

Patent Exhaustion— A Simple Problem Made Hard

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The U.S. Supreme Court will revisit this Term, for the first time in sixty-five years, the “patent exhaustion” or “first sale” doctrine. In *Quanta Computer, Inc. v. LG Electronics, Inc.*,¹ the defendant petitioners, supported somewhat surprisingly by the U.S. Solicitor General (SG), are asking the Court to hold as a matter of law that a patent cannot be enforced against entities that use or resell a patented product in contravention of lawful license restrictions imposed by the patent owner. Specifically, the *Quanta* defendants ask the Court to hold that their purchase of patented microprocessors from Intel, a licensee of the plaintiff patent owner LGE, carries with it an absolute right to incorporate those microprocessors into computer systems also covered by LGE’s patents, notwithstanding an express limitation to the contrary in the patent license to Intel and their knowledge of that limitation. The SG, while recognizing the contractual freedom of a patent owner to impose reasonable conditions on its licensees, would make formal transfer of title to a licensed product an operative event to cut off any subsequent assertion of patent rights against that product or a larger product into which it is incorporated. Although the SG suggests that antitrust concerns underlie its position, it offers little but the decades-old mantra of “exhaustion” to justify a rule that would operate in every case regardless of the commercial circumstances of a transaction or the intent of the patent owner and those with whom it deals.

It is time for the Court to abandon the formulaic and dogmatic approach that has characterized the case law on patent exhaustion for over a century. The Court should ground the analysis instead on fundamental, uncontroversial, and widely accepted principles of patent licensing, foremost among which is the freedom of knowledgeable entities to enter into a binding license that serves the needs of their particular technology and industry. The commercial realities facing companies that use and rely on the patent system provide a better basis for determining when there should be exhaustion of the patent right than does an automatic rule rooted in common law prohibitions against restraints on alienation. Nor should antitrust law dictate the outcome, at least not the now defunct notions of per se illegality that characterized much of antitrust analysis during the first seventy-five years of the 20th century and that played a role in shaping the exhaustion doctrine. If patent licenses happen to be used by those with market power to restrain trade beyond the scope of the lawful exclusive rights awarded by their patents, then antitrust law is amply equipped to address that situation without rote reliance on the exhaustion formalism.

The global economy today is markedly more complex than that of the 19th and early 20th centuries, when the exhaustion doctrine first took shape, as are the products that reach consumers. In contrast to a century ago, there are many situations today in which a patent owner, in an effort to maximize the implementation of new technology, may want to license one or more entities to

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¹ LG Elecs., Inc. v. Bizcom Elecs., Inc., 453 F.3d 1364 (Fed. Cir. 2006), cert. granted sub. nom. Quanta Computer, Inc., v. LG Elecs., Inc., 128 S. Ct. 28 (2007).

make separate patented components of a larger whole, others to combine these components into patented systems, and still others to sell such systems for use in specified applications. As long as there exists a set of lawful contracts that carefully define the rights of the patent owner and its licensees in such arrangements, it is difficult to justify judicial intervention to prohibit the assertion of patent rights against those who violate or ignore the license terms and who otherwise meet the statutory definition of infringement.

It is no answer to argue that the patent owner might have contractual remedies against an errant licensee in the event of a breach, because that remedy may not apply to the offending parties (as may be true in the *Quanta* case). Moreover, the patent statute gives the patent owner the exclusive right to control—separately—the importation, manufacture, sale, and use of its invention, and any one of these activities undertaken without a license is deemed an infringement.² Companies that knowingly purchase products in violation of a use or resale restriction imposed by the patent owner are in no position to argue that their activities are nonetheless “licensed” by the patent owner. Accordingly, those activities should be treated as infringement no less than the manufacture of patented components without authorization.³

Origins of Exhaustion

The exhaustion doctrine, at its inception, addressed a default situation in which a patent owner or its licensee has sold a patented product to an ordinary customer for its intended use. In *Adams v. Burke*, the plaintiff patent owner licensed the sale of patented coffin lids within a specified geographical area.⁴ The defendant undertaker purchased such a lid from the licensee within the designated area but used it outside that area. In ruling for the purchaser of the lid in a suit brought by the patent owner, the Court acknowledged that “the right to manufacture, the right to sell, and the right to use are each substantive rights, and may be granted or conferred separately by the patentee.”⁵ Nevertheless, the Court held that the patent rights had been exhausted by the sale because the patent owner had been fully compensated for use of the patent as to that sale. “[W]hen the patentee . . . sells a machine or instrument whose sole value is in its use, he receives the consideration for its use and he parts with the right to restrict that use.”⁶ In *Adams*, exhaustion made sense because there was no evidence of any restriction on use or resale imposed by the patent owner on the customer, only a restriction on where the lid initially was to be sold which had been duly observed.⁷

² 35 U.S.C. § 271.

