No.

In the
Supreme Court of the United States

QUANTA COMPUTER, INC., QUANTA COMPUTER USA, INC., Q-LITY COMPUTER, INC., COMPAL ELECTRONICS, INC., BIZCOM ELECTRONICS, INC., SCEPTRE TECHNOLOGIES, INC., FIRST INTERNATIONAL COMPUTER, INC. AND FIRST INTERNATIONAL COMPUTER OF AMERICA, INC.,

PETITIONERS,

v.

LG ELECTRONICS, INC.,

RESPONDENT.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

Whether the Federal Circuit erred by holding, in conflict with decisions of this Court and other courts of appeals, that respondent's patent rights were not exhausted by its license agreement with Intel Corporation, and Intel's subsequent sale of product under the license to petitioners.

PARTIES TO THE PROCEEDING

Pursuant to Rule 14.1(b), the following list identifies all of the parties appearing here and before the Federal Circuit Court of Appeals.

The petitioners here and appellees and cross-appellants below are Bizcom Electronics, Inc., Compal Electronics, Inc., and Sceptre Technologies, Inc.; Quanta Computer, Inc., Quanta Computer USA, Inc., and Q-Lity Computer, Inc.; and First International Computer, Inc., First International Computer of America, Inc. The additional appellee below was Everex Systems, Inc.

The appellant and cross-appellee below and respondent here is LG Electronics, Inc.

RULE 29.6 STATEMENT

First International Computer, Inc. is the parent company of First International Computer of America, Inc. No other publicly held company owns 10% or more of the stock of either company.

Quanta Computer, Inc. is the parent corporation of Quanta Computer USA, Inc. and Q-Lity Computer, Inc. No other publicly held company owns 10% or more of the stock of any of those companies.

Compal Electronics is the 100% owner of Bizcom Electronics, Inc. Compal Electronics is the only publicly held company owning 10% or more of Sceptre Technologies, Inc.'s stock.

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The opinion of the U.S. Court of Appeals for the Federal Circuit (Pet. App. 1a-25a) is reported at 453 F.3d 1364. Three opinions of the district court are relevant. The first (Pet. App. 26a-51a) is unreported. The second (Pet. App. 52a-61a) is reported at 248 F. Supp. 2d 912. The third (Pet. App. 62a-81a) is unreported.

JURISDICTION

The Federal Circuit denied a petition for rehearing or rehearing *en banc* on September 1, 2006. Pet. App. 82a-83a. This Court has jurisdiction under 28 U.S.C. § 1254(1).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

"[W]hoever without authority makes, uses, offers to sell, or sells any patented invention, within the United States or imports into the United States any patented invention during the term of the patent therefor, infringes the patent." 35 U.S.C. § 271(a).

STATEMENT OF THE CASE

Respondent LG Electronics, Inc. ("LGE") purchased a portfolio of patents for [redacted] and now contends that those patents are infringed by every computer in the world, whenever microprocessors and chipsets are combined with generic components such as busses and memory. A year after its purchase, LGE resolved its standoff with Intel Corporation ("Intel") by negotiating a [redacted] license payment from Intel that gave Intel an unrestricted right to "make, use, [and] sell" products incorporating LGE's patents. LGE insisted, however, that Intel send a "notice" to its own customers purporting to inform them that Intel's license did not protect *them* from infringement suits if they actually used microprocessors or chipsets purchased from Intel in a computer. The district court correctly found that Intel had every right under its license to make and sell chips to petitioners—and that the only reasonable use of those products was to incorporate them into computers in the manner that LGE now contends is infringing.

Under the patent exhaustion doctrine that this Court has applied for more than 90 years—since *Henry v. A.B. Dick Co.*, 224 U.S. 1 (1912), was overruled by *Motion Picture Patents Co. v. Universal Film Manufacturing Co.*, 243 U.S. 502 (1917)—an authorized first sale of a patented article exhausts the patent owner's rights in that article, and nullifies any "conditions" that the patent owner has tried to attach to its use or resale. Beginning with its decision in *Mallinckrodt, Inc. v. Medipart, Inc.*, 976 F.2d 700 (Fed. Cir. 1992), however, the Federal Circuit has steadily eroded the exhaustion doctrine. In this decision the Federal Circuit held that exhaustion is entirely optional, and easily nullified by a "notice" announcing that the patent owner would prefer that it not apply. That is an unprecedented and extremely dangerous expansion of the patent monopoly, in direct conflict with numerous decisions of this Court.

This case is important on several levels. First, on these specific facts LGE is now holding the entire computer industry hostage for billions of dollars in duplicative royalties, on patents that under this Court's precedents have clearly been exhausted. Second, on a broader level the Federal Circuit's new jurisprudence of "notice" restrictions threatens to usher in a new era of servitudes and restraints on alienation running with chattels, by which patent owners attempt to suppress competition and control the use of patented goods after an authorized first sale. If LGE's tactics are not rejected now, they are likely to spread through the economy like the common cold—producing decades of litigation over "notice" restrictions stamped on sold goods such as "single use only," "for use only with Microsoft software," "cannot be resold for less than $1000," and anything else that patent owners can dream up.

Statement of Facts

The basic facts are undisputed. On May 3, 1999, LGE purchased a portfolio of more than [redacted] U.S. and foreign patents and patent applications for less than [redacted] in contemporary U.S. dollars. A4701.028; A4701.070-4701.079.[1] LGE contends that every computer that contains Intel chips infringes up to four of these patents. (LGE also contends that computers containing *non-Intel* chips infringe, but those computers are not at issue in this petition.)

Petitioners are original equipment manufacturers of computers and file servers, who purchase licensed microprocessors and chipsets from Intel and incorporate them into computers in exact accordance with the specifications they receive from Intel. Petitioners in no way modify the chips after purchasing them and, indeed, have no choice but to follow Intel's specifications because they have no way of knowing the specifics of the chips' internal designs, which Intel protects as trade secrets. Once Intel's chips are incorporated into them, the computers petitioners make are then sold in the U.S. and around the world to companies such as Dell, HP, IBM, and Gateway.

Under pressure from LGE's extraordinary infringement claims, on September 7, 2000 Intel agreed to pay LGE [redacted], in exchange for the complete and unrestricted right to make, use, sell, offer to sell, import or otherwise dispose of its own products free from LGE's patent claims. A3605-3632(§3.2); A3578.142-3578.143(¶¶6,7). The "make, use, [and] sell" phrasing is a term of art in patent law, which encompasses the entire scope of the exclusionary rights granted to a patent owner. Nonetheless, in a separate agreement with LGE, Intel agreed to send a "notice" to its own customers, purporting to inform them that they did not receive any "license" from LGE to use products purchased from Intel in any product made "by combining an Intel product with any non-Intel product." A3632. [redacted]

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[1] All citations to record evidence are to material in the Joint Appendix ("A") that was before the Federal Circuit.

