No. 06-937

In the Supreme Court of the United States

QUANTA COMPUTER, INC., QUANTA COMPUTER USA, INC., Q-LITY COMPUTER, INC.,
PETITIONERS,

v.

LG ELECTRONICS, INC.,
RESPONDENT.

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

BRIEF FOR PETITIONERS

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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 24.1, 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 Quanta Computer, Inc., Quanta Computer USA, Inc., and Q-Lity Computer, Inc. The additional appellees below were Bizcom Electronics, Inc., Compal Electronics, Inc., Everex Systems, Inc., First International Computer, Inc., First International Computer of America, Inc., and Sceptre Technologies, Inc.

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

RULE 29.6 STATEMENT

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.

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OPINIONS BELOW

The opinion of 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).

STATUTORY PROVISIONS INVOLVED

The statutory appendix reproduces the relevant portions of the patent statutes.

STATEMENT OF THE CASE

This Court has held for more than a century 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." *Adams v. Burke*, 84 U.S. (17 Wall.) 453, 456 (1873). That "patent exhaustion" doctrine is triggered by any authorized sale of the patented article, or by the authorized sale of any "uncompleted article which, because it embodies essential features of his patented invention, is within the protection of his patent [and is] destined … to be finished by the purchaser in conformity to the patent." *United States v. Univis Lens Co.*, 316 U.S. 241, 250–51 (1942). After an authorized sale the patentee may enforce *contractual* promises it has obtained from the purchaser by suing for breach, but "may not thereafter, by virtue of his patent, control the use or disposition of the article" by suing for *patent infringement*. *Id.* at 250.

Respondent LG Electronics, Inc. ("LGE") gave Intel Corporation ("Intel") authority to sell microprocessors and chipsets that embody essential features of LGE's patents, that were within the protection of those patents according to LGE's own contributory infringement allegations, and that were inevitably destined to be combined by purchasers with generic memory chips and busses to make the combinations that LGE contends infringe. The District Court found, and the Federal Circuit did not disagree, that Intel's microprocessors and chipsets have no other reasonable use. LGE nonetheless claims a right to sue Intel's customers—and their customers, and their customers, down through the chain all the way to end consumers—for patent infringement, based on the theory that it did not convey an express or implied "license" to Intel's purchasers.

That claim confuses the statutory limits of the patent grant, as defined by the exhaustion rule, with the separate doctrine of "implied license." The Federal Circuit has embraced precisely the reasoning that this Court briefly adopted in *Henry v. A.B. Dick Co.*, 224 U.S. 1 (1912), which proved to be such a serious error that it was overruled only five years later in *Motion Picture Patents Co. v. Universal Film Manufacturing Co.*, 243 U.S. 502 (1917). If LGE wants to restrict the use of sold articles after an authorized sale, it must secure contractual promises *and enforce them under contract law* like any ordinary seller.

Statement of Facts

The basic facts are undisputed. On May 3, 1999, LGE purchased a portfolio of U.S. and foreign patents and patent applications. A4701.028; A4701.071–4701.079.[1] LGE contends in this case that every computer that contains Intel chips infringes three of these patents.[2] LGE also contends that computers containing *non-Intel* chips infringe, but those computers are not at issue here. Pet. App. 30a n.2.

Petitioners (together "Quanta") purchase microprocessors and chipsets from Intel and incorporate them into computers and file servers in exact conformance with Intel's specifications. Pet. App. 39a. The computers Quanta makes are then sold in the U.S. and around the world to companies such as Dell, HP, IBM, and Gateway. Quanta in no way modifies the chips after purchasing them. Quanta has no choice but to follow Intel's specifications because it has no way of knowing the specifics of the chips' internal designs, which Intel protects as trade secrets. A3706 ¶4; Dckt #448(4:3-5). As the District Court found, "[t]he failure to follow Intel's design specification would render [Petitioner's] computers

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[1] The confidential financial details of that purchase, and of LGE's subsequent cross-license with Intel, appear in the unredacted petition.

Citations to "A" refer to the Joint Appendix before the Federal Circuit, "Dckt" to the District Court record in case 4:01-cv-02187-CW, "Pet. App." to the Petition Appendix, and "JA" to the Joint Appendix before this Court.

[2] A3633–35; A3671–78; A3683–86; A3690–3702; *see also* Dckt #448(2:21–3:1) (LGE's allegations are directed at 146 products, each of which incorporates an Intel chipset, and the chipsets satisfy elements of LGE's asserted claims).

inoperable." Pet. App. 46a.

1. The patents and LGE's infringement claims

LGE claims that, by merely combining Intel's licensed chips with generic computer components (such as memory), Quanta's computers infringe three of LGE's patents, U.S. Patent Nos. 4,939,641 (the "'641 patent"), 5,077,733 (the "'733 patent"), and 5,379,379 (the "'379 patent"). A3679; Dckt #145 Ex. G (14), Ex. H (22). Understanding the relationship between the patented inventions and the products LGE licensed Intel to sell requires a brief review of the claims.

The asserted claims of the '641 patent describe a protocol to ensure memory coherency between a system's main memory and its cache memory. JA211(1:53–55), JA212(3:28–34). Cache memory is a high speed memory often closely associated with a computer system's microprocessor. Each of the Quanta products that LGE alleges infringes its patents uses an Intel microprocessor that includes cache memory "on chip." A3671, A3676. Memory coherency between a system's main memory and its cache memory is important because both the cache memory and the main memory may have data associated with the same memory address. JA211(1:31–35). When a device or component of a computer system requests data stored at a specific memory address, the '641 patent discloses a system in which a "cache memory" monitors the system bus[3] for read responses returning from main memory. JA214(7:17–20, 26–36). If the data

[3] A bus is simply a set of wires that connects the various components of a system and over which data, commands and addresses travel.

in the main memory is "stale" (i.e., the cache memory has data associated with a memory address that was more up to date), the cache memory will retransmit the up to date data to the requesting device. JA210(Fig. 10C), JA216(12:59–65). LGE's main allegations are that Quanta's products infringe claims 1 and 14 of the '641 patent. A3671–77; Dckt #1078(2:7-8). Claim 1 of the '641 patent is directed to a "central processing unit," which comprises a cache memory and which operates in the manner described above. A3671–72. Claim 14 is directed to the cache memory itself. A3676–77.

The '733 patent discloses a rotating priority system that permits computer components to alternate access to a "system bus." JA231(1:19–27). This priority or "arbitration" system acts as a traffic cop for components competing for access to a bus. JA231(1:19–27). LGE alleges that certain "chipsets" in Quanta's products are responsible for bus arbitration. A3683, A3686. Intel manufactures the chipsets used in most of Quanta's products.

The '379 patent, like the '641 patent, claims a system and method for ensuring that "stale" data is not retrieved from memory. JA255(1:23–33). The apparatus claims of the '379 patent are directed to a "memory control unit." A3690–93.[4] The '379's method claims are directed to the operation of the memory control unit.[5] A3694–97. LGE alleges that the

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[4] Claims 22 and 23 are no longer at issue. Dckt #1052 Ex. A (Tab 4).

[5] Quanta has consistently argued that the method claims in LGE's patents-at-issue merely cover the ordinary use of the device claimed in the apparatus claims of the same patents. Dckt

"memory control unit" in Quanta's products is a "chipset." A3690; Dckt #145 Ex. G (14), Ex. H (22). Intel supplies the chipsets in Quanta's accused computers. Pet. App. 2a. The invention disclosed in the '379 patent prevents the return of stale data from system memory by comparing the address of each read request coming into the memory control unit to see if it matches an address of a write request already buffered (or stored) in the memory control unit. If there is a match, the write request is executed first, so that what is read from memory is the most current data. Pet. App. 21a.