³ See, e.g., *Aro Mfg. Co., Inc. v. Convertible Top Replacement Co., Inc.*, 377 U.S. 476 (1964). In *Aro Manufacturing*, the Court explained: But with Ford lacking authority to make and sell, it could by its sale of the cars confer on the purchasers no implied license to use, and their use of the patented structures was thus “without authority” and infringing under § 271(a). Not only does that provision explicitly regard an unauthorized user of a patented invention as an infringer, but it has often and clearly been held that unauthorized use, without more, constitutes infringement.

Id. at 484 (citations and footnote omitted).

⁴ 84 U.S. (17 Wall.) 453 (1873).

⁵ *Id.* at 456.

⁶ *Id.*

⁷ See also *Keeler v. Standard Folding Bed Co.*, 157 U.S. 659, 666 (1895) (“[A]s between the owner of a patent on the one side, and a purchaser of an article made under the patent on the other, the payment of a royalty once, or, what is the same thing, the purchase of the article from one authorized by the patentee to sell it, emancipates such article from any further subjection to the patent throughout the entire life of the patent.”); *Bloomer v. McQuewan*, 55 U.S. (14 How.) 539, 553 (1853) (“The right to construct and use these planing machines [had] been purchased and paid for without any limitation as to the time for which they were to be used. They were the property of the respondents. Their only value consists in their use.”).

By contrast, in *Mitchell v. Hawley*, on which the *Adams* Court relied, the Court did not find exhaustion, holding that the intent of the patent owner was determinative as to the scope of the license.⁸ The Court affirmed a finding of infringement by one who had purchased a patented machine from a licensee who had the right to make and use but did not have the right to sell the machine during the term of the patent. The Court distinguished the situation before it, in which the patent owner had clearly restricted the right of a licensee to sell machines, from one in which “the sale is absolute, and without any conditions” and the buyer would therefore be free to treat the machine as his or her “private, individual property.”⁹

Facially, it might seem that a rule of law derived from these seminal cases would not support exhaustion in situations where, as in *Quanta*, the patent owner has contractually imposed use restrictions on sales by its licensee and has communicated those restrictions to customers of the licensee. Unfortunately, the law on exhaustion has grown needlessly confusing and ambiguous, in part because the Court itself has not been consistent in describing the rationale for applying the doctrine or its reach. Moreover, dicta in many cases have exceeded the actual holdings. In some cases, the Court has held that exhaustion does not apply to sales made by a licensee that were subject to use restrictions.¹⁰ In other cases, the Court has treated exhaustion as an absolute concept that arises from the fact of sale itself, whether by a licensee or the patent holder, and renders nugatory the imposition of contractual restrictions on use or resale.¹¹ Still other cases fall somewhere in between. In *United States v. General Electric Co.*, for example, the Court accepted, without analysis, that a *sale by a patent owner* would “exhaust the monopoly” and preclude the imposition of price restrictions on resale, but ruled that a license provision imposing price restrictions on *sales by a licensee* would be proper and lawful.¹² This formal distinction between sales made by a licensee and those made by a patent owner makes little sense. If a patent owner is permitted to control the prices charged by its manufacturing licensee, it is difficult to understand why its sales through a reseller distributor should be subject to a different rule.¹³

⁸ 83 U.S. (16 Wall.) 544, 548 (1873).

⁹ *Id.*

¹⁰ For example, in *General Talking Pictures Corp. v. Western Electric Co.*, 305 U.S. 124 (1938), discussed *infra*, the Court affirmed a finding of infringement by a company that used patented sound amplifiers in violation of a use restriction in the seller’s license. *See also* *Mitchell*, *supra* note 8.

¹¹ An example of this approach is reflected in *United States v. Univis Lens Co.*, 316 U.S. 241 (1942), also discussed *infra*, in which the Court used the exhaustion doctrine as part of its rationale for holding that the patent owner’s effort to establish minimum prices to be charged by licensees for patented multifocal eyeglasses was a per se violation of the Sherman Act. The “first sale” was the patent owner’s sale of patented lens blanks that were subsequently ground into patented lenses to be sold by licensees.

¹² 272 U.S. 476 (1926). The *General Electric* Court reasoned:

It would seem entirely reasonable that [the patent owner] should say to the licensee, “Yes, you may make and sell articles under my patent, but not so as to destroy the profit that I wish to obtain by making them and selling them myself.” He does not thereby sell outright to the licensee the articles the latter may make and sell, or vest absolute ownership in them. He restricts the property and interest the licensee has in the goods he makes and proposes to sell.

Id. at 490.