[redacted]

Pursuant to its side agreement with LGE, and *after* many of the sales at issue here had already occurred, Intel sent the demanded "notice" letter to petitioners. LGE sued petitioners, alleging that they cannot actually use the computer chips they bought from Intel in any computer (even though the chips were made and sold under a valid license, and even though their use is the one called for by Intel's own specifications) without infringing LGE's patents. Petitioners have no way to evaluate that claim because, again, Intel protects the design and operation of its chips as a trade secret. LGE has also targeted more than 70 other major companies whom it insists must pay it a second round of royalties before they may use Intel chips in computers.

Proceedings Below

Between late 2000 and Spring 2001, LGE brought separate suits against petitioners in the United States District Court for the Northern District of California, alleging that petitioners (and another company with whom LGE has since settled) infringe six of LGE's patents on computer technology. The District Court consolidated all of the cases for pretrial purposes. Five of the original patents at issue (U.S. Patent Nos. 4,918,645, 4,939,641, 5,077,733, 5,379,379 and 4,926,419) relate to technology allegedly used in microprocessors and memory controllers made by Intel and its competitors. Following the Court's claim construction decision, LGE dropped its allegations of infringement with respect to U.S. Patent No. 4,926,419, leaving four Intel-related patents at issue. In the District Court, LGE contended that the essential features of these four patents are found in Intel's chips, and that the patents are infringed by merely combining Intel chips with generic components such as busses and memory.

On August 20, 2002, the District Court issued a carefully reasoned opinion and Order granting petitioners' motion for partial summary judgment of non-infringement on the ground that LGE's unrestricted license to Intel and Intel's subsequent sale of chips to petitioners exhausted LGE's rights to recover royalties with respect to those chips. Pet. App. 32a-45a. The district court found as a fact that, if LGE's broad infringement contentions were correct, there could be no reasonable use of Intel's chips that did not infringe LGE's patents. *Id.* at 45a-49a. Relying on the patent exhaustion doctrine discussed at length in this Court's decision in *United States v. Univis Lens Co.*, 316 U.S. 241 (1942), the District Court held that LGE's patent rights had been exhausted and that LGE's demand for additional royalties from petitioners was an impermissible attempt to extend the patent monopoly and obtain a double royalty on the same patents. *Id.* at 50a, 40a, 32a.

LGE requested reconsideration, and the District Court issued another Order on February 6, 2003, upholding the finding of exhaustion with respect to LGE's apparatus claims but holding that the *method* claims in those same patents were not exhausted even though they essentially covered the mere use of the device claimed in the exhausted apparatus claims. *Id.* at 57a-61a. It concluded that method claims could never be exhausted, relying on language from two Federal Circuit decisions, *Bandag, Inc. v. Al Bolser's Tire Stores, Inc.*, 750 F.2d 903, 924 (Fed. Cir. 1984), and *Glass Equipment Development, Inc. v. Besten, Inc.*, 174 F.3d 1337, 1341 n.1 (Fed. Cir. 1999). *Id.* at 61a.

In Spring 2004, petitioners moved for summary judgment of non-infringement. The District Court granted petitioners' motion in late 2004 and entered a final judgment against LGE in January 2005. LGE appealed each of the District Court's rulings to the Federal Circuit. Petitioners cross-appealed on several grounds, including the holding that LGE's method claims were not exhausted.

On appeal, petitioners argued, *inter alia*, that LGE cannot nullify the patent exhaustion resulting from LGE's unrestricted license to Intel and Intel's subsequent licensed sales to petitioners simply by having Intel notify petitioners, post-sale in some instances, that they do not receive a license from LGE to use the products purchased from Intel for their only reasonable use. Petitioners argued that, because LGE imposed no restrictions on Intel's rights to practice the licensed patents (and, indeed, explicitly recognized the applicability of the patent exhaustion doctrine in the license agreement), LGE cannot ignore the unrestricted license it granted to Intel and attempt to restrict the activities of Intel's *customers*.

The Federal Circuit reversed. It held that the patent exhaustion doctrine applies only to "unconditional" sales, and that the "notice" Intel agreed to send to its customers imposed a "condition" on the sale that the patent exhaustion doctrine would not apply. Pet. App. 5a-6a. The Federal Circuit implied that petitioners had agreed to such a "condition" by failing to object to Intel's "notice" under New York's version of the U.C.C. "battle of the forms" provision, *Id.* at 6a. (The Federal Circuit did not actually discuss New York law, or explain why New York law should govern). It also held that, even if the sales in question were not "conditional," the exhaustion doctrine would not apply to LGE's method claims because "the sale of a device does not exhaust a patentee's rights in its method claims." *Id.*

REASONS FOR GRANTING THE WRIT

This Court has consistently held for more than a century that no patent owner is entitled to more than one royalty on the sale of a patented article, and that an authorized first sale fully exhausts the patent owner's rights with respect to that article during its ordinary useful life. The patent owner's "monopoly remains so long as he retains the ownership of the patented article. But sale of it exhausts the monopoly in that article and the patentee may not thereafter, by virtue of his patent, control the use or disposition of the article." *Univis Lens*, 316 U.S. at 250. An authorized sale exhausts the patent owner's rights in any device patents infringed by the article itself, and in any method or combination patents that will be infringed by the only reasonable use of the sold article. "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." *Id.* at 249. Consistent with those principles, this Court has held that purchasers may not be sued for patent infringement for violating a "notice" that purports to restrict the usage or resale of goods after an authorized sale.

By contrast, a patent owner *may* place restrictions on manufacturing licensees. As this Court explained in 1926,

> [i]t is well settled ... that where a patentee makes the patented article and sells it, he can exercise no further control over what the purchaser may wish to do with the article after his purchase. It has passed beyond the scope of the patentee's rights. But the question is a different one ... when we consider what a patentee who grants a license to one to make and vend the patented article may do in limiting the licensee in the exercise of the right to sell.

United States v. Gen. Elec. Co., 272 U.S. 476, 489-90 (1926) (citations omitted). Just as a patent owner who manufactures its own product may decide to whom it will sell, a patent owner may (within limits imposed by antitrust and misuse law) tell its licensees which customers they may sell to—and may enforce knowing violations of such restrictions through infringement suits. *See, e.g., Gen. Talking Pictures Corp. v. W. Elec. Co.*, 304 U.S. 175, 181 (1938). A sale made in violation of a valid license restriction is not an authorized sale, and does not trigger exhaustion.