There is no genuine dispute that Intel's microprocessors and chipsets "embod[y] essential features of" each of LGE's combination or method patents. *Univis*, 316 U.S. at 250–51. The petition plainly asserted that "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." Pet. 18. LGE did not dispute that characterization in its opposition or supplemental filing, and hence has waived the right to do so. S. Ct. R. 15.2. That concession is plainly correct. All of the disputed patents relate to ways that Intel products use or communicate with generic computer components such as memory or busses, and the inventive aspects of the patented methods or combinations (such as bus

#360(5–10); Appellee Br. 32–36. LGE has never disputed this characterization. Under Patent and Trademark Office practice, a single patent can contain both method and apparatus claims only if those claims are directed to the same invention. *See* U.S. PTO, U.S. Dep't of Commerce, *Manual of Patent Examining Procedure* §806.05(e) (2006).

arbitration or ensuring consistency between cache and main memory) are executed within Intel's products. A3679; Dckt #145 Ex. G (14), Ex. H (22). The District Court found that LGE's infringement allegations "identify[] Intel chipsets as integral to [LGE's] infringement claims." Pet. App. 34a; *see also* Pet. App. 46a ("LGE claims that by incorporating the Intel microprocessors and chipsets into their computers in accordance with Intel's design specifications, Defendants infringe five of LGE's patents."). And throughout the course of a lengthy discovery dispute with Intel, LGE repeatedly assured the court that Intel's products "indisputably comprise key aspects of LGE's infringement contentions." Dckt #448(18:5); *see also* Dckt #951(15:19–20) (Intel's "products indisputably comprise key aspects of LGE's infringement contentions because they satisfy numerous claim limitations.").

If LGE's broad infringement allegations are accepted, Intel's microprocessors and chipsets are also "within the protection of [LGE's] patent[s]," and are "destined … to be finished by the purchaser in conformity to the patent." *Univis*, 316 U.S. at 250–51. LGE contends that Intel contributorily infringes its combination and method patents, and negotiated a licensing agreement with Intel on that basis. *E.g.*, JA143. And the District Court made a finding—undisturbed by the Federal Circuit—that Intel's microprocessors and chipsets have no reasonable use except to be combined into the various combinations that LGE claims are covered by its apparatus patents, or used in the ways that LGE claims are covered by its method patents. *See* Pet. App. 46a ("such use is the sole contemplated use for the devices"); Pet. App. 49a

("The microprocessors and chipsets at issue here cannot be disassembled and they cannot be used to carry out a non-patented function.").

2. The LGE-Intel license

Under pressure from LGE's infringement claims, on September 7, 2000 Intel agreed to a confidential cross-licensing deal that included the right to "make, use, sell (directly or indirectly), offer to sell, import or otherwise dispose of" its own products free from LGE's patent claims. JA145–173(§3.2(a)). 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. Accordingly, the District Court found that LGE's license to Intel was "unrestricted." Pet. App. 33a.

The Patent License Agreement contains a proviso that no license "is granted by either party hereto … to any third party for the combination by a third party of Licensed Products of either party with items, components, or the like acquired … from sources other than a party hereto, or for the use, import, offer for sale or sale of such combination." JA164(¶3.8). The next sentence provides, however, that "[n]otwithstanding anything to the contrary contained in this Agreement, the parties agree that nothing herein shall in any way limit or alter the effect of patent exhaustion that would otherwise apply when a party hereto sells any of its Licensed Products." JA164(¶3.8).

In a separate Master Agreement, not referenced in the Patent License Agreement, 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." JA198. That agreement also provides that "a breach of this Agreement shall have no effect on and shall not be grounds for termination of the Patent License." JA176(¶1).

3. Intel's sales to Quanta

Quanta purchases an ongoing stream of microprocessors and chipsets from Intel. Pursuant to its agreement with LGE, and *after* many of the sales at issue here had already occurred, Intel sent the demanded "notice" letter to Quanta. Pet. App. 60a; JA143–44. The record does not reveal Quanta's response to that notice, but there is no evidence that Quanta made any promise to Intel that it would limit or restrict its use of Intel's chips. The District Court found that "[Quanta's] purchase of the microprocessors and chipsets from Intel was unconditional, in that [Quanta's] purchase … was in no way conditioned on [its] agreement not to combine the Intel microprocessors and chipsets with other non-Intel parts and then sell the resultant products." Pet. App. 58a. LGE's complaint does not include a breach of contract claim.

Although Quanta has been arguing for years that LGE's infringement claims are barred by exhaustion because Intel's sales to Quanta were authorized, LGE also has never contended that *Intel* breached any contractual or license obligations owed to LGE.

Proceedings Below

Between late 2000 and Spring 2001, LGE brought separate infringement suits against Quanta and several other companies (which have since settled). The District Court consolidated 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.[6] LGE dropped its allegations with respect to U.S. Patent Nos. '419 and '645, leaving three patents at issue: the '733, '641, and '379 patents.

The District Court granted Quanta's motion for partial summary judgment on the ground that Intel's authorized sale of chips exhausted LGE's patent rights. 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. Pet. App. 45a–49a. It also found that Quanta had "purchased essential components of LGE's patented devices from a licensed source of those components." Pet. App. 59a. Relying on *Univis*, it held that LGE's patent rights had been exhausted and that LGE was improperly attempting to obtain a double royalty. Pet. App. 50a, 40a, 32a.

On reconsideration, the District Court upheld its finding of exhaustion with respect to LGE's apparatus claims but held 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. Pet. App. 57a–61a. It concluded that method claims could never be exhausted, relying on language from two Federal

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[6] U.S. Patent No. 5,892,509 was never relevant to exhaustion, and LGE has dismissed its claims based on that patent.

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). Pet. App. 60a.

Quanta subsequently moved for summary judgment of non-infringement. The District Court granted Quanta's motion and entered final judgment against LGE in January 2005. A0109–0114. LGE appealed to the Federal Circuit. Quanta cross-appealed on several grounds, including the holding that LGE's method claims were not exhausted.

The Federal Circuit reversed. It held that the patent exhaustion doctrine applies only to "unconditional" sales, and that these sales were "conditional" because LGE did not intend to convey any "license" to purchasers. Pet. App. 5a–6a. The Federal Circuit implied that Quanta had somehow agreed to such a "condition" under the U.C.C. Pet. App. 6a. It also held that, even if the sales in question were not "conditional," "the sale of a device does not exhaust a patentee's rights in its method claims." Pet. App. 6a.

SUMMARY OF THE ARGUMENT

"[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," the patentee "has sold his invention so far as it is or may be embodied in that particular article." *Univis*, 316 U.S. at 250–51. If LGE's broad infringement allegations are accepted, the microprocessors and chipsets that LGE authorized Intel to sell plainly embody essential features of LGE's patents, were within the protection of those patents, and were inevitably destined to be combined by purchasers with generic memory and busses in the manner that LGE now contends is infringing. The District Court correctly found that these products have no other reasonable use. Under long-settled precedents of this Court, therefore, LGE's patent rights are exhausted. LGE's "monopoly remains so long as [it] 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." *Id.* at 250.

LGE claims that the "notice" letter it had Intel send to Quanta preserved its ability to sue for infringement, by specifying that Intel's sales would not have the statutory consequence (exhaustion) that this Court has always held an authorized sale will have. The Federal Circuit agreed, holding that exhaustion is triggered only by "unconditional" sales, and that these sales were "conditional" because LGE did not intend to convey an "implied license" to Quanta. In prior cases the Federal Circuit has clarified that it believes such "conditions" are enforceable so long as they do not "venture[] beyond the patent grant and into behavior having an anticompetitive effect not justifiable under the rule of reason." *Mallinckrodt, Inc. v. Medipart, Inc.*, 976 F.2d 700, 708 (Fed. Cir. 1992).

That reasoning is a jumble of mismatched principles. The Federal Circuit has "creat[ed] 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). Patent licenses can indeed carry conditions, and breach of those conditions can justify an infringement suit, but that is only because a license is needed to immunize conduct that would otherwise be infringement. Quanta does not need a license (express or implied) because LGE's patent rights have been exhausted. That is not a question of what LGE intended, but of the statutory scope of the patent grant. In traditional terms, *no* restriction after an authorized sale is "reasonably within the patent grant." And nothing about these principles turns on whether a post-sale restriction is *anticompetitive*. The point of the exhaustion doctrine is that "[b]y a valid sale and purchase the patented machine becomes the private individual property of the purchaser," and "is no longer specially protected by the laws of the United States." *Bloomer v. Millinger*, 68 U.S. (1 Wall.) 340, 351 (1864).