¹³ The SG acknowledges the apparent anomaly in drawing this distinction but argues that it is a “necessary and explicable result” of the decision in *General Talking Pictures*. Brief for the United States as Amicus Curiae Supporting Petitioners at 17–18, *Quanta Computer, Inc., v. LG Elecs., Inc.*, No. 06-0937 (U.S. Nov. 2007). This is oddly true, but only if one accepts the propriety of using the formulaic legalism of exhaustion for the analysis.

Time to Simplify

In *Quanta*, the Supreme Court has an opportunity to simplify the exhaustion doctrine and to reconcile it with 21st century economics and widely accepted licensing principles. The key lies in examining the nature of the patent right and asking why the exhaustion doctrine exists in the first place. Although described and applied in many different ways, the exhaustion doctrine at bottom is properly analyzed as a species of implied license made necessary by the Patent Act itself.¹⁴

By statute, a patent owner is given the exclusive and severable rights to make, use, and sell the patented invention, along with the right to proceed against others for any one or more of those activities undertaken without its authorization.¹⁵ Because these rights are severable, a patent owner theoretically could sue its own customer for using or reselling a patented product, were it not for the fact that the sale itself normally carries with it an implied authorization to put the product to its intended use and enjoyment. In a typical sales transaction, the patent owner—whether selling directly or through a licensee—captures the full value of its invention in the initial sales price and conveys to the buyer an unrestricted right to use the patented product whenever and wherever it chooses, including the right to resell the product to others who can enjoy the same rights. In such a transaction, the patent owner remains silent about the authorization of downstream uses and resale because it intends to part, fully and permanently, with any rights to control the product after it is sold.

Analyzed in light of the multiple exclusive rights awarded by the Patent Act, the ordinary buyer in this type of transaction acquires—in addition to ownership of the patented product—an implied license to use and to resell the product and to pass along the same set of rights to subsequent owners, free and clear of claims of the patent owner. It is reasonable to assume, moreover, that if the patent owner wanted to restrict the freedom of the first purchaser in some way, either the purchase price would be lower or there would be fewer customers willing to accept the more limited

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¹⁴ Notably, the patent and copyright statutes differ significantly in the types of exclusive rights they confer and the economic incentives they intend to foster, a point that argues in favor of analyzing exhaustion separately for copyrights and patents. Some of the more confusing exhaustion cases are those that equate the two. *See, e.g.,* *Bauer & Cie v. O'Donnell*, 229 U.S. 1, 17 (1913) (“Upon such facts as are now presented we think the right to vend secured in the patent statute is not distinguishable from the right of vending given in the copyright act. In both instances it was the intention of Congress to secure an exclusive right to sell, and there is no grant of a privilege to keep up prices and prevent competition by notices restricting the price at which the article may be resold.”).

¹⁵ 35 U.S.C. § 271(a) of the Patent Act provides that whoever imports, makes, uses, offers to sell or sells any patented invention infringes the patent. 35 U.S.C. § 271(a). Section 271(b) provides that whoever actively induces others to infringe also infringes. 35 U.S.C. § 271(b). Under Section 271(c), whoever knowingly sells or offers to sell something especially adapted to infringe the patent infringes contributorily. 35 U.S.C. § 271(c). This aggregate description of activities that constitute acts of infringement is qualified by the phrase “without authority,” which allows those who might otherwise be held infringe to show that they were “authorized” by the patent owner—i.e., licensed either directly or indirectly—to import, make, use, offer to sell or sell, as appropriate, the patented invention. Where an activity infringes, Sections 281–283 allow the patent owner to bring a civil action for damages and injunctive relief. 35 U.S.C. §§ 281–283.

¹⁶ Even this type of exhaustion is not absolute. A well recognized limitation on the rights of the owner of any patented product comes into play when it seeks to rebuild a worn out product. An extensive body of case law exists in which the Supreme Court and Federal Circuit have attempted to define the point at which permissible repair becomes impermissible reconstruction. *See, e.g.,* *Aro Mfg. Co. v. Convertible Top Replacement Co.*, 377 U.S. 476, 484–85 (1964) (distinguishing the infringing repair of an unlicensed convertible top structure, which perpetuated the infringing use, from the permissible repair of a licensed convertible top structure, as seen in *Aro Mfg. Co. v. Convertible Top Replacement Co.*, 365 U.S. 336 (1961)); *Wilbur-Ellis Co. v. Kuther*, 377 U.S. 422, 424–25 (1964) (holding that refurbishing a fish-canning machine and adapting it to pack fish into five-ounce cans instead of one-ounce cans constitutes permissible repair); *Fuji Photo Film Co. v. ITC*, 474 F.3d 1281, 1297 (Fed. Cir. 2007) (holding that the legal distinction between repair and reconstruction does not hinge upon whether the element being replaced is deemed to be an “essential” or “distinguishing” part of the invention).

