

CLIENT ALERT

Supreme Court Expands Exhaustion Doctrine and Restricts Patent Owners From Collecting Downstream Royalties

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Summary

On June 9, 2007, the United States Supreme Court issued its decision in *Quanta Computer, Inc. v. LG Electronics, Inc.*, limiting the ability of patent owners to demand downstream royalties from customers of licensees.

Background

The Court had long held that the initial unconditional sale of a patented article by a patent owner (or its licensee) terminated or “exhausted” all patent rights to that item. Under that doctrine, the purchaser of the article could use or resell the article as the purchaser pleased. In *Quanta*, LGE had licensed its patents to Intel to manufacture and sell microprocessors. LGE was demanding that Quanta, an Intel customer, obtain a separate license to use the Intel products to practice the patent claims covering the use of Intel’s microprocessor with other components. The Court was asked to decide whether the exhaustion doctrine terminates LGE’s rights so that Quanta does not need a license.

Expansion of Exhaustion Doctrine

In ruling against LGE, the Court clarified two issues and, as a result, expanded the exhaustion doctrine to cover situations in which the lower court, the United States Court of Appeals for the Federal Circuit, had previously allowed patent holders to exercise control after an initial transaction.

The first clarification by the Court deals with method (or process) patent claims. Many inventions, such as, for example, computer programs, can be patented either as articles (“a computer program that performs operations A, B, and C”) or as methods (“a method comprising performing operations A, B, and C”). The lower court had ruled that the doctrine of exhaustion applied only to patents for articles. The Supreme Court disagreed, holding that the doctrine of exhaustion also applies to method patent claims. Thus, under the exhaustion doctrine, LGE cannot require purchasers of Intel microchips to take licenses under its method patents (covering uses of the microchips) since Intel, the manufacturer of the microchips, itself has a license under those patents.

The Court also clarified that a sale can exhaust patent rights even though the sale is of something less than the entire invention – i.e., the patent claims cover more than the item sold. For example, LGE claimed the invention to include a novel microchip together with standard parts such as buses or a memory. Since Intel sold only the microchip, LGE argued that the sale did not exhaust its patent rights. As the Court explained, however, exhaustion applies if the item sold “sufficiently

embodies” the patent, even if it does not completely practice the patent. The Court gave as an example where “the only reasonable and intended use” of the item was to practice the patent and the item "embodied the essential features" of the invention. Thus, Intel’s sale of the novel microchips exhausted the patent rights even though to practice the entire invention the microchips had to be connected to buses or a memory.

Unanswered Question

Importantly, perhaps, the Court left open the question whether a patent owner can avoid exhaustion by expressly conditioning a license or sale, such as, for instance, by contractually forbidding a licensee to sell to certain specified customers or for certain specified uses. LGE had not crafted its license agreement to avoid the patent exhaustion doctrine. Although Intel had agreed to notify its customers that LGE had not licensed them, the agreement did not restrict Intel from making sales to unlicensed customers. It remains to be seen what contractual terms courts will approve to negate the exhaustion doctrine.

What Should You Do?

You may wish to have your Wolf Greenfield attorney review your current license agreements to advise whether any should be amended, if possible, in light of this decision. In the future, you may wish to give more attention to patent exhaustion when entering into license agreements.

For Further Information

Please contact your Wolf Greenfield attorney regarding any questions you may have concerning how this decision might affect your IP strategies.

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