Unfortunately, this Court's early exhaustion cases are notoriously confusing, and this Court has not spoken to the issues for more than half a century. The distinction between *sales* and *licenses* has also been muddied by the advent of computer software. Because a new, potentially infringing, "copy" of computer software is created every time that software is loaded into memory, software must always be licensed, not sold. Software makers have taken advantage of the resulting opportunity to impose various use and resale restrictions in their licenses. But physical goods like cars and toasters and books cannot be burdened with "notices" providing that they may be used only in particular ways, or cannot be resold, because the patent exhaustion doctrine, and similar "first sale" doctrines in copyright and other areas of intellectual property law, prohibit restraints on use or alienation after a valid sale.

In a series of decisions beginning 14 years ago with *Mallinckrodt* and culminating here, the Federal Circuit has eviscerated all of these traditional distinctions. In this case it is undisputed that Intel *sold* microprocessors and chipsets to petitioners—*i.e.,* petitioners did not *license* anything. It is undisputed that all of those sales were fully authorized by LGE through the license it gave to Intel. The district court also correctly found that the sold products have no reasonable use that would not infringe the combination and method patents that LGE now seeks to enforce. On traditional principles, there has been an authorized first sale and LGE's patent rights are exhausted. Instead, the Federal Circuit held that the exhaustion doctrine applies only to "unconditional" sales, and that these sales were "conditional" because the circumstances indicated that LGE did not intend to convey an "implied license" to petitioners.

That holding is a nonsensical jumble of mismatched principles. Licenses may be conditional, but there has been no such thing as a conditional *sale* since this Court overruled *A.B. Dick* in 1917. Petitioners do not need a license, implied or otherwise, because LGE's patents have been exhausted. That is not a question of what LGE intended, but of the substantive scope of the patent monopoly. Exhaustion has never (until now) been just a default rule that patentees could opt out of by sending a "notice" to purchasers.

The *Mallinckrodt* decision and its progeny have been the subject of harsh scholarly criticism. One commentator pointed out that it "overrul[ed] a century of Supreme Court decisional law under the exhaustion doctrine." Richard H. Stern, *The Unobserved Demise of the Exhaustion Doctrine in U.S. Patent Law: Mallinckrodt v. Medipart*, 15 Eur. Intell. Prop. Rev. 460, 461 (1993). He was led to wonder whether "the Federal Circuit panel simply ha[d] its own notion of whether it or the Supreme Court is in charge?" *Id.* at 464. Another wrote that the Federal Circuit has "vitiate[d] a distinction between sale and license which had grown to be well accepted" and "create[d] a confusing *melange* in which exhaustion, misuse, and antitrust principles are all conflated although all have somewhat different origins and purposes." James B. Kobak, Jr., *Contracting Around Exhaustion: Some Thoughts About the CAFC's Mallinckrodt Decision*, 75 J. Pat. & Trademark Off. Soc'y 550, 554 (1993). Even Judge Gajarsa worried in print that this line of precedent from his own court could usher in a "conceptual collapse of contract law and property law." Arthur J. Gajarsa et al., *How Much Fuel to Add to the Fire of Genius? Some Questions About the Repair/ Reconstruction Distinction in Patent Law*, 48 Am. U. L. Rev. 1205, 1229-30 (1999) (capitalization altered).

The facts of this case illustrate the pernicious consequences of the Federal Circuit's new, optional version of the exhaustion doctrine. LGE purchased these patents as part of a portfolio of [redacted] different patents and patent applications, for which it paid less than [redacted]. Intel paid LGE approximately [redacted] for a license that gives Intel an unlimited right to practice the patents. LGE now contends that Intel's *customers* need to pay LGE again before incorporating those microprocessors and chipsets into computers—which is, of course, their only reasonable use. LGE contends that every computer in the world infringes these patents, and is attempting to shake down the entire computer industry for several billion dollars in duplicative licensing fees. If computer manufacturers relent and agree to purchase a license from LGE, LGE may next insist that they too send a "notice" informing consumers that they do not have any "implied license" from LGE, and must obtain a third license before turning any computer on. This is precisely the sort of mischief that the patent exhaustion doctrine has always been designed to prevent.

More broadly, the Federal Circuit's new jurisprudence threatens to kick off a new era of "notices" attached to sold goods. Obvious candidates include "single use only," "no use outside of Massachusetts," "no repair," "no resale," or "no resale for less than the price of purchase." Under the Federal Circuit's rule, patent owners may use such notices to extend territorial division and resale price maintenance schemes from distributors down to end consumers, and to eliminate competition from aftermarket resales of the patented good. Violation of such arbitrary restrictions will subject the consumer to the full range of damages available under the patent laws for infringement. The Federal Circuit has suggested that some notices may not be effective, if they are not "reasonably within the patent grant" or "venture[] beyond the patent grant and into behavior having an anticompetitive effect not justifiable under the rule of reason." *Mallinckrodt*, 976 F.2d at 708. Against the backdrop that traditional patent law would not have permitted *any* of these conditions, such vague caveats are (at best) an invitation to decades of wasteful litigation.

The Federal Circuit's holding in this case is flatly inconsistent with precedents of this Court and other courts of appeals, and expands the patent monopoly beyond all reasonable bounds. It threatens to entangle the free flow of commerce with restraints on the use and alienation of chattels that have not been permitted by this Court for almost 90 years. And the Federal Circuit's exclusive jurisdiction over patent appeals means that further percolation in the lower courts is now impossible. This Court's intervention is urgently needed.

I. UNDER THIS COURT'S PRECEDENTS, AN AUTHORIZED SALE EXHAUSTS THE PATENT OWNER'S RIGHTS IN THE SOLD ARTICLE

It has been clear since at least 1917 that an authorized first sale of a patented article exhausts the patent holder's rights in that article, and that "notices" purporting to reserve such rights are void. As one commentator put it:

> Until the Federal Circuit's *Mallinckrodt* decision, an unbroken line of Supreme Court and lower court precedents held that the patentee's patent right over a product that the patentee sold (or that a licensee authorised to make a sale sold) ended at the point of sale. Accordingly, a customer did not commit patent infringement by disobeying a notice, contract, or other "remote control" limitation that the patentee sought to impose on the use of goods that it had sold to the customer.

Stern, 15 Eur. Intell. Prop. Rev. at 461. The doctrine took several twists and turns during its early development, however, so an overview of this Court's cases is essential to understanding where the Federal Circuit has gone astray.

The tension and confusion in the early cases is illustrated by two decisions of this Court from 1873. In *Adams v. Burke*, 84 U.S. 453 (1873), widely regarded as the leading case on patent exhaustion, the owner of a patent on coffin lids granted exclusive territories to various dealers. When an undertaker purchased coffin lids within one territory and used them in another, the patent owner sued for infringement. This Court rejected that claim, holding that:

> in the essential nature of things, when the patentee, or the person having his rights, 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. The article, in the language of the court, passes without the limit of the monopoly. That is to say, the patentee or his assignee having in the act of sale received all the royalty or consideration which he claims for the use

> of his invention in that particular machine or instrument, it is open to the use of the purchaser without further restriction on account of the monopoly of the patentees.