In addition, it has long been held that foreign sales of a product under a foreign counterpart of a U.S. patent do not exhaust the U.S. patent rights of the patent owner. *Boesch v. Graff*, 133 U.S. 697, 703 (1890).

set of rights. This, in a nutshell, is the exhaustion doctrine: the first sale exhausts the patent rights because normally that is what both parties are deemed to have intended at the time of sale, whether or not they expressed that intent.¹⁶

That the vast majority of commercial transactions involving patented products are of this ilk, however, is not a reason for prohibiting other ways of commercializing inventions. There is a fundamental difference between implying a license to use and resell when the first sale is unconditional and implying one when the patent owner has stated—clearly and unambiguously as was done in the *Quanta* case—that the sale of licensed components does not include a license to use them in a patented system without a separate license from the patent owner. In the first situation, the exhaustion doctrine is anchored in common sense and traditional commercial practices. In the latter, it is based only on formalistic incantation, uninformed by the purpose of the patent system or the needs of the parties. It is well settled in other contexts that the parties to a contract are permitted to override implied rights with express provisions.¹⁷

Three Anchoring Principles

A proper analysis of exhaustion can be grounded on three relatively uncontroversial principles that underlie the U.S. patent system. First principle: The U.S. patent system is one in which free market forces and their effects on a process of arms-length bargaining determine patent value. Stated differently, a patent owner is normally free to charge “whatever the market will bear” by way of a sales price or a royalty.¹⁸ Applied in a licensing context, this means that a patent owner should be permitted to capture value from its licensees in whatever form makes commercial sense. If a patent owner chooses to license one company to manufacture and sell a product embodying some or all of the patented invention, but not to pass on to the first purchasers a license to further use the product absent a further license, the patent owner should be permitted to do so because that may be the most efficient way to maximize the value of the invention. As long as the licensee understands and assents to such a condition, there is no compelling argument—rooted in either

¹⁷ Compare Uniform Commercial Code implied warranties (U.C.C. §§ 2-314 and 2-315) with express modifications of such warranties (U.C.C. § 2-316). See also *Met-Coil Sys. Corp. v. Korners Unlimited, Inc.*, 803 F.2d 684, 686–87 (Fed. Cir. 1986).

Adding to the confusion that attends this subject is the Federal Circuit’s apparent treatment of the exhaustion question as separate and distinct from whether there is an implied license. In the *Quanta* case, the Federal Circuit dismissed the defendant’s claim of an implied license before addressing exhaustion because the manufacturing licensee, Intel, had informed its customers, the defendants, that they were not licensed for the uses to which the products were put. *LG Elecs., Inc. v. Bizcom Elecs., Inc.*, 453 F.3d 1364, 1369 (Fed. Cir. 2006), *cert. granted sub. nom. Quanta Computer, Inc. v. LG Elecs., Inc.*, 128 S. Ct. 28 (2007). There is no apparent need for this separate inquiry. The license itself made clear that Intel was not empowered to grant a use license to its customers for the accused systems. *Id.* Unless such a license restriction is unlawful, that should end the inquiry regardless of what the licensee did or did not do.

¹⁸ See *Biotechnology Indus. Org. v. Dist. of Columbia*, 496 F.3d 1362, 1372 (Fed. Cir. 2007) (“[T]he Patent Act creates an incentive for innovation. The economic rewards during the period of exclusivity are the carrot. The patent owner expends resources in expectation of receiving this reward. Upon grant of the patent, the only limitation on the size of the carrot should be the dictates of the marketplace.”) (quoting *King Instrs. Corp. v. Perego*, 65 F.3d 941, 950 (Fed. Cir. 1995)), *reh’g & reh’g en banc denied*, 2007 U.S. App. LEXIS 25351 (Fed. Cir. Oct. 30, 2007); *Schor v. Abbott Labs.*, 457 F.3d 608, 610 (7th Cir. 2006) (“The price of NORVIR cannot violate the Sherman Act: a patent holder is entitled to charge whatever the traffic will bear.”), *cert. denied*, 127 S. Ct. 1257 (2007).

A few courts have, from time to time, expressed the erroneous view that excessive royalty demands by a patent owner may give rise to a form of patent misuse, rendering the patent unenforceable. See, e.g., *American Photocopy Equip. Co. v. Rovico, Inc.*, 384 F.2d 813 (7th Cir. 1967). In *Dawson Chemical Co. v. Rohm & Haas Co.*, 448 U.S. 176, 215 (1980), the Supreme Court held that a patent owner has no obligation to license its patent. Implicit in that holding is that the patent owner should be permitted to hold out for whatever royalty it chooses as long as the demand does not restrain trade in commerce beyond the scope of the patent or inhibit the development of competing technologies.

antitrust law or patent law—for prohibiting the arrangement.¹⁹ If the licensee wants a broader set of rights than the patent owner has offered, the licensee is free to offer more for the license in hopes of encouraging the patent owner to enlarge the scope. The property right, however, belongs to the patent owner, who should not be prohibited from capturing value from the marketplace in whatever form or fashion it chooses.