This Court has repeatedly invalidated attempts by patentees to reserve or extend their statutory rights after an authorized sale. "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." 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). "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." *Id.* In

Motion Picture Patents, for example, this Court held that a patent owner could not enforce a notice telling the purchaser that additional royalties would be owed at a later date and that the machine could only be used with the patentee's supplies. 243 U.S. at 518. *Univis* held that resale price restrictions in "license" agreements signed by purchasers were purely contractual and "derive[d] no support from the patent" because the sale exhausted the patentee's statutory rights. 316 U.S. at 251. To our knowledge the *only* case in which this Court has ever permitted a patent owner to sell goods while reserving the statutory right to sue for infringement if certain conditions are not met is *A.B. Dick*, which embraced a conflation of exhaustion and "implied license" identical to what the Federal Circuit has done here. *A.B. Dick* was overruled by this Court 90 years ago.

Like any ordinary seller of goods, LGE may insist that purchasers sign contracts agreeing that they will make future payments to LGE, or use or resell the purchased goods only in certain ways. Such contracts would be enforceable, or not, under the ordinary rules of contract and antitrust law. The Federal Circuit's half-hearted ("*cf.*") suggestion that a contract might have been formed here under U.C.C. §2-202 is both wrong and irrelevant—since that would at most entitle LGE to sue for *breach*, not *infringement*. What LGE wants (and the Federal Circuit has authorized) here is a rule of property, not contract, allowing patentees to impose servitudes or restraints on alienation running with chattels and enforceable with the full weight of patent law. Ordinary sellers of goods have no such powers, and Judge Gajarsa has correctly warned that these cases illustrate 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).

If there were any reason to change the traditional rule, then the impetus should come from Congress—which has legislated against the backdrop of this Court's exhaustion precedents for 150 years without expressing any discontent. Regardless, the exhaustion principle makes sound economic and policy sense. That rule minimizes transaction costs by forcing the patent owner to exact the full value of its patent rights in one negotiation with the first purchaser, which can then share the burden with the rest of the distribution chain by charging a higher price. Exhaustion also allows purchasers to trust that they have the right to use purchased goods, at least for their only reasonable use. It "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." *Keeler v. Standard Folding Bed Co.*, 157 U.S. 659, 666–67 (1895). And "[t]he inconvenience and annoyance to the public that an opposite conclusion would occasion are too obvious to require illustration." *Id.* at 667.

ARGUMENT

I. AN AUTHORIZED SALE OF A PRODUCT THAT EMBODIES ESSENTIAL FEATURES OF THE PATENT AND HAS NO REASONABLE NON-INFRINGING USE EXHAUSTS THE PATENT

This Court's exhaustion cases recognize important but subtle distinctions—between sales and "licenses," between authorized and unauthorized sales, and between patent and contract law—that the Federal Circuit has now abandoned or conflated.

A. An Authorized Sale Exhausts A Patentee's Statutory Rights

Patent law grants the patentee the "right to exclude others from making, using, offering for sale, or selling the invention." 35 U.S.C. §154(a)(1). But when a patented invention "passes to the hands of the purchaser," it "passes outside" the scope of the patentee's rights and is no longer governed by patent law. *Bloomer v. McQuewan*, 55 U.S. (14 How.) 539, 549 (1853). That interpretation of the statutory scope of the patent grant derived from background property law rules, as well as the principle that "[p]atentees … are entitled to but one royalty for a patented machine." *Millinger*, 68 U.S. at 350. 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 …." *Id.*

In the leading early exhaustion case, *Adams*, the owner of a patent on coffin lids granted exclusive territories to various dealers. When an undertaker purchased coffin lids in one territory and used them in another, the patentee sued for infringement. This Court held 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.

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

In *Keeler*, this Court considered an exclusive territories case similar to *Adams*, but 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 "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 "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.*

The Federal Circuit's error in this case has its roots in a misunderstanding of *Mitchell v. Hawley*, 83 U.S. (16 Wall.) 544 (1873), which was decided the same year as *Adams*. The patentee granted a licensee "the exclusive right to make and use 'and to license to others the right to use the said machines'" in Massachusetts and New Hampshire for the original term of the patent. *Id.* at 548–49. But the license also provided that the licensee had no authority to "'dispose of, sell, or grant any license to use the said machines beyond the expiration' of the original term." *Id.* at 549. The licensee nonetheless sold the machines and the patentee sued the purchasers for infringement after the term of the patent was extended.

Consistent with *Adams*, this Court noted that sold goods "become the private individual property of the purchasers, and are no longer specifically protected by the patent laws." *Id.* at 548. But this Court permitted the infringement suit to proceed because the seller "was only a licensee and never had any power to sell a machine so as to withdraw it indefinitely from the operation of the franchise secured by the patent." *Id.* at 551. "Notice to the purchaser in such a case is not required, as the law imposes the risk upon the purchaser, as against the real owner, whether the title of the seller is such that he can make a valid conveyance." *Id.* at 550. The holding of *Mitchell* is that the licensee had no authority to sell, and the authorized transfer of title that triggers exhaustion did not occur.

In several passages that spawned later confusion, however, this Court explained that sales "may be made by the patentee with or without conditions, as in other cases, but where the sale is absolute, and without any conditions, the rule is well settled that the purchaser may continue to use" the article "until it is worn out, or he may repair it or improve upon it as he pleases, in same manner as if dealing with property of any other kind." *Id.* at 548. The Federal Circuit has now seized on that language to hold that patent owners can impose "conditions" on the use of sold goods and enforce them with infringement suits. But that misunderstands this Court's point.

Mitchell emphasized that patentees can engage in "conditional sales" only in the "same manner as if dealing with property of any other kind." *Id.* at 548. This Court's cases of that era recognized that as a matter of property law "restraints upon … alienation" after a valid sale "have been hateful to the law from Lord Coke's day to ours, because obnoxious to the public interest." *Straus v. Victor Talking Mach. Co.*, 243 U.S. 490, 501 (1917). Ordinary sellers of property generally *are not* entitled to impose use-restricting servitudes that run with the sold good (although they might, as noted in *Keeler*, negotiate a *contractual* use restriction with the purchaser). *See generally John D. Park & Sons Co. v. Hartman*, 153 Fed. 24, 39 (6th Cir. 1907) (such restraints "offend against the ordinary and usual freedom of traffic in chattels or articles which pass by mere delivery"); Thomas W. Merrill & Henry E. Smith, *Optimal Standardization in the Law of Property: The Numerus Clausus Principle*, 110 Yale L.J. 1, 18 & n.68 (2000) (noting that "American precedent is largely, if not quite exclusively, in accord" with the proposition that "one cannot create servitudes in personal property").

At the time *Mitchell* was decided a "conditional sale" was an "*agreement* to sell," in which a party does not convey title to the buyer until performance of a condition precedent.[7] Such transactions were more

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[7] *See, e.g.*, *Harkness v. Russell*, 118 U.S. 663, 666 (1886) (a conditional sale is "a mere agreement to sell upon a condition, to be performed"); *Fosdick v. Schall*, 99 U.S. (9 Otto) 235, 250–51 (1879) (a conditional sale is one "'with a right of rescission on the part of the vendor, in case the purchaser shall fail in payment of his installments'" (citation omitted)). Title vests, and the sale becomes "absolute," only upon the occurrence of a condition

common before the modern law of secured transactions, and they did not trigger exhaustion until the condition was performed and title transferred. But that principle does not permit sellers to impose conditions *subsequent* to the transfer of title, and enforce those conditions in a suit for conversion or trespass to chattels if the purchaser violates them.