Adams, 84 U.S. at 456 (footnote omitted).

On the other hand, in *Mitchell v. Hawley*, 83 U.S. 544 (1873), that same year, the defendants had bought patented machines from the patent owner's licensee. The seller's license agreement provided that he had no authority to "'dispose of, sell, or grant any license to use the said machines beyond the expiration' of the original [patent] term." 83 U.S. at 549. When the patent term was later extended and purchasers continued using the machines during the extension period, the patent owner sued them for infringement. This Court reasoned that patented goods may be sold "with or without conditions," *id.* at 548, and that because the licensee had no title or authority to grant any right to use the patent beyond the original term, purchasers from him could not have acquired such a right, *id.* at 550-51.

After *Adams* and *Mitchell* the exhaustion doctrine remained unsettled for decades. In *Keeler v. Standard Folding Bed Co.*, 157 U.S. 659 (1895), this Court considered an exclusive territories case very similar to *Adams*, with the wrinkle that the licensee *knew* that the purchaser intended to use the goods outside of his territory. This Court held that the seller's knowledge was irrelevant, and that a

> brief history of the cases shows that ... as 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.

157 U.S. at 666. This Court held that under patent law "one who buys patented articles of manufacture from one authorized to sell them becomes possessed of an absolute property in such articles, unrestricted in time or place." *Id.*

It noted that "[w]hether a patentee may protect himself and his assignees by special contracts brought home to the purchasers is not a question before us, and upon which we express no opinion." *Id.* But this Court emphasized that "[i]t is, however, obvious that such a question would arise as a question of contract, and not as one under the inherent meaning and effect of the patent laws." *Id.* That clarification appears to be inconsistent with *Mitchell*, which suggested that conditions imposed on end-users could be enforced *under the patent laws*, via suits for infringement.

The early cases were much less ambivalent about conditions imposed on *manufacturing licensees*, restricting the terms under which they were authorized to make and sell the product. In *Bement v. National Harrow Co.*, 186 U.S. 70, 91 (1902), for example, this Court stated that "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." In *Bement* this Court upheld a resale price restriction imposed on a manufacturing licensee. "The owner of a patented article can, of course, charge such price as he may choose, and the owner of a patent may assign it or sell the right to manufacture and sell the article patented upon the condition that the assignee shall charge a certain amount for such article." *Id.* at 93.

These cross-currents came to a head in *A.B. Dick* in 1912. The patentee sold a mimeograph machine stamped with a notice that said "This machine is sold by the A.B. Dick Co. with the license restriction that it may be used only with the stencil paper, ink, and other supplies made by A.B. Dick Company, Chicago, U.S.A." 224 U.S. at 11. A supplier who sold ink to a purchaser of the machine was sued for contributory infringement, and defended on the ground that the restriction was either invalid on exhaustion grounds or (as suggested in *Keeler*) at most enforceable only in an action for breach of contract. This Court rejected those arguments, and in the process recast the entire exhaustion doctrine as a waivable *implied license* to use the product. "If sold unreservedly the right to the entire use of the invention passes, because that is the implied intent; but this right to use is nothing more nor less than an unrestricted license presumed from an unconditional sale." *Id.* at 24. But this Court reasoned that "if the right of use be confined by specific restriction, the use not permitted is necessarily reserved to the patentee," and that "[i]f that reserved control of use of the machine be violated, the patent is thereby invaded." *Id.* at 24-25. So long as the purchaser had notice, this Court indicated (citing *Bement*) that virtually any condition imposed on purchasers would be upheld. *Id.* at 47. This Court viewed the restriction in *A.B. Dick* as a legitimate adjunct to the patent owner's strategy for capitalizing on his patent, which was apparently to sell the machines at cost and make money on the ink. *Id.* at 32.

The clear rule of *A.B. Dick* was, however, extremely short-lived. The next year, in *Bauer & Cie v. O'Donnell*, 229 U.S. 1 (1913), this Court held that a "notice" stating that the product "is licensed by us for sale and use at a price not less than one dollar" could not be enforced against retailers selling the product for less. This Court noted that it had refused to enforce similar notices under the copyright statute, on the ground that an authorized first sale of a book exhausts the copyright, *see Bobbs-Merrill Co. v. Straus*, 210 U.S. 339 (1908), and reasoned that "there is a strong similarity between and identity of purpose in the two statutes" in their implementation of the exclusive right to *sell* the patented or copyrighted good. *Bauer*, 229 U.S. at 12-13. This Court distinguished *A.B. Dick* as involving a restriction on the purchaser's right to *use*, which has no equivalent in the copyright statute. *Id.* at 13-15. It also dismissed as a "mere play on words" and "perversion of terms" the patent owner's attempt to cast the restriction as a limitation on *use* as opposed to *resale*. *Id.* at 16; *see also Straus v. Victor Talking Mach. Co.*, 243 U.S. 490, 498 (1917) (use notice was "a disguised attempt to control the prices of its machines after they have been sold and paid for").

The *A.B. Dick* rule was laid completely to rest in 1917 in *Motion Picture Patents*, in which a notice purported to restrict movie projectors to use only with film leased from the patent owner, and subject to "other terms to be fixed by the [patent owner]." 243 U.S. at 506. This Court stated that the issue, "which is arising with increasing frequency in recent years," was "the extent to which a patentee or his assignee is authorized ... to prescribe by notice attached to a patented machine the conditions of its use ..., under pain of infringement of the patent." *Id.* at 509. This Court noted that *A.B. Dick* and its predecessors had "led to an immediate and widespread adoption" of use restrictions, which had evolved in this case into "[t]he perfect instrument of favoritism and oppression." *Id.* at 515. This Court cited with approval the reasoning of *Bauer* that, by analogy to copyright, "the right to vend is exhausted by a single, unconditional sale." *Id.* at 516. But this Court abandoned *Bauer's* attempt to preserve the holding of *A.B. Dick* by distinguishing "use" rights from "vend" rights. "The statutory authority to grant the exclusive right to 'use' a patented machine is not greater, indeed it is precisely the same, as the authority to grant the exclusive right to 'vend'" the patented article. *Id.* This Court held that the notice was invalid, and that *A.B. Dick* was expressly overruled. *Id.* at 518. It also endorsed the earlier reasoning from *Keeler* that "[t]he extent to which the use of the patented machine may validly be restricted to specific supplies or otherwise by special contract between the owner of a patent and the purchaser or licensee is a question outside the patent law," and that any such right "must be derived from the general [contract law] and not from the patent law." *Id.* at 509 (citing *Keeler*, 157 U.S. at 659); *see also id.* at 513.