Second principle: The patent owner should be free to relinquish selectively its right of exclusivity to the various activities granted by statute, i.e., the rights to import, make, offer, sell and use the invention, unless to do so would violate antitrust or other laws. Since the beginnings of the patent system, courts have recognized that a patent owner can subdivide its exclusive rights in any manner it chooses. As noted by the Court in *Bement v. National Harrow Co.*,

The property right, however, belongs to the patent owner, who should not be prohibited from capturing value from the marketplace in whatever form or fashion it chooses.

Notwithstanding [certain] exceptions, the general rule is absolute freedom in the use or sale of rights under the patent laws of the United States. The very object of these laws is monopoly, and the rule is, with few exceptions, that any conditions which are not in their very nature illegal with regard to this kind of property, imposed by the patentee and agreed to by the licensee for the right to manufacture or use or sell the article, will be upheld by the courts.²⁰

Particularly illustrative of this principle is *General Talking Pictures Corp. v. Western Electric Co.*, where the Supreme Court held that use of a patented product in contravention of a license restriction imposed on a licensed seller was infringement.²¹ The patents in question covered sound amplifiers and had been licensed separately to a number of companies for various types of home use, with the restriction that licensed amplifiers were not to be sold for or used in commercial theaters. The latter market the patent owner reserved for itself. The defendant theater operator purchased its sound system from an entity licensed to sell only for amateur radio applications. It argued that the exhaustion doctrine nevertheless allowed theater use of the amplifiers because they had been manufactured by a licensee “under the patent” and sold “in the ordinary channels of trade” for full consideration.²² The Supreme Court disagreed, holding that the amplifiers at issue had not been made and sold under the patent because the field of use restriction limited the scope of the seller’s license.²³ The defendant theater operator had notice of this restriction because the seller had included a “license notice” with each sale setting forth the restriction on use.²⁴

¹⁹ Of course, such a licensee may have an obligation to inform its customers that they cannot use or resell the product without a separate use license from the patent owner, but this is largely a matter of contract between the licensee and its customers, and not an issue necessarily involving the patent owner. It is elementary that a licensee cannot pass onto to a customer any greater license rights than it receives from the patent owner. *See Mitchell v. Hawley*, 83 U.S. (16 Wall.) 544, 550 (1873) (“Persons, therefore, who buy goods from one not the owner, and who does not lawfully represent the owner, however innocent they may be, obtain no property whatever in the goods, as no one can convey in such a case any better title than he owns, unless the sale is made in market overt, or under circumstances which show that the seller lawfully represented the owner.”).

²⁰ 186 U.S. 70, 91 (1902). *See also Adams v. Burke*, 84 U.S. (17 Wall.) 453, 456 (1873) (“The right to manufacture, the right to sell, and the right to use are each substantive rights, and may be granted or conferred separately by the patentee.”); *accord Simpson v. Union Oil Co.*, 377 U.S. 13, 24 (1964).

²¹ 305 U.S. 124 (1938).

²² *Id.* at 127.

²³ *Id.* at 125, 127.

²⁴ *Id.* at 125. The dissent by Justices Black and Reed is noteworthy. Relying upon *Motion Picture Patents Co. v. Universal Film Co.*, 243 U.S. 502 (1917), a tying case, the dissent argued that a patent owner was not permitted to restrict the use of a product once it was sold. *General Talking Pictures*, 305 U.S. at 129 (Black, J., dissenting). The majority rejected this view in favor of the broader principle of freedom to contract. Whatever relevance the *Motion Pictures* case may have ever had was effectively eliminated with the passage of 35 U.S.C. § 271(d)(5),

Patent owners thus may license separately (or in some selected combination) the importation, manufacture, use, and/or sale of the invention.²⁵ They may restrict the geographical territory and/or the field of use in which a license is effective, the duration of the license, and the customers to which the licensee may sell.²⁶ They may license some claims of a given patent, but not others, or some but not all of their patents that relate to a given technology. In short, patent owners are given wide latitude to offer and bargain for a license that is appropriate for their particular industry.

