel license effectively limited third-party rights and that, in any event, the first sale doctrine should not apply to method claims because such claims are not linked to a tangible article that can be sold.

DECISION

The Supreme Court first disposed of the argument that method claims could not be exhausted by a “first sale” by noting that almost any patent could be drafted to include a method claim. A method claim exception, therefore, would allow an “end-run” around the doctrine and leave no purchaser of patented items from a licensed manufacturer safe from an infringement suit. Slip op. at 10. Instead, the Court reaffirmed its holding in *United States v. Univis Lens Co.*, 316 U.S. 241 (1942), that an authorized sale of an uncompleted article that substantially embodies the patent exhausts the patent holder’s patent rights as to that article. An uncompleted article substantially embodies the patent where (1) the uncompleted article as sold has no reasonable use other than in practicing the patent, and (2) the only step necessary to practice the patent with the uncompleted article is the application of common processes or the addition of standard parts. Slip op. at 12-14. The Intel-licensed microprocessors and chipsets in this case sufficiently embodied the LGE patents because they had no reasonable use other than connection to data buses and main memory, and only this addition of standard parts was necessary to practice the patent.

In addition, the Court held that Intel’s sales to Quanta were “authorized” despite the license’s language purporting to limit third party rights. While the license here required a notice directed to third parties, the license did not condition

Intel's right to make, use or sell products embodying the LGE patents on a third-party purchaser's decision to abide by that notice. In short, because Intel operated within its license, Intel's sales to Quanta were "authorized" by the license regardless of Quanta's decision not to abide by the notice. The Court distinguished a pair of 1938 cases in which the "first sale" doctrine did not apply because the manufacturer breached its license agreement with the patent holder in making the sale, suggesting that a properly crafted license agreement may still circumvent the first sale doctrine by rendering particular sales "unauthorized." *See Gen. Talking Pictures Corp. v. W. Elec. Co.*, 304 U. S. 175 (1938) (holding a manufacturer and its customer each liable for patent infringement where each were aware the sale was outside the scope of the manufacturer's license from the patent holder). It appears that an "unauthorized" sale, even if the third party believed in good faith that the sale came under the manufacturer's license, likely would leave the third party liable as an innocent infringer, although with an indemnification claim against the manufacturer.

CONCLUSION

If a patent license authorizes a manufacturer to produce an article that (1) has no reasonable use except in the patented invention and (2) requires only the addition of common processes or standard parts to complete the invention, that license also protects the purchaser of the article from a patent infringement suit. Conversely, a patent holder who wishes to exclude certain purchasers from using the invention must draft the manufacturer's license agreement to make clear that the manufacturer is not authorized to sell to those purchasers. Finally, a large-scale purchaser of an article marked as patented should request a copy of the manufacturer's patent license and ensure that the sale is authorized under the license, and/or request an indemnification clause from the manufacturer that covers any suit by the patent holder.

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