Although *Motion Picture Patents* indicated that "notice" restrictions imposed on *purchasers* are (by analogy to copyright) not enforceable through infringement suits, this Court remained receptive to explicit conditions imposed on manufacturing *licensees*. In *General Electric*, this Court explained that it was "well settled" that a patent owner "can exercise no future control over what the purchaser may wish to do with the article" after an authorized sale, but that "the question is a different one which arises when we consider what a patentee who grants a license to one to make and vend the patented article may do in limiting the licensee in the exercise of the right to sell." 272 U.S. at 489-90. This Court explained that *Motion Picture Patents* had overruled *A.B. Dick* but not *Bement,* and that the cases invalidating restrictions on purchasers did not apply to restrictions in manufacturing licenses. *Id.* at 493. Cases like *Bauer* and *Victor Talking Machine,* this Court wrote, "are only instances of the application of the principle of *Adams v. Burke* ... that a patentee may not attach to the article made by him, or with his consent, a condition running with the article in the hands of purchasers." *Id.* at 493-94.

In *General Talking Pictures* in 1938, this Court held that if a purchaser knowingly buys from a manufacturing licensee in violation of a restriction in the license, both the licensee and the purchaser may be sued for infringement. This Court explained that a sale that is not authorized by the license is not a sale "made under the patents," and that therefore the purchaser was not "a purchaser in the ordinary channels of trade" and exhaustion did not apply. 304 U.S at 180-81. This Court thus declined to consider whether a use restriction stamped on the product could have been enforced against an *authorized* purchaser. *Id.* at 182.

This Court's last significant pronouncement on the exhaustion doctrine is *Univis Lens.* Univis Lens owned several patents for making eyeglass lenses. It produced lens blanks, and sold them to three categories of licensees. Wholesalers ground the lenses and resold them to prescription retailers. Finishing retailers ground their own lenses, mounted them in glasses, and sold directly to consumers. Prescription retailers purchased ground lenses from wholesalers, mounted them into glasses, and sold them to consumers. Univis Lens had license agreements with all three groups that restricted to whom, and for how much, they could sell. It took all its profits from a 50-cent royalty on each lens blank it sold. 316 U.S. at 243-45. This Court held that the price restrictions in the licenses "derive[d] no support from the patent" and were invalid. *Id.* at 251.

This Court emphasized that "where the sale of the blank is by the patentee or his licensee ... to a finisher, the only use to which it could be put and the only object of the sale is to enable the latter to grind and polish it for use as a lens by the prospective wearer." *Id.* at 249. It explained that "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," *id.*, and that "sale of it exhausts the monopoly in that article and the patentee may not thereafter, by virtue of his patent, control the use or disposition of the article," *id.* at 250. This Court therefore held that the sale of the lens blanks to wholesalers and finishers exhausted the patent holder's rights. "[W]here one has sold an uncompleted article which, because it embodies essential features of his patented invention, is within the protection of his patent, and has destined the article to be finished by the purchaser in conformity to the patent, he has sold his invention so far as it is or may be embodied in that particular article." *Id.* at 250-51. *Univis Lens* remains the authoritative precedent from this Court on exhaustion.

II. THE FEDERAL CIRCUIT HAS EVISCERATED THE PATENT EXHAUSTION DOCTRINE

A. LGE's Patent Rights Have Been Exhausted

The Federal Circuit held in this case that LGE's patent rights were not exhausted because LGE's license to Intel, and Intel's sale to petitioners, were "conditional." The "condition" in question was LGE's purported reservation of the right to sue petitioners for infringement if they did not obtain a separate license from LGE. In other words, LGE authorized Intel to "make, use, [and] sell" its products subject to the "condition" that such sales would not exhaust LGE's patent rights as against downstream purchasers. That holding is inconsistent with *Univis Lens*. Indeed, the Federal Circuit has embraced the discredited reasoning of

A.B. Dick, which this Court overruled nearly a century ago.

It is undisputed that the products at issue—chipsets and microprocessors—were *sold* by Intel to petitioners under the authority of Intel's license from LGE. Neither LGE nor the Federal Circuit have ever suggested that Intel's sales to petitioners were unauthorized and constituted infringement, as in *General Talking Pictures.* The district court also correctly found that these products have no reasonable use that would not infringe the combination and method patents that LGE now seeks to enforce. The Federal Circuit did not disagree. "[U]pon 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." *Univis Lens*, 316 U.S. at 249. And the chips sold by Intel clearly embraced the "essential features" of the asserted patents, which LGE contends are infringed merely by combining the chips with generic components such as memory. *Id.* at 250-51. LGE's patent rights have actually been exhausted twice, because (as the Federal Circuit acknowledged) a license granting the complete right to "make, use, [and] sell" also "constitutes a sale for exhaustion purposes." Pet. App. 5a. (citing *United States v. Masonite Corp.*, 316 U.S. 265, 278 (1942)).

The Federal Circuit reasoned that exhaustion applies only after an "unconditional sale," *id.*, and that both of the sales here were "conditional" because Intel separately promised to send its customers a notice informing them that they were not licensed by LGE to use products purchased from Intel in combination with non-Intel components (i.e., for their only reasonable use). But that is flatly inconsistent with *Univis Lens.* The purchasers in *Univis Lens* were bound by explicit license agreements in which they made a variety of promises that restricted their use and resale of the patented goods. In the Federal Circuit's rubric, those sales were clearly "conditional." Nonetheless this Court held that all of those "conditions" were void because the patent owner had sold a component that was "capable of use only in practicing the patent," which "upon familiar principles ... is a relinquishment of the patent monopoly with respect to the article sold." 316 U.S. at 249. The notice sent by Intel to petitioners therefore purports to reserve rights in LGE that, as a matter of law, simply do not exist.

Even if "conditions" on the use of sold goods were sometimes enforceable, the Federal Circuit's reasoning in this case would be deeply flawed. Indeed, this decision illustrates the extent to which the Federal Circuit will distort legal principles in order to maximize patent rights.

First, a "condition" that purchasers not use a product for its only reasonable use is absurd and unconscionable. Even commentators friendly to permitting servitudes on chattels recognize that such restrictions could be justified only as a way to facilitate price discrimination between higher and lower valued uses. *See* Thomas Arno, *Use Restrictions and the Retention of Property Interests in Chattels Through Intellectual Property Rights*, 31 San Diego L. Rev. 279 (1994). A restriction purporting to bar usage of a product for its *only* reasonable use is a confession of contractual bad faith, and serves no social purpose whatsoever. This Court recognized as much in *Univis Lens*, when it held that a sale of the product necessarily exhausted any patent covering its sole reasonable use—even though the parties' actual agreements and expectations were plainly to the contrary.

Second, the first sale here (LGE's grant of a complete license to "make, use, [and] sell" to Intel) was not conditional at all, and even if it was, the conditions were satisfied. [redacted] Regardless, it is undisputed that Intel kept its promise.