Third principle: The exhaustion doctrine plays an extremely important role where the patent owner has failed to state, clearly and expressly, the limitations it seeks to impose upon its own sales or those of a licensee. As already noted, under these circumstances the sales contract between the first seller and the first buyer implies a license to use and resell without restriction that arises at the moment of sale for the agreed upon price. It is both unfair and commercially disruptive to allow the patent owner thereafter to change the rules and exact additional value from use or resale of the product.²⁷

In this connection, the Court must also keep in mind that it may not always be easy to ascertain whether the patent owner has been sufficiently explicit in limiting the license to overcome the implied right that buyers are otherwise entitled to assume. These issues can arise in many ways. At one extreme are cases like *Quanta*, where the agreement between LGE and Intel was explicit that the license did not extend to systems in which products of the licensee were combined with components supplied by unlicensed entities and where the buyers of the licensed components were fully aware of this restriction. This situation is virtually indistinguishable from that of *General Talking Pictures*. At the other extreme are cases in which the first sale is unrestricted and made under circumstances where the first purchaser is entitled to assume that it enjoys free and unrestricted control of the patented products. These situations can be seen in *Adams* and some of the other cases where exhaustion was found. Between these extremes, the number of possible variations is almost unlimited and reflects a continuum of factual issues that will often require careful analysis of what reasonable expectations attended the first sale.

It is only fair that ambiguity in the terms and conditions of any license restrictions should be charged against the patent owner, so that repose in commercial transactions is not disrupted. In addition, there may be further obligations imposed on a patent owner regarding notice to customers of its licensees. Although such issues will need to be worked out on a case-by-case basis, with attention paid to contemporary commercial standards and customs in the marketplace, they should not be predetermined through mere recitation of an ancient legalism.

Addressing *Mallinckrodt*

One decision of the Federal Circuit that has received much attention and criticism in this area is *Mallinckrodt, Inc. v. Medipart, Inc.*²⁸ There, the Federal Circuit provided an extensive analysis of the exhaustion doctrine in the context of a patented device (a “nebulizer”) used for inhaling

which provides that tying in a patent license cannot be challenged as anticompetitive unless the patent owner enjoys market power in the patented tying product.

²⁵ See, e.g., *Mitchell v. Hawley*, 83 U.S. (16 Wall.) 544 (1873).

²⁶ See, e.g., *General Talking Pictures*, 305 U.S. 124; *Adams v. Burke*, 84 U.S. 453 (1873).

²⁷ In *Met-Coil Systems Corp. v. Korners Unlimited, Inc.*, 803 F.2d 684 (Fed. Cir. 1986), the Federal Circuit refused to allow the patent owner, after the initial sale, to impose use restrictions on its customers, noting that the implied license to use arose at the moment an unrestricted sale was made. The court acknowledged that the same restriction imposed before the sale would have been proper. *Id.* at 686–87.

²⁸ 976 F.2d 700 (Fed. Cir. 1992).

radioactive material for diagnostic or therapeutic purposes. Mallinckrodt sold the nebulizer, complete with a specified quantity of the diagnostic material, and included a “single use only” label restriction attached to the device and also in the packaging. A hospital to which the device was sold, despite knowledge that Mallinckrodt did not intend to license its patent for subsequent use of the device, nevertheless sent used devices to defendant Medipart for sterilization and other processing and then reused them. Like the hospital, Medipart was also aware of the restriction imposed by Mallinckrodt. The district court held, as a matter of law, that the exhaustion doctrine nullified any effect of the label restriction on the hospital’s license to use and enjoined Mallinckrodt’s efforts to provide additional notice to correct any contractual deficiency in that regard. The district court held that no cause of action could lie for patent infringement and declined to decide whether a contract cause of action might lie.

The Federal Circuit reversed, relying principally on *General Talking Pictures*, and held that the exhaustion doctrine was not controlling and could not be applied without first determining whether Mallinckrodt’s efforts to control subsequent use of its devices were contractually binding on the hospital as a license restriction. The court remanded for further consideration of these contract issues.²⁹ In reaching its decision, the Federal Circuit addressed and rejected most if not all of the principal arguments for an expansive reading of the exhaustion doctrine that the Supreme Court will be considering in *Quanta*. Indeed, it appears to be more the Federal Circuit’s narrow treatment of exhaustion in *Mallinckrodt* that has motivated the SG to favor Supreme Court review in *Quanta* than the latter case’s relatively unremarkable facts.