This Court did briefly permit enforceable conditions subsequent under the patent laws. In *A.B. Dick* in 1912, the patentee sold a mimeograph machine stamped: "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 was sued for contributory infringement, and defended by arguing that the restriction was invalid on exhaustion grounds or 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

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precedent. *See, e.g., Conway's Ex'rs & Devisees v. Alexander*, 11 U.S. (7 Cranch) 218, 240–41 (1812) (conveyance of a deed with an option to repurchase was a conditional sale, which became absolute once the option period expired); *Southard v. Russell*, 57 U.S. (16 How.) 547, 566 (1854) (transaction could either be "a conditional sale to become absolute on the failure to refund the purchase-money within the time, or a security for the loan of money"); *Albright v. Teas*, 106 U.S. 613, 617 (1883) (party could not sue for patent infringement because he had sold "all his title and interest in the inventions covered by his patents" making "[t]he transfer … absolute and unconditional"); *Bailey v. Baker Ice Mach. Co.*, 239 U.S. 268, 271 (1915) (in a conditional sale the vendor remains the owner, subject to the vendee's right to acquire the title by complying with the stipulated condition, while in an absolute sale, the vendee immediately becomes the owner, subject to any lien created by the mortgagee).

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, "if the right of use be confined by specific restriction, the use not permitted is necessarily reserved to the patentee," and "[i]f that reserved control of use of the machine be violated, the patent is thereby invaded." *Id.* at 24–25. This Court viewed the tying restriction in *A.B. Dick* as a legitimate adjunct to the patentee's strategy for capitalizing on his patent, which was to sell the machines at cost and make money on the ink. *Id.* at 32.

The *A.B. Dick* rule was short-lived. The next year, in *Bauer & Cie v. O'Donnell*, 229 U.S. 1, 8 (1913), this Court held that a "notice" to purchasers stating that the sold product "is licensed by us for [re]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 exhausts the copyright, *see Bobbs-Merrill Co. v. Straus*, 210 U.S. 339, 350–51 (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 limited conveyance of the patentee's exclusive right to *use*, which has no equivalent in the copyright statute. *Id.* at 13–15. It also dismissed as a "mere play upon words" and "perversion of terms" the patent owner's attempt to cast the restriction in *Bauer* as a limitation on *use* as opposed to *resale*. *Id.* at 16; *see also Victor Talking Mach.*, 243 U.S. at 498 (use notice was "a disguised attempt to control the prices of its machines after they have been sold and paid for").

A.B. Dick was conclusively overruled 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] … (which other terms shall only be the payment of a royalty or rental …).'" 243 U.S. at 506 (emphasis omitted). 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* 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. It read *Bauer* to hold that "the right to vend is exhausted by a single, unconditional sale, the article sold being thereby carried outside the monopoly of the patent law and rendered free of every restriction which the vendor may attempt to put on it." *Id.* at 516. Obviously that sentence would make no sense if such attempted restrictions themselves prevented a sale from being "unconditional." As Justice Holmes's dissent clarified, a "conditional" sale is one "retaining the title until a future event after delivery." *Id.* at 520–21 (Holmes, J., dissenting) (citing *Bailey*, 239 U.S. at 272); *see supra* pp. 19–20 n.7.

The *Motion Picture Patents* Court abandoned *Bauer*'s attempt to distinguish *A.B. Dick* from the copyright precedents on the ground that "use" rights differ somehow 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. 243 U.S. at 516. As in *Bauer*, this Court analogized to copyright principles when reasoning that a good, after being "sold and paid for," could no longer be subject "to any restrictions or conditions as to use or royalty which the company which authorized its sale may see fit, after the sale, from time to time to impose." *Id.* at 515. This Court held that the notice was invalid, and that *A.B. Dick* was expressly overruled. *Id.* at 518.[8] It also endorsed *Keeler*'s reasoning 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*).

This Court's last significant pronouncement on exhaustion is *Univis*. Univis Lens owned several

[8] This Court has cited *A.B. Dick* a handful of times for principles inapplicable to this case, such as federal patent jurisdiction and contributory infringement. *See, e.g., Christianson v. Colt Indus. Operating Corp.*, 486 U.S. 800, 808 (1988); *Metro-Goldwyn-Mayer Studios, Inc. v. Grokster, Ltd.*, 545 U.S. 913, 932–33, 935 (2005); *id.* at 943 (Ginsburg, J., concurring). It has consistently recognized that *A.B. Dick*'s patent exhaustion holding has been overruled. *E.g., Dawson Chem. Co. v. Rohm & Haas Co.*, 448 U.S. 176, 191–92 (1980); *Metro-Goldwyn-Mayer*, 545 U.S. at 932, 943.

patents for making eyeglass lenses. It produced lens blanks, and sold them for 50¢ each to three categories of licensees. 316 U.S. at 243–45. 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 the processed blanks. When it was sued under the antitrust laws, Univis Lens argued that the resale price restrictions were immune from antitrust scrutiny because they were contained in a valid patent license. This Court held that the price restrictions in the licenses "derive[d] no support from the patent" because the patent owner's rights had been exhausted. *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. "[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," this Court reasoned, "he has sold his invention so far as it is or may be embodied in that particular article." *Id.* at 250–51.

This Court recently and unanimously reaffirmed the analogous "first sale" copyright doctrine discussed in *Bauer* and *Motion Picture Patents*. *See Quality King Distribs., Inc. v. L'Anza Research Int'l, Inc.* 523 U.S. 135 (1998). Once a lawful sale has occurred, even "unauthorized resales" do not constitute "an infringement of [the copyright owner's] exclusive right to distribute." *Id.* at 143. This Court explained that "[t]he whole point of the first sale doctrine is that once the copyright owner places a copyrighted item in the stream of commerce by selling it, he has exhausted his exclusive statutory right to control its distribution." *Id.* at 152. Just as with patent exhaustion, the first sale doctrine is based upon "the critical distinction between statutory rights and contract rights." *Id.* at 143.

B. Exhaustion Is Not An "Implied License" That Can Be Repudiated By The Patentee

Under the separate doctrine of "implied license," "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." *Hewlett-Packard Co. v. Repeat-O-Type Stencil Mfg. Corp.*, 123 F.3d 1445, 1451 (Fed. Cir. 1997), *cert. denied*, 523 U.S. 1022 (1998). "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." *Id.* Implied license thus grants broader rights than exhaustion, but can be disclaimed or limited. Courts have "frequently conflated the two doctrines," but "while patent exhaustion stems from inherent limits on the grant of the patent right, implied license is a doctrine of quasi-contract, and depends on the beliefs and expectations of the parties to the sales transaction." Julie E. Cohen & Mark A. Lemley, *Patent Scope and Innovation in the Software Industry*, 89 Cal. L. Rev. 1, 31–32 (2001).

In *A.B. Dick*, this Court briefly embraced the idea that exhaustion was "nothing more nor less than an unrestricted license presumed from an unconditional sale." 224 U.S. at 24. But this Court rejected that entirely contractual view of the exhaustion doctrine in *Motion Picture Patents*. And although this Court has used "implied license" language in some subsequent cases, a careful look at the holdings makes clear this Court did not intend to revive *A.B. Dick*.

It was perfectly clear in *Univis*, for example, that the patentee intended to restrict its purchasers' use or resale, and that the purchasers had expressly agreed to those restrictions. 316 U.S. at 244–45 (discussing restrictions). If exhaustion were merely a license implied in fact from a sale that could be limited or conditioned by contract, this Court would not have viewed the restrictions in *Univis* as an illegitimate attempt to extend the statutory monopoly—and would have reached the opposite result in that case.