Third, the second sale (from Intel to petitioners) was also unconditional. Perhaps recognizing that patent holders are no longer permitted to unilaterally restrict the usage of sold goods as a matter of patent law, the Federal Circuit strains to find a *contractual promise* by petitioners not to use the products without securing a license from LGE. But the district court correctly found that "Defendants' purchase of microprocessors and chipsets from Intel was in no way conditioned on their agreement not to combine the Intel microprocessors and chipsets with other non-Intel parts and then sell the resulting products," and that while the notice letter might negate the implication of an implied license it "is not sufficient to transform what would otherwise be the unconditional sale of the microprocessors and chipsets into a conditional one." Pet. App. 58a, 59a.

In cases like this, the Federal Circuit reflexively invokes the U.C.C. "battle of the forms" provision to find an enforceable contract, without actually examining the relevant state law. *See, e.g., Mallinckrodt*, 976 F.2d at 708 n.7. As commentators have pointed out, the Federal Circuit "can reach that result only by mutilating contract law." Julie E. Cohen & Mark Lemley, *Patent Scope and Innovation in the Software Industry*, 89 Cal. L. Rev. 1, 33-34 (2001).[2] But the more critical point is that even if there were a contractual promise by petitioners not to use these products for their only reasonable use, the enforceability and effect of that promise would—as explained in *Keeler* and *Motion Picture Patents*—be a question for general contract law. Breach of contract might give rise to an action for contract damages, but not for patent infringement. By suing for infringement the patentee is not seeking to enforce

[2] The Federal Circuit assumes that the patent holder is the accepting rather than offering party in the "battle of the forms," even though "the opposite conclusion seems more logical." 89 Cal. L. Rev. at n.130. It also ignores the statutory proviso that such terms become part of the contract only if they do not "materially alter" the bargain. *Id.* A promise not to use the product for its only reasonable purpose is clearly material. *See* Kobak, 75 J. Pat. & Trademark Off. Soc'y at 563 n.50. Petitioners buy these chips to incorporate them into computers, which are then sold; the idea that they can be retroactively liable for infringement because of a notice received *later* is outrageous, and clearly a material alteration.

any contract promise, but to rescind the authorized sale and proceed under what the law would have been absent the contract. But rescission requires a "material" breach, which under New York law means a breach "so substantial and fundamental as to strongly tend to defeat the object of the parties in making the contract." *Callanan v. Powers*, 199 N.Y. 268, 284 (1910). Obviously any such promise was not the principal "object" of the contract between Intel and LGE. And under basic principles of restitution and election of remedies, a party seeking rescission must also give up the benefits of the contract and attempt to restore the *status quo ante* so far as is possible. *See, e.g.*, Restatement (Second) of Contracts § 384 (1981). The Federal Circuit allows the patent holder to retain all of the benefits of its bargain while pretending that the license contract does not exist. That is wholly inconsistent with contract principles.

Finally, the Federal Circuit also held in this case that even if these sales *were not* "conditional," exhaustion would not apply to LGE's method patent claims because "the sale of a device does not exhaust a patentee's rights in its method claims." Pet. App. 6a. That too is inconsistent with *Univis Lens*. At least one of the patents held exhausted in *Univis Lens* was a pure method patent. *See United States v. Univis Lens Co.*, 41 F. Supp. 258, 262-63 (S.D.N.Y. 1941) (explaining that asserted U.S. Patent No. 1,869,769 covered "only a method for producing a lens to eliminate prismatic imbalance"), *aff'd in part and rev'd in part*, 316 U.S. 241 (1942). This Court's holding was that "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." 316 U.S. at 249.

The Federal Circuit's decision in this case represents an odd jumble of mismatched and poorly understood principles, the end result of which is to render this Court's decisions in *Univis Lens* and *Motion Picture Patents* dead letters—and to revive the legal regime this Court rejected in *A.B. Dick*.

B. The Federal Circuit's Exhaustion Jurisprudence Is Inconsistent With This Court's Precedents And Decisions Of The Other Courts of Appeals

The Federal Circuit's holding in this case is not a one-time error, but the culmination of a line of decisions that have steadily eroded the exhaustion doctrine and authorized patent owners to impose "notice" restrictions on sold goods.

The Federal Circuit's departure from the principles laid out in this Court's cases began in its 1992 *Mallinckrodt* decision. In *Mallinckrodt,* the patent owner sold a medical device called a "nebulizer" to hospitals, stamped with a "single use only" notice. The devices were in fact capable of multiple uses, and hospitals sent them to Medipart for reconditioning. The patent owner sued Medipart for infringement, and in a thoughtful opinion the district court examined this Court's precedents and correctly held that the "single use only" restriction was void on exhaustion grounds. *Mallinckrodt, Inc. v. Medipart, Inc.,* 15 U.S.P.Q.2d (BNA) 1113 (N.D. Ill. 1990), *rev'd in part, vacated in part, remanded by* 976 F.2d 700 (Fed. Cir. 1992). Mallinckrodt argued that under *General Talking Pictures* a patent owner may impose conditions on the sale of goods and enforce those conditions through infringement suits—and that contrary cases such as *Bauer, Motion Picture Patents,* and *Univis Lens* should be understood as antitrust decisions simply rejecting particular conditions as anticompetitive. *See id.* at 1118 ("Mallinckrodt urges that *Motion Picture Patents* is a tying case, plain and simple ...."). The district court rejected that interpretation, "not only because the[] language [of this Court's cases] suggests broader application, but because there is a strong public interest in not stretching the patent laws to authorize restrictions on the use of purchased goods." *Id.* at 1119. It concluded that regardless of "whether Mallinckrodt's 'Single Use Only' restriction might be enforceable on a legal theory other than patent infringement," such as breach of contract, it "is not enforceable under the patent laws." *Id.* at 1119-20.

The Federal Circuit reversed. It agreed with

Mallinckrodt that *Bauer*, *Motion Picture Patents* and *Univis Lens* established only "that price-fixing and tying restrictions accompanying the sale of patented goods were per se illegal. These cases did not hold, and it did not follow, that all restrictions accompanying the sale of patented goods were deemed illegal." *Mallinckrodt*, 976 F.2d at 704. The Federal Circuit stated that this Court's cases did not displace "the rule of contract law that sale may be conditioned," and that "[u]nless the condition violates some other law or policy (in the patent field, notably the misuse or antitrust law ...), private parties retain the freedom to contract concerning conditions of sale." *Id.* at 708. "The appropriate criterion is whether Mallinckrodt's restriction is reasonably within the patent grant, or whether the patentee has ventured beyond the patent grant and into behavior having an anticompetitive effect not justifiable under the rule of reason." *Id.*

As noted above, *supra* p. 9, commentators have been harshly critical of the *Mallinckrodt* decision. The Federal Circuit's reasoning in *Mallinckrodt* and subsequent cases (including this one) suffers from several serious flaws. First, it has essentially collapsed the patent exhaustion doctrine into the separate and distinct doctrine of *implied license*, which governs whether a sale of an article impliedly grants the purchaser a right to use that article in a manner that may infringe a patent. The implied license doctrine is somewhat broader and more factbound than exhaustion:

> Generally, when a seller sells a product without restriction, it in effect promises the purchaser that in exchange for the price paid, it will not interfere with the purchaser's full enjoyment of the product purchased. The buyer has an implied license under any patents of the seller that dominate the product or any uses of the product to which the parties might reasonably contemplate the product will be put.

Hewlett-Packard Co. v. Repeat-O-Type Stencil Mfg. Corp., 123 F.3d 1445, 1451 (Fed. Cir. 1997). Because implied license is an inference about the parties' contractual intent, it may be disclaimed through contract language. But a purchaser's implied right to practice patents covering any "reasonably contemplate[d]" use is very different from the related exhaustion principle that "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." *Univis Lens*, 316 U.S. at 249.

By permitting patent owners to "opt out" of exhaustion simply by expressing a desire that it not apply, the Federal Circuit has destroyed that distinction. Commentators have rightly warned that this shift "could signal the death of the exhaustion doctrine, at least in any case where the patentee is smart enough to unilaterally (or after the fact) characterize the sale as a limited license instead." Cohen & Lemley, 89 Cal. L. Rev. at 33-34; *see also* Stern, 15 Eur. Intell. Prop. Rev. at 461 (explaining that in *Mallinckrodt* a "century or more of exhaustion doctrine law was suddenly swept away, and the rule permitting limited-scope licenses swallowed up the exhaustion doctrine"). This is precisely the discredited reasoning of *A.B. Dick*, where a majority of this Court briefly embraced the notion that exhaustion was "nothing more nor less than an unrestricted license presumed from an unconditional sale." 224 U.S. at 24. This Court rejected that entirely contractual view of the exhaustion doctrine in *Motion Picture Patents*, and then again in *Univis Lens*. Again, it was perfectly clear from the conditional license agreements in *Univis Lens* that the patent owner in that case *did not* intend to grant its purchasers any right to use the lenses free of conditions. Nonetheless this Court held that the conditions imposed by the licenses were invalid because of the exhaustion doctrine.

Second, the Federal Circuit has essentially eliminated the traditional distinction between licenses and sales generally that this Court described as "well settled" as early as the *General Electric* case in 1926. 272 U.S. at 489-90. Properly understood, *General Talking Pictures* holds that breach of a condition in a manufacturing license permits an infringement suit against both licensee and purchaser, because exhaustion is triggered only by an *authorized* sale. That rule is necessary to maintain symmetry with the fact that a patent owner who chooses to manufacture its own products can always decide which customers to sell to, and which not to sell to. But under *Motion Picture Patents* and *Univis Lens*, breach of a condition imposed on a *purchaser* has no effect at all—at least not under the patent laws.

"The distinction between sales and manufacturing licenses can be very fine .... Nonetheless US case law has always maintained the distinction as critical." Stern, 15 Eur. Intell. Prop. Rev. at 462. Court of appeals cases pre-dating the Federal Circuit's creation correctly applied that distinction. For example, in *Hensley Equipment Co. v. Esco Corp.*, 383 F.2d 252, 263, *amended*, 386 F.2d 442 (5th Cir. 1967), the Fifth Circuit held that the "[p]atent monopoly is 'exhausted' by the first authorized sale of the patented item, and the patent law does not protect attempts by the patentee or his licensees to control use of the product after such sale." Therefore a manufacturer cannot "restrict persons to whom an article may be traded after the manufacturer has parted with dominion over it." *Id.* By contrast, the courts of appeals followed *General Talking Pictures* to hold that restrictions on the right to sell imposed on manufacturing licensees were enforceable. *See, e.g., In re Yarn Processing Patent Validity Litig.*, 541 F.2d 1127, 1135 (5th Cir. 1976) ("[T]he restrictions on sale were within the scope of the patent grant because they were applied to a manufacturing licensee and not a purchaser of the patented articles ...."), *cert. denied*, 433 U.S. 910 (1977); *Automatic Radio Mfg. Co. v. Hazeltine Research, Inc.*, 176 F.2d 799, 803 (1st Cir. 1949) (enforcing restriction against licensee, and noting that "[t]here may be circumstances under which a notice of restricted use would be inoperative and unenforceable as against subsequent purchasers, but that problem is not presented in the case at bar"), *aff'd*, 339 U.S. 827 (1950), *overruled on other grounds by Lear, Inc. v. Adkins*, 395 U.S. 653 (1969); *Armstrong v. Motorola, Inc.*, 374 F.2d 764, 774 (7th Cir. 1967) (permitting restriction on manufacturing licensee), *cert. denied*, 389 U.S. 830 (1967).

The Federal Circuit has nullified this long-standing distinction in patent law. *See, e.g.*, Kobak, 75 J. Pat. & Trademark Off. Soc'y at 554 (noting that *Mallinckrodt* "vitiates a distinction between sale and license which had grown to be well accepted"). It reads *General Talking Pictures* for the proposition that "conditions" imposed on *anyone* are enforceable through infringement suits, and distinguishes *Motion Picture Patents* and *Univis Lens* as antitrust cases holding only that particular conditions were anticompetitive. The Federal Circuit reached that result in *Mallinckrodt* by dismissing this Court's actual reasoning in those cases as "dicta." But "[w]hen the *Mallinckrodt* panel says that this is dictum, it is merely saying in a peculiar manner that it does not like the Supreme Court's reasoning and thinks that the Court should have held something else—that it should have reached its end result by a different conceptual route." Stern, 15 Eur. Intell. Prop. Rev. at 465. This Court explained clearly in *General Electric* that the exhaustion cases nullifying resale price restrictions, for example, *are not* antitrust decisions but instead "are only instances of the application of the principle of *Adams v. Burke* ... that a patentee may not attach to the article made by him, or with his consent, a condition running with the article in the hands of purchasers." 272 U.S. at 493-94; *see also* Kobak, 75 J. Pat. & Trademark Off. Soc'y at 555 (noting that the Federal Circuit "ignored completely the gloss given to the price restriction cases by the Supreme Court in *General Electric* and the clear distinction drawn by the Court between sales and licenses cases") (footnote omitted).

The distinction between sales and licenses has of course been blurred in recent decades by the ubiquity of "shrink wrap" or "click wrap" licenses imposing restrictions on the use of computer software. But such restrictions are permissible only because of the technical quirk that software purchasers also need a license to create new instances of the patented product whenever it is loaded into memory. The peculiarities of software should not be permitted to destroy the license/sale distinction throughout the law.

Finally, the Federal Circuit's new jurisprudence of notice restrictions muddles together important distinctions between patent and contract law—leading Judge Gajarsa to warn of a "conceptual collapse." The license conditions in *General Talking Pictures*, and the sale conditions permitted by *A.B. Dick*, were enforced against purchasers under the property law principle that a purchaser cannot receive greater title than his seller intended to convey. Even after it rejected the enforcement of such conditions under patent/property law, this Court acknowledged that there was still a separate question about whether conditions might be enforced by state contract law. *See, e.g., Motion Picture Patents*, 243 U.S. at 509; *Keeler*, 157 U.S. at 666. The Federal Circuit has now attempted to revive the enforcement of such conditions by invoking contract principles—hence its contorted use of the U.C.C. here and in *Mallinckrodt*, and its occasional statement that exhaustion applies absent "a restriction having contractual significance," *Hewlett-Packard*, 123 F.3d at 1453, or an "express contractual undertaking by the purchaser," *Jazz Photo Corp. v. ITC*, 264 F.3d 1094, 1108 (Fed. Cir. 2001), *cert. denied*, 536 U.S. 950 (2002). But contractual enforcement must proceed under actual contract law—including contract damages and rescission principles, privity limitations, and a genuine analysis of the state law of offer and acceptance rather than the Federal Circuit's absurd pretense that any letter mailed to a consumer becomes an enforceable contract under the U.C.C. "battle of the forms." *See supra* pp. 6, 20 and note 2. No genuine contract analysis could bear the weight the Federal Circuit has tried to put on it: reviving the *A.B. Dick* rule that purchasers violating a use-restricting "notice" may be sued *for patent infringement*.

The Federal Circuit tries to justify its holdings by arguing that "[p]atent owners should not be in a worse position, by virtue of the patent right to exclude, than owners of other property used in trade," and invoking a supposed "rule of contract law that sale may be conditioned." *Mallinckrodt*, 976 F.2d at 708. But ordinary contract law does not permit a manufacturer to stamp use-restricting "notices" on goods and enforce them against downstream purchasers. That would be a servitude or restraint on alienation running with chattels, and therefore necessarily a creature of *property* not contract law. Such restrictions have been disfavored by the law for centuries. In fact the Federal Circuit has given patent owners vastly greater rights to continue to restrict the subsequent use and disposition of sold goods than are enjoyed by sellers of ordinary goods, or even of other forms of intellectual property. *See, e.g.*, Kobak, 75 J. Pat. & Trademark Off. Soc'y at 562.

III. THIS CASE RAISES QUESTIONS OF NATIONAL IMPORTANCE

The Federal Circuit's decision in this case, and its broader patent exhaustion jurisprudence, raise issues of vital national importance that merit review by this Court.

On its own facts, this case involves an attempt by LGE to hold the entire international computer industry hostage for billions of dollars in royalties for incorporating Intel chips into their products—even though Intel has already paid LGE for an unrestricted license; even though Intel's products have no other reasonable use; and even though this Court has always held that "[p]atentees ... are entitled to but one royalty for a patented machine," and therefore "when a patentee has ... authorized another to construct and sell it ... and the consideration has been paid to him for the right, he has then to that extent parted with his monopoly, and ceased to have any interest whatever in the machine so sold ...." *Bloomer v. Millinger*, 68 U.S. 340, 350 (1864). Other patentees are waiting eagerly to see if this maneuver is permissible. LGE itself could replicate it by negotiating a license settlement with petitioners and other manufacturers that requires them to send a similar "notice" to consumers, and then demanding a *third* round of royalties. The core purpose of the exhaustion rule has always been to prevent such vexatious demands. In circumstances like these, it reduces transaction costs by forcing one negotiation, up front, with the first purchaser. As this Court explained in *Keeler*, enforcing exhaustion "does not deprive a patentee of his just rights, because no article can be unfettered from the claim of his monopoly without paying its tribute. *The inconvenience and annoyance to the public that an opposite conclusion would occasion are too obvious to require illustration.*" 157 U.S. at 666-67 (emphasis added).

The Federal Circuit's remarkable new holding in this case that method claims can never be exhausted will also wreak havoc with commerce and the inventing community. Most patents include method claims; indeed, almost any device invention can also be described as a method of using that device, and most are. If method claims are now exempt from exhaustion, there will be an explosion of infringement suits seeking a second round of royalties from persons who (like petitioners) purchased goods and paid full price for them expecting that the patentee's claims were satisfied. Indeed, virtually all companies and consumers are likely infringing scores of patents under this reasoning.

More broadly, the Federal Circuit's decision threatens to usher in a new era of patent owners attaching "notices" to sold goods that purport to impose use restrictions that "run with" the sold articles. They will attempt to eliminate aftermarket competition by imposing "no resale" or resale price maintenance restrictions that follow the product throughout its lifetime. They will eliminate the purchaser's traditional right to repair the patented good (and nullify patent law's careful distinctions between permissible repair and impermissible reconstruction, *see, e.g., Aro Mfg. Co. v. Convertible Top Replacement Co.*, 377 U.S. 476 (1964)) with "no repair" or "single use only" restrictions, as in *Mallinckrodt*. They will try "field of use" restrictions facilitating territorial division or price discrimination schemes, enforced by the full weight of patent law.

There will be years and perhaps decades of litigation over whether particular "notices" are enforceable. The

Federal Circuit has said that "[t]he appropriate criterion is whether [the] restriction is reasonably within the patent grant, or whether the patentee has ventured beyond the patent grant and into behavior having an anticompetitive effect not justifiable under the rule of reason." *Mallinckrodt*, 976 F.2d at 708. As applied by the Federal Circuit, that test is meaningless and circular. *No* restrictions on use or resale of the product after an authorized first sale are "within the patent grant" under well-settled traditional law. What the Federal Circuit likely means is that any condition that does not violate the antitrust laws will be permissible—but even that supplies no coherent limiting principle, because under antitrust law patentees are permitted to do things that others are not.

> If one takes the CAFC at its word and abolishes the distinction between a restriction in a license and a restriction in a sales transaction, and if one then applies to sales conditions the never overruled logic of *General Electric*, *General Talking Pictures* and other license restriction cases—that is, that any restriction likely to maximize the patentee's reward should be considered as inherent in the patent right—virtually *any* restriction, including in theory even a resale price restriction, would be immune from challenge under either antitrust or misuse principles.

Kobak, 75 J. Pat. & Trademark Off. Soc'y at 560-61 (footnotes omitted). At a minimum, there will be great confusion and litigation before these rules are settled.

Because Federal Circuit has cast the breach of any such notice or restrictive covenant as an issue of federal patent infringement, it will have exclusive jurisdiction over any appeals and therefore has guaranteed that its extraordinary and unprecedented jurisprudence will govern the enforcement of such conditions everywhere in the country. *See id.* at 560. Only this Court can straighten out this mess.

CONCLUSION

The petition for certiorari should be granted.

Respectfully submitted,

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