A primary argument advanced by the SG for reversing the Federal Circuit in *Quanta*, and for rejecting the rationale of *Mallinckrodt*, harkens back to the 1942 decision of the Supreme Court in *United States v. Univis Lens Co.*³⁰ There, the Antitrust Division challenged as an unlawful restraint of trade under the Sherman Act a licensing system created by Univis for the manufacture and sale of lenses for multifocal eyeglasses, which included control of the prices at which the lenses could be sold by licensed laboratories and resold by retailer opticians. Lens blanks covered by the Univis patent in question were manufactured and sold by a Univis subsidiary to finishing laboratories, which then completed the process of grinding them into lenses and resold the finished lenses to retailers. Univis, the patent owner, received its entire compensation in the form of royalties from its subsidiary when the lens blanks were sold to the finishers. Univis argued that under the 1926 *General Electric* case, its licensing scheme was “excluded by the patent monopoly from the operation of the Sherman Act,” thereby giving it the right to control the prices of the finished lens.³¹

The Supreme Court rejected this argument, invoking principally the exhaustion doctrine, and held the price restrictions to be per se unlawful. The Court concluded that sale of the blanks was an authorized sale that exhausted Univis’s patent rights. The Court gave no weight to the fact that purchasers of the blanks practiced the patent separately by grinding and polishing the blanks into finished lenses and that their customers also practiced the patent by selling the finished lenses at retail:

²⁹ Unfortunately, the findings ordered by the Federal Circuit were never made because the *Mallinckrodt* case was settled a few months after the decision. 1992 U.S. Dist. LEXIS 22902 (N.D. Ill. 1992). In *B. Braun Medical Inc. v. Abbott Laboratories*, 124 F.3d 1419, 1426–27 (Fed. Cir. 1997), the Federal Circuit reversed a finding of patent misuse based on the defendant’s claim that the patent owner had imposed improper conditions on a customer’s use of a patented product, and it remanded for further findings on whether the conditions restrained trade that was not legitimately within the exclusive rights given to the patent owner.

³⁰ 316 U.S. 241 (1942).

³¹ *Id.* at 242.

An incident to the purchase of any article, whether patented or unpatented, is the right to use and sell it, and upon familiar principles 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. . . . Sale of a lens blank by the patentee or his licensee is thus in itself both a complete transfer of ownership of the blank, which is within the protection of the patent law, and a license to practice the final stage of the patent procedure. In the present case the entire consideration and compensation for both is the purchase price paid by the finishing licensee to the Lens Company.³²

Based on the fact that Univis had received its full pecuniary reward through royalties generated by sale of the blanks, the Court ruled that Univis could not lawfully impose price restrictions on sale and resale of finished lenses without violating Section 1 of the Sherman Act.³³

Univis, as an antitrust decision, reflects an earlier era when the Court's antitrust jurisprudence was far less grounded on sound economic principles than it is today. If *Univis* were before the Court today, the facts would likely be viewed in much the same way as those in *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*³⁴ Univis had developed an advanced technology for creating multifocal lenses for use in glasses. It believed, as did the defendant in *Leegin*, that the best way to market its lenses was to control the quality of production from glass blanks to finished lenses and also to maintain healthy margins as incentives for lens grinders and retailers to maintain and emphasize the quality of the product delivered to patients and to provide related fitting services. As in *Leegin*, there was no danger that the pricing policy would cause any lessening of consumer welfare or diminished output because Univis had no more than a 3 percent share of the market for multifocal lenses. Indeed, Univis had adopted its pricing policy primarily as a way of increasing its market share and therefore its contribution to the total output. To whatever extent the Supreme Court believes that *Univis* stands as an obstacle to simplification and rationalization of the law on exhaustion, it should overrule *Univis*, leaving to rule of reason analysis any antitrust inquiry into the competitive impact of license restrictions.

A footnote in the United States' brief suggests that the SG's principal concern in the Federal Circuit's approach to the exhaustion doctrine lies in the danger that it expands the "scope of the patent defense" and thereby limits application of "rule-of-reason analysis to resale price maintenance agreements involving patented goods."³⁵ No citation is offered for this point and none is apparent. To the extent that a patent license raises antitrust concerns, nothing in the *Mallinckrodt*

³² *Id.* at 249–50.

³³ Importantly, only one of several patents owned by Univis was used in making each lens blank and finishing it into the final consumer product. *Id.* at 248 ("As appellees concede, the invention of only a single lens patent is utilized in making each blank and finishing it as a lens. We therefore put to one side questions which might arise if the finisher of a particular lens blank utilized the invention of some patent other than the patent which was practiced in part by the manufacture of the blank."). This is a significant issue today because companies may have multiple patents on different aspects of their technology. It would be counterproductive to require patent owners, however, wishing to structure their licenses around an unyielding application of the exhaustion doctrine, separately to patent different aspects and uses of an invention.