Then, in the 1960s, this Court decided a pair of cases holding that purchasers from an authorized seller have an inherent right to repair patented goods. *Aro Mfg. Co. v. Convertible Top Replacement Co.*, 365 U.S. 336 (1961) ("*Aro I*"); *Aro Mfg. Co. v. Convertible Top*

Replacement Co., 377 U.S. 476 (1964) ("*Aro II*"). In *Aro II*, this Court did state that the "sale of a patented article by the patentee or under his authority carries with it an 'implied license to use.'" 377 U.S. at 484 (citing *Adams*, 84 U.S. at 456; *Univis*, 316 U.S. at 259, 250–51). But nothing in *Aro I* or *Aro II* suggests that this Court intended to bring back *A.B. Dick*'s optional version of the exhaustion doctrine. Indeed, the patentee in *Aro II* tried to restrict purchasers' right of use and repair, and this Court held those restrictions invalid under the "long line of this Court's decisions delimiting the scope of the patent grant," reiterating that after sale of an article "the patentee cannot thereafter restrict [its] use by imposing a condition that replacement parts may be purchased only from a licensed supplier." *Id.* at 497 (plurality opinion). This Court also explained in *Aro I* that a patentee "'cannot prevent those to whom he sells from … reconditioning articles worn by use unless they in fact make a new article.'" 365 U.S. at 343 (alteration in original). To the extent *Aro II* suggests that exhaustion may be conceived of as an "implied license," the license in question is clearly implied *in law*, and cannot be disclaimed.[9] Reading the "implied license" reference any other way would allow a patentee to "eliminate the right of repair by contract," which is inconsistent with the whole point of *Aro I* and *II*. Mark R. Patterson,

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[9] *See Dawson*, 448 U.S. at 186 (citing *Univis* and *Adams* for concession that purchaser of unpatented product can practice method patent "by virtue of an 'implied license' they obtained[ed] when [the patentee] relinquished its monopoly by selling" the product); *id.* at 184 (referring to same facts as "'implied' licenses conferred by operation of law"); *Leitch Mfg. v. Barber Co.*, 302 U.S. 458, 461 (1938) (upon purchase of product "law implies authority to practice invention").

Contractual Expansion of the Scope of Patent Infringement Through Field-of-Use Licensing, 49 Wm. & Mary L. Rev. 157, 195–97 (2007); *see also* Stern, *supra*, at 465.

The Federal Circuit's suggestion that "the exhaustion doctrine is *merely* an implied license that can be eliminated by the patentee … finds no support in *Univis* or in any other Supreme Court decision." Patterson, *supra*, at 203. It "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, *supra*, at 34.

C. Licenses Granted To Manufacturing Licensees Can Carry Enforceable Conditions

Although restrictions imposed on *purchasers* are not enforceable through infringement suits, this Court has permitted conditions imposed on manufacturing *licensees*, restricting the terms under which they are authorized to make, use and sell the product.

In *Bement v. National Harrow Co.*, 186 U.S. 70, 91 (1902), 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.

In *United States v. General Electric Co.*, 272 U.S. 476, 489–90 (1926), this Court stated 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." 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 (emphasis added).

In *General Talking Pictures Corp. v. Western Electric Co.*, 304 U.S. 175 (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. Since the sale was unauthorized, the purchaser was not "a purchaser in the ordinary channels of trade" and exhaustion did not apply. *Id.* at 180–81.

The *General Talking Pictures* principle is consistent with *Mitchell*, and with the sound observation in *Bement* that the patentee is free to decide who it wishes to sell to (and on what terms) if it manufactures the patented article itself. "Restrictions on the purchasers of patented goods, however, cannot be viewed as equivalent to [self-imposed] restrictions on the patentee itself." Patterson, *supra*, at 165.

D. Exhaustion Does Not Depend on Whether the Patentee's "Conditions" Would Otherwise Violate Antitrust or Misuse Principles

The Federal Circuit held in *Mallinckrodt* that *Bauer* and *Motion Picture Patents* 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. Treating patent exhaustion as nothing more than a species of competition or misuse law, the Federal Circuit held that "[t]he 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.* at 708. That test is incorrect and unworkable.

First, that is not what this Court's cases say. Misuse derives from the equitable doctrine of "unclean hands" and provides alleged infringers an affirmative defense where a patentee has extended his "monopoly" beyond its legal bounds until such time as the patentee has purged his misconduct. *See U.S. Gypsum Co. v. Nat'l Gypsum Co.*, 352 U.S. 457, 465 (1957); *Brulotte v. Thys Co.*, 379 U.S. 29, 32–33 (1964). Antitrust law is designed to foster competition by restricting unreasonable restraints of trade. But exhaustion defines the scope of the patent grant, as interpreted by this Court in light of general property law principles. Cohen & Lemley, *supra*, at 31; Kobak, *supra*, at 554. Although the exhaustion cases have often involved restraints with anticompetitive effects, this Court's reasoning has never rested on antitrust principles.

In *Bauer*, for example, this Court rejected a patentee's attempt to restrict resale prices based on the "line of cases in which this court from the beginning has held that a patentee who has parted with a patented machine by passing title to a purchaser has placed the article beyond the limits of the monopoly secured by the patent act." 229 U.S. at 17. The exhaustion doctrine in the cited "line of cases" did not turn on antitrust concerns. And later in *Boston Store v. American Graphophone Co.*, 246 U.S. 8, 23 (1918), this Court described *Bauer* as holding that a patent holder "could not use and exhaust the right to sell, as to which a monopoly was given him by the patent law, and yet by conditions and stipulations continue that law in effect so as to make it govern things which by his voluntary act were beyond its scope." It also explained that *Motion Picture Patents* simply "reiterat[ed]" the rule that after an authorized sale a patentee "could not, by qualifying restrictions as to use, keep under the patent monopoly a subject to which the monopoly no longer applied." *Id.* at 25. The Federal Circuit reached a contrary conclusion in *Mallinckrodt* by dismissing this Court's actual reasoning in these key 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, *supra*, at 465; s*ee also* Patterson, *supra*, at 167–71.

Second, the Federal Circuit's focus on anticompetitive effects is inconsistent with the result in several of this Court's cases. In *Motion Picture*

Patents, the sale was "not only" subject "to restriction as to supplies to be used," (the "tying" restriction), but also "subject to conditions as to use or *royalty to be paid*[,] to be imposed thereafter at the discretion of the patent owner." 243 U.S. at 515, 516 (emphasis added). The patentee sought to impose a royalty "upon the purchaser graduated by the size of the theater in which the machine was to be used." *Id.* at 518. Graduated royalties are common and only *anticompetitive* in unusual circumstances. But this Court drew no distinction between that restriction and the restraints on resale or tying. *Id.* at 516. Instead, it emphasized that a good, after being "sold and paid for" could no longer be subject "to any restrictions or conditions as to use or royalty which the company which authorized its sale may see fit, after the sale, from time to time to impose." *Id.* at 515.

In *General Electric* and *Bement*, this Court *upheld* price-fixing conditions because they were imposed through a limited licensing arrangement (not after an authorized sale). *E.g.*, *Gen. Elec.*, 272 U.S. at 489–91. If exhaustion turned on antitrust policy, those conditions should have been invalidated. Stern, *supra*, at 464–65 (if exhaustion hinged on antitrust concerns, this Court "would have held GE guilty of price-fix antitrust violations, instead of exonerating it"). Since there had been no sale, however, the patent monopoly saved the price-fixing restriction from antitrust scrutiny.

Similarly, the restrictions in *Univis* clearly violated the Sherman Act as then interpreted. As in *General Electric*, the patentee argued that its restrictions were lawful nevertheless because they were contained in a valid patent license. This Court rejected that argument only because it concluded that an authorized sale had exhausted the patent—and that the patentee's restrictions thus "derive[d] no support from the patent." *Univis*, 316 U.S. at 251–52.

Third, the Federal Circuit's test is circular and imposes no meaningful limits in practice. Whether a restriction is "within the patent grant" is precisely the question to be decided in exhaustion cases. On traditional principles *no* restrictions after an authorized sale are "within the patent grant," because the patentee's monopoly is exhausted. Once that bright line is abandoned there is no principled basis for distinctions. Indeed "as the requirement has in fact come to be interpreted" by the Federal Circuit, it "simply mean[s] that the defendant's activity in some way involves the patented invention." Patterson, *supra*, at 170. And, as illustrated by *Bement*, *A.B. Dick*, *General Electric*, and *Univis*, the Federal Circuit's purported scrutiny of whether a post-sale restriction is "anticompetitive" is also illusory. If exhaustion has not been triggered, then the power of the patent saves the restriction from antitrust review. Patterson, *supra*, at 176, 181.

E. Exhaustion Can Be Triggered By Sale Of An Unfinished Article Or Components

Of course the exhaustion doctrine does not apply to every sale of an uncompleted article or component. Sale of patented widgets with many uses, only some of which are infringing, will not exhaust patents covering one device that could be constructed with those widgets, or method claims covering one use for them. But this Court has recognized that if the patentee chooses to sell an unfinished article or component that has *no reasonable use* other than to practice a patent or be finished into an infringing device, and if the sold article "embodies essential features" of the invention and is "within the protection of the patent" (i.e., an unlicensed seller could be sued for contributory infringement), then it is reasonable to say that he "has sold his invention so far as it is or may be embodied in that particular article." *Univis*, 316 U.S. at 250–51.

The *Univis* test harmonizes the exhaustion doctrine with the related law of contributory infringement. *See id.* at 249–50 (citing *Leitch Mfg. Co. v. Barber Co.*, 302 U.S. 458, 460–61 (1938); *B.B. Chem. Co. v. Ellis*, 314 U.S. 495, 497–98 (1942)); *id.* at 248 (assuming that "sale of the blanks by an unlicensed manufacturer to an unlicensed finisher for their completion would constitute contributory infringement by the seller"). This symmetry was codified by Congress in 1952. 35 U.S.C. §271(c) assesses contributory liability regardless of whether the vending party sold "a component of a patented machine," a "combination or composition," *or* "a material or apparatus for use in practicing a patented process." In all three instances, the seller is liable as a contributory infringer if the "component" sold "constitut[es] a material part of the invention," is known to be "especially made or adapted for use in an infringement of such patent," and is "not a staple article or commodity of commerce suitable for substantial noninfringing use." *Id.*

The exhaustion doctrine would be a dead letter if not triggered by sale of components that embody essential features of the invention and are within the protection of the patent. LGE could, for example, authorize the sale of computers that are finished but for the microprocessor to be inserted in a socket—and thereby preserve its patent rights all the way down the distribution chain against end consumers who are required to perform the (trivial) final step in assembly.

F. Patent Exhaustion Applies To Method Claims

The Federal Circuit held that "the sale of a device does not exhaust a patentee's rights in its method claims." Pet. App. 6a. That too is inconsistent with precedent and the purposes of the exhaustion doctrine. This Court's cases show that method claims are subject to exhaustion, if that method will be practiced by the only reasonable use of the sold article.

In *Ethyl Gasoline Corp. v. United States*, 309 U.S. 436, 446 (1940), the patentee had patents covering lead additive and leaded fuel, and a method patent covering "a method of using fuel containing the patented fluid in combustion motors." The patentee took his reward solely by selling the lead additive to refiners, but specified that the refiners could only sell fuel to licensed distributors (called "jobbers"), and used its leverage over the distributors to maintain resale prices. The issue (as in *Univis*) was whether that resale price maintenance was within the patent grant. This Court held that "by the authorized sales of the fuel by refiners to jobbers the patent monopoly over it is exhausted, and after the sale neither [the patentee] nor the refiners may longer rely on the patents to exercise any control over the price at which the fuel may be resold." *Id.* at 457. Implicit in that analysis is a holding that the method patent was exhausted—since otherwise sales of fuel by jobbers would have been contributory infringement, and hence a legitimate subject of license restrictions.

Univis also involved a method patent—and, although the treatment of that patent is unclear in the opinion,[10] this Court's reasoning applies equally to method claims covering the only reasonable use of the sold article. This Court held that sale of the lens blank was "a relinquishment of the patent monopoly with respect to the article sold," as well as with respect to "the final stage of the patent procedure." 316 U.S. at 249–50.

General Electric also involved a method patent. 272 U.S. at 480. Exhaustion did not apply because the defendant was a manufacturing licensee rather than a purchaser, not because the patent was for a method. *Id.* at 490. Likewise, in *Leitch*, 302 U.S. at 461, this Court held that purchasers of emulsion from the owner of a patented method to surface roadways were necessarily given legal authority to practice the

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10 *Univis* involved one pure method patent that "deal[t] primarily with the grinding procedure followed by the Univis wholesale and finishing retailer licensees in correcting for prismatic imbalance." Appellees & Cross-Appellants' Br. 23, *Univis Lens Co. v. United States* (U.S. Apr. 7, 1942) (Nos. 855, 856); *United States v. Univis Lens Co.*, 41 F. Supp. 258, 262–63 (S.D.N.Y. 1941) (U.S. Patent No. 1,869,769 covered "only a method for producing a lens to eliminate prismatic imbalance"). This Court's opinion said there were five (unspecified) method patents covering only the making of the blanks, and that "[e]ach of the remaining eight patents relates to the shape, size, composition, and *disposition* of the [lens blanks]." 316 U.S. at 246–47 (emphasis added). This Court ultimately determined that it could "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." *Id.* at 248. To do so, this Court must either have (1) concluded that the '769 patent was practiced in part at both stages, and was exhausted, or (2) erred in assuming that the patent was practiced only in making the blanks.

patented method. More recently, in *Dawson*, this Court (citing *Univis Lens* and *Adams*), accepted the parties' concession that a patentee's sale of a chemical specially suited for use in a patented process exhausts the patent in that process. 448 U.S. at 186.

Even the Federal Circuit has applied exhaustion to method claims. *Repeat-O-Type* involved an apparatus claim for ink cartridges and method claims for providing ink and filling ink reservoirs. The court stated that "use of the cartridges covered by the apparatus claims would necessarily infringe the asserted process claims" and cited *Univis* for the proposition that when a patentee sells a device, "it parts with the right to enforce *any* patent that … would interfere with the use of the purchased device." 123 F.3d at 1455 (emphasis added); *see also Intel Corp. v. ULSI Sys. Tech., Inc.*, 995 F.2d 1566 (Fed. Cir. 1993) (no distinction made between apparatus and method claims in same patent described in district court opinion, 782 F. Supp. 1467, 1469 (D. Or. 1991)).

Any other rule would allow patentees to eradicate exhaustion. A patent may contain both apparatus and method claims directed at the same invention. *Manual of Patent Examining Procedure* §806.05(e); *United States ex rel. Steinmetz v. Allen*, 192 U.S. 543, 557 (1904) (rejecting PTO regulations prohibiting joinder of apparatus and process claims in the same patent); John R. Thomas, *Of Text, Technique, and the Tangible: Drafting Patent Claims Around Patent Rules*, 17 J. Marshall J. Computer & Info. L. 219, 226 (1998). If only apparatus claims can be exhausted, applicants will simply include a method claim covering the intended use of the apparatus.[11] As this Court accepted over a century ago, apparatus and method claims "may approach each other so nearly that it will often be difficult to distinguish the process from the function of the apparatus." *Steinmetz*, 192 U.S. at 559. The Federal Circuit has recognized that "claims defining some inventions can by competent draftsmanship be directed to either a method or an apparatus[,]" and that "[t]here is nothing improper in this state of affairs." *Bandag*, 750 F.2d at 922.

This case exemplifies the problem. There is no dispute that each of the patents containing a method claim also includes an apparatus claim. JA220–267; *see also* Appellee Br. 33. Under LGE's infringement theory, Quanta's use of the sold products infringed both types of claims. To exempt method claims contained in the very same patent and infringed by the very same act would be to exalt form over substance and cut the heart out of the exhaustion doctrine.

II. LGE'S PATENT RIGHTS WERE EXHAUSTED BY INTEL'S AUTHORIZED SALES TO QUANTA

Under the principles explained above, LGE's rights in the three disputed patents were exhausted.

First, it is undisputed that Intel had authority to

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[11] *See* Thomas, *supra*, at 225 ("Even the most novice claims drafter would encounter scant difficulty in converting a patent claim from artifact [i.e., apparatus] to technique [i.e., method] and back again."); *id.* at 252–53 (outlining an "exceptionally worthwhile" "drafting exercise" that would allow the patentee to "avoid altogether the usual principal that artifact claims are exhausted through the sale of artifacts" and permit the "force of the patent to intrude deeply into the stream of commerce").

sell these items to Quanta, and that Intel's sales did not constitute infringement.

Second, the District Court made a finding, undisturbed by the Federal Circuit, that if LGE's broad infringement claims are accepted these microprocessors and chipsets have no reasonable use that would not infringe LGE's combination and method patents. Pet. App. 46a. LGE contends that these patents are infringed whenever Intel's products are combined with busses and memory to make a functional computing device. Pet. App. 46a. LGE has never claimed that there are other *functional* uses. It has argued that Quanta could avoid technical infringement by using them overseas, or as replacement parts, or by disabling the patented functions—but such possibilities do not defeat exhaustion. Pet. App. 46a–49a.

Third, these microprocessors and chipsets clearly embody "essential features" of the patents. LGE repeatedly represented to the District Court that key limitations of its claims are embodied in Intel's products. *Supra* p. 7. That is obviously true, since the patent claims essentially cover ways that Intel microprocessors can keep on-chip cache memory in synch with external memory, and ways that Intel chipsets referee competing demands for access to data transfer busses. Although these patented functions will not operate until the microprocessors or chipsets are connected to busses or memory, they are carried out entirely within the microprocessor or chipset. *Everything* inventive about these patents is therefore contained within Intel's products.[12]

Finally, under LGE's own infringement allegations Intel's products would be "within the protection of" LGE's patents but for Intel's license. The Intel-LGE license agreement arose directly out of LGE's contention that Intel's products contributorily infringe these patents. JA174.

The Federal Circuit's holding that exhaustion was not triggered because these sales were "conditional" or did not convey an "implied license" is, as explained above, based on a serious misunderstanding of this Court's precedents. Intel's sales to Quanta were not "conditional" in the historic sense relevant to exhaustion, because there was no condition precedent to the transfer of title. And there has been no such thing as a condition *subsequent* to the transfer of title, enforceable under the patent laws, since this Court overruled *A.B. Dick*.

The facts of this case illustrate the Federal Circuit's confusion. LGE imposed no "conditions" upon Intel's license authority to sell, and that license specified

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[12] The *Univis* rule is clear and workable. Any component that embodies essential features of the patent and is contributorily infringing is, by definition, a substantial enough embodiment of the patent for an authorized sale to trigger exhaustion. *See, e.g., Baldwin-Lima-Hamilton Corp. v. Tatnall Measuring Sys. Co.*, 169 F. Supp. 1, 32 (E.D. Pa. 1958) (holding that sale of a component could not constitute contributory infringement, even if specially adapted only to the invention, because it was not a "material part of the invention" as required by statute). But even if exhaustion might be inappropriate in extreme hypotheticals involving components that somehow were contributorily infringing but nonetheless trivial, the facts of this case would satisfy any sensible standard.

(although such clarification was unnecessary) that it would not alter the ordinary exhaustion consequences of Intel's sales. In a separate agreement, LGE did obtain a promise that Intel would send its customers a "notice" informing them that they did not obtain a "license" from LGE. JA164(¶3.8). But that agreement also specified that "[t]he parties agree that a breach of this Agreement shall have no effect on and shall not be grounds for termination of the Patent License." JA176(¶1). Regardless, Intel kept its promise. And LGE did not make Intel's authority to sell "conditional" on it obtaining any agreement *from Quanta*. 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." Pet. App. 58a.

The Federal Circuit has sometimes stated that exhaustion applies absent "a restriction having contractual significance," *Repeat-O-Type*, 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). And here, as in *Mallinckrodt*, it invoked the U.C.C. to suggest that Quanta agreed to LGE's conditions by failing to object to the notice. That analysis entirely misconceives the issue. LGE's complaint does not include a breach of contract claim. JA134–42. Regardless, breach of a contractual promise would not permit LGE to sue for patent infringement. Breach of a *patent license* does permit infringement suits, but only because a license is permission to do something that would otherwise be infringement. *See Storage*

Tech. Corp. v. Custom Hardware Eng'g & Consulting, Inc., 421 F.3d 1307, 1316 (Fed. Cir. 2005) ("uses" that exceed a license agreement constitute copyright infringement only when those uses would violate copyright law in the absence of any license agreement). Using or reselling goods after an authorized sale is not infringement. The Federal Circuit is simply ignoring the difference between a true conditional *license* and a mere contract fixing contractual rights after the patentee's statutory rights have been exhausted. That error "is especially troubling" because it "allow[s] patentees to use contract law to transform previously permissible conduct into patent infringement," effectively giving "patentees carte blanche to expand the scope of infringement." Patterson, *supra*, at 161, 193–200, 204.

Commentators have also recognized that the Federal Circuit's *ad hoc* "combination of contract law and patent law in the cases [has] prevented [it] from carefully focusing on either body of law." *Id.* at 177, 185; *see also* Cohen & Lemley, *supra*, at 33–34 ("One can reach that result only by mutilating contract law ...."). The Federal Circuit presumes that a "notice" denying the purchaser an implied-in-fact license creates a valid contract. But "notice of the terms that a seller would like to impose is not sufficient to establish a contract on the basis of those terms." Patterson, *supra*, at 185. As the "click wrap" and "shrink wrap" cases illustrate, there must be real scrutiny of whether the purchaser agreed.[13]

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[13] *See, e.g., Step-Saver Data Sys., Inc. v. Wyse Tech.*, 939 F.2d 91, 104 (3d Cir. 1991) (where the seller does not obtain the purchaser's express assent, the purchaser "can reasonably believe

Here, as in *Mallinckrodt*, the Federal Circuit's reliance on the U.C.C. is perplexing. U.C.C. §2-202 relaxes the parol evidence rule, permitting contracting parties to offer evidence of "consistent" additional terms *on which the parties actually agreed* to supplement a non-integrated writing. But the Federal Circuit here never inquired whether Quanta agreed to such "additional" terms or whether its purchase contracts with Intel were fully integrated. And a new condition denying the purchaser the right to use the sold product for its only reasonable use is hardly a "consistent" additional term. §2-207, relied on in *Mallinckrodt*, is equally inapt. That provision governs non-material additional terms sent in "a definite and seasonable expression of acceptance or a written confirmation which is sent within a reasonable time" and not objected to. U.C.C. §2-207(1). But that assumes that the patentee is the accepting rather than offering party in the "battle of the forms," even though "the opposite conclusion seems more logical." Cohen & Lemley, *supra*, at 33 n.130. And, again, terms that "materially alter" the contract are not incorporated. U.C.C. §2-207(2)(b); Patterson, *supra*, at 186–87. "It simply is not true … that a patentee can impose

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that, while [the seller] desires certain terms, it has agreed to do business on other terms—those terms expressly agreed upon by the parties"); Patterson, *supra*, at 188–90 (discussing cases). Computer software also raises unique exhaustion issues because of the technical wrinkle that a new copy of a software program is made whenever it is loaded into memory to be used. Unlike purchasers of ordinary goods, therefore, software purchasers always need a kind of limited manufacturing license to make additional (transient) copies of the patented or copyrighted article. Self-replicating seeds raise the same problem, which obviously is not presented here.

contractual terms on a purchaser by publishing those terms in labels or trade journals, even if the purchaser sees those terms." *Id.* at 188.[14]

Finally, even if there were some room for "conditions" on sold goods enforceable through the patent laws, the condition here is indistinguishable from the one this Court called a "perfect instrument of favoritism and oppression" in *Motion Picture Patents*. 243 U.S. at 515. Here, as there, LGE has reserved the right to insist upon additional royalties, long after the sale, from anyone in the distribution chain it chooses to target (including end consumers), in an amount subject only to its sole discretion. This defeats the core principle that a patentee is entitled to only one royalty from each sale of the patented invention.

III. THIS COURT SHOULD ADHERE TO THE TRADITIONAL EXHAUSTION RULE.

A. Any Change Should Come From Congress

Article I entrusts patent policy to *Congress*, and this Court "require[s] a clear and certain signal from Congress before approving the position of a litigant who … argues that the beachhead of privilege is wider,

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[14] LGE has never sought rescission of the license agreement that gave Intel authority to make these sales, and could not. *See, e.g.*, *Callanan v. Keesville, Ausable Chasm & Lake Champlain R.R. Co.*, 199 N.Y. 268, 284 (1910); Edwin E. Richards, *Drafting Licenses to Guide Whether Potential Disputes Lie in Contract or Infringement*, 7 Comp. L. Rev. & Tech. J. 45, 54 (2002) ("[R]escission by an aggrieved party allows that party to bring an action for infringement for any subsequent use of the property. Without rescission, the contract remains in force and limits the action to one of breach of contract."); Restatement (Second) of Contracts §384 (1981) (rescission requires party to tender back benefits of bargain).

and the area of public use narrower, than the courts had previously thought." *Deepsouth Packing Co. v. Laitram Corp.*, 406 U.S. 518, 531 (1972); *see also Bonito Boats, Inc. v. Thunder Craft Boats, Inc.*, 489 U.S. 141, 168 (1989) ("It is for Congress to determine if the present system of design and utility patents is ineffectual in promoting the useful arts in the context of industrial design."); *United States v. Dubilier Condenser Corp.*, 289 U.S. 178, 189 (1933) ("To the laws passed by the Congress, and to them alone, may we look for guidance as to the extent and the limitations of the respective rights of the inventor and the public.").

Despite a century and a half of opportunities, Congress has never seen a need to modify this Court's exhaustion precedents. Congress reenacted the patent laws in 1952 and changed various aspects of settled law, most notably in the areas of misuse and contributory infringement. But it did not alter the exhaustion doctrine. And, when amending the Patent Code again in 1988 to limit the defense of misuse, exhaustion remained unchanged. When "'judicial interpretations have settled the meaning of an existing statutory provision, repetition of the same language in a new statute indicates, as a general matter, the intent to incorporate its … judicial interpretations as well.'" *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Dabit*, 547 U.S. 71, 85 (2006) (citation omitted) (alteration in original); *see also Square D Co. v. Niagara Frontier Tariff Bureau, Inc.*, 476 U.S. 409, 424 (1986) (There is a "strong presumption of continued validity that adheres in the judicial interpretation of a statute.").

B. Sound Policy and Economic Analysis Support The Traditional Exhaustion Rule

Regardless, the exhaustion doctrine rests on sound public policy and there is no good reason to reconsider it. This Court has always recognized that "[t]he inconvenience and annoyance to the public that an opposite [rule] would occasion are too obvious to require illustration." *Keeler*, 157 U.S. at 667. The Federal Circuit's holding threatens to constrain the free flow of patented goods, raise transaction costs throughout the economy, and grant patent owners a device for abusing market power while remaining immune from antitrust liability. There is no reason to endure these consequences when patentees can impose post-sale restrictions *by contract*—subject to the requirements of contract and antitrust law.

First, the exhaustion doctrine is grounded, in part, on property principles. *See* 35 U.S.C. §261 ("Subject to the provisions of this title, patents shall have the attributes of personal property."). A patented invention is "as much entitled to protection as any other property," *Seymour v. Osborne*, 78 U.S. (11 Wall.) 516, 533 (1870), but not *more* so. "[S]ince patents are privileges restrictive of a free economy, the rights which Congress has attached to them must be strictly construed so as not to derogate from the general law beyond the necessary requirements of the patent statute." *United States v. Masonite Corp.*, 316 U.S. 265, 278–80 (1942) (quoting *Pennock v. Dialogue*, 27 U.S. (2 Pet.) 1, 19 (1829); *Kendall v. Winsor*, 62 U.S. (21 How.) 322, 329 (1859)).

Post-sale restrictions that run with personal property are generally not allowed at common law.

Supra p. 19. The Federal Circuit thus has given patent owners greater rights to restrict the use and disposition of sold goods than sellers of unpatented goods and, for that matter, even other forms of intellectual property. *See* Kobak, *supra*, at 562 ("a clear difference now exists" because of *Mallinckrodt* "between post-sale restrictions on patented goods on the one hand and those on copyrighted and trademarked goods on the other"). In effect, it has enabled patent owners to create a form of property rights—personal property servitudes—not generally recognized in property law.

There are only a few well-recognized forms by which property rights may be conveyed. These forms allow parties to identify and verify, with manageable information costs, the legal interests that are being bought or sold.[15] If a property owner were permitted to divvy up his "bundle of sticks" in any manner he saw fit, the property regime would become too complex and inefficient to promote the free transfer of property to its greatest use. Thus, "incidents of a novel kind can[not] be devised and attached to property at the fancy or caprice of any owner." *Keppell v. Bailey*, 39 Eng. Rep. 1042, 1049 (1834). Our economy operates on the premise that a buyer of personal property like a car can trust that he has the right to use it—and does not need to investigate whether a prior owner has carved away some arbitrary limitation, such as the right to drive the car in Virginia. Real property law does permit certain arcane partial ownership interests, but

[15] *See generally* Merrill & Smith, *supra*; Henry Hansmann & Reiner Kraakman, *Property, Contract, and Verification: The Numerus Clausus Problem and the Divisibility of Rights*, 31 J. Legal Stud. 373 (2002).

it has also evolved costly systems for public recording and title searches.

Contract law allows parties to order their rights and relationships in far more novel and complex ways. But (with limited exceptions) it also requires privity and genuine agreement. The possibility of contract restrictions on the use of goods thus does not threaten to raise transaction or search costs generally. Buyers can trust that they already know about any relevant contractual restraints.

Petitioners did receive a "notice" from Intel. But as LGE conceded in its opposition to certiorari, nothing about its (or the Federal Circuit's) legal theory requires such notice. Br. in Opp. 19–20. LGE relies on the general principle of property law that a seller cannot convey greater title than he has. And "'[n]otice to the purchaser in such a case is not required, as the law imposes the risk upon the purchaser, as against the real owner, whether the title of the seller is such that he can make a valid conveyance.'" *Id.* (quoting *Mitchell*, 83 U.S. at 550). As the *amicus* brief filed in support of certiorari by Minebea Co., Ltd. explained, the Federal Circuit's decision is already being (correctly) interpreted to permit patentees to enforce "conditions" *even against purchasers without notice*.

Perhaps this Court could ameliorate the harshness of that result by inventing a new equitable jurisprudence of "notice" restrictions. But the need to do so illustrates how unprecedented the Federal Circuit's analysis is. And even if there were some reason to change traditional law to allow sellers to create equitable servitudes running with chattels, with or without notice, it would make little sense to limit that ability to sellers of *patented* goods. Nothing about the policy arguments for or against such servitudes has anything to do with the goals of patent law, except in the sense that arbitrarily giving patentees special rights not enjoyed by other property owners might somehow further increase rewards to invention.

Second, the genius of the traditional exhaustion rule is that it greatly reduces transaction costs *without* reducing the patentee's reward. 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." *Keeler*, 157 U.S. at 666–67. A rational patentee cannot obtain more by negotiating separately with the manufacturer, distributor, retailer, and consumer than he could have obtained by charging the entire amount to the first party in the chain and relying on it to pass the cost along in the form of higher prices. There is only one monopoly profit to be obtained in any vertical distribution chain.[16] Quanta would not be willing to pay *more* for microprocessors free from LGE's patent claims if it wrote separate

[16] *See* 3A Phillip E. Areeda & Herbert Hovenkamp, *Antitrust Law* ¶756b2 (2d ed. 2002) ("Under any given cost and demand conditions, there is but one optimal monopoly profit to be gained from the sale of an end product."); Richard A. Posner & Frank H. Easterbrook, *Antitrust Cases, Economic Notes, and Other Materials* 870 (2d ed. 1981) ("There is only one monopoly profit to be made from a chain of production."); Robert H. Bork, *The Antitrust Paradox* 229 (1978) ("vertically related monopolies can take only one monopoly profit"); *E&L Consulting, Ltd. v. Doman Indus., Ltd.*, 472 F.3d 23, 30 (2d Cir. 2006) ("'The power to restrict output to maximize profit is complete in the manufacturing monopoly, and there is no additional monopoly profit to be made by creating a monopoly in the retail distribution of the product."), *cert. denied*, 2007 U.S. LEXIS 10366 (Oct. 1, 2007).

checks to Intel and LGE, than if it wrote one larger check to Intel.

There is only one reason why a patentee might want to parcel its royalty out between different levels of the distribution chain: to prevent arbitrage among downstream buyers from eroding price discrimination. Subject to certain antitrust limitations, the law generally permits sellers to charge different prices to customers in different markets. Of course there is a risk that products from the "cheaper" market will leak into the one being charged higher prices or royalties, eroding profit margins (and willingness to pay) in the more expensive market. That phenomenon afflicts all sellers, and has nothing to do with the goals of patent law. Sometimes it can be prevented by contract. But patentees are not