³⁴ 127 S. Ct. 2705 (2007). In *Leegin*, the Supreme Court abandoned the use of per se illegality to analyze a vertical restraint imposed by a manufacturer on the minimum resale price for its goods. *Cf. County Materials Corp. v. Allan Block Corp.*, 2007 U.S. App. LEXIS 22216, at *12 (7th Cir. Sept. 18, 2007) (observing that "[m]ost of the [misuse case law] on which County Materials relies come from an era before the Supreme Court recognized the efficiencies that might flow from vertical restrictions, which is the type of restriction we have when a patent owner (which does not compete in the manufacturing sector) imposes restraints on a manufacturing licensee").

³⁵ Brief for the United States as Amicus Curiae Supporting Petitioners at 14 n.5, *Quanta Computer, Inc., v. LG Elecs., Inc.*, No. 06-0937 (U.S. Nov. 2007).

decision precludes anyone from raising them.³⁶ Indeed, in *Mallinckrodt* the Federal Circuit observed that competitive effects outside the reach of the patent claims would be reviewable under a rule of reason antitrust analysis, but added that a patent owner should not be worse off than one selling unpatented goods merely because its goods are covered by a patent.³⁷

A number of the briefs filed on behalf of petitioner, including that of the United States, emphasize that the microprocessors at issue in the infringement allegations have no use other than as components of a larger system. Whether or not this is correct, it is irrelevant to whether there should be a per se exhaustion rule. Although the customer's inability to use a product without a further license from the patent holder might be probative of whether the totality of facts surrounding a given transaction show an *implied* license, where there are *express* provisions limiting the ability of purchasers to use the product without a further license, the absolute rule urged by the SG and the *Quanta* defendants runs contrary to basic principles of contract law.

Another argument made implicitly in the SG's brief, and made more explicit in recent articles on the exhaustion doctrine, addresses the commercial fairness of allowing a patent owner to exact its compensation at multiple levels of the commercial process.³⁸ This is really just a disguised way of saying that the patent owner should be required to take less for its technology than what the market is willing to pay. Such a result would be inconsistent with how Congress intended the patent system to operate, allowing inventors to derive pecuniary rewards for their discoveries and innovations from the free market.

Conclusion

The issues in *Quanta* are important. However the Court chooses to tackle the exhaustion question, the effort is likely to have far-reaching implications for the way in which patent property (and to a lesser extent copyrighted property) is exploited. One hopes that the commercial realities of today's global economy and current economic learning will guide the Court's work. A return to first principles is likely to be more useful in the long run than an opinion that tries to reconcile the multitude of conflicting outcomes and rationales that one finds in a century and a half of exhaustion cases. And while per se rules may provide unmistakable bright lines to parties structuring their transactions, such rules needlessly diminish commercial flexibility and complicate the ability of at least some patent owners to maximize the value of their inventions. ●

³⁶ *Mallinckrodt, Inc. v. Medipart, Inc.*, 976 F.2d 700, 703 (Fed. Cir. 1992) ("The conditions of such waiver are subject to patent, contract, antitrust, and any other applicable law, as well as equitable considerations such as are reflected in the law of patent misuse.").

³⁷ *Id.* at 708 ("Patent owners should not be in a worse position, by virtue of the patent right to exclude, than owners of other property used in trade."). See generally U.S. Dep't of Justice & Federal Trade Comm'n, Antitrust Guidelines for the Licensing of Intellectual Property §§ 5-6 & Ex. 7 (1995), available at <http://www.usdoj.gov/atr/public/guidelines/0558.pdf>. Numerous examples exist of successful enforcement actions involving products covered by intellectual property rights. See, e.g., *United States v. Microsoft Corp.*, 253 F.3d 34 (D.C. Cir. 2001) (affirming findings of monopolization in market for copyrighted software); *United States v. General Elec. Co.*, 1999-1 Trade Cas. (CCH) ¶ 72,399 (D. Mont. 1999) (defendant enjoined from restricting competition from licensees of medical equipment software); *Summit Tech. Inc. & VISX Inc.*, FTC Docket No. 9286 (1998) (patent pool that combined competitive technology for photorefractive keratectomy ordered dismantled), available at <http://www.ftc.gov/os/1999/03/d09286summit.do.htm> & <http://www.ftc.gov/os/1999/03/d09286visx.do.htm>.

³⁸ See, e.g., Mark R. Patterson, *Contractual Expansion of Patent Infringement Through Field of Use Licensing*, (Fordham Law Legal Studies Research Paper No. 946413, Nov. 14, 2006), available at <http://ssrn.com/abstract=946413>. Mr. Patterson identifies a number of situations in which patent owners have employed restrictions on use, reuse, and resale to increase the profitability of their technology, including some in which he concludes that licenses actually increased the range of conduct that should be held to infringe. The authors have some difficulty understanding just how conduct that lies outside the scope of a patent claim can infringe. To the extent that patent licenses are used contractually to affect commerce outside the scope of what is patented, they must pass muster under a rule of reason antitrust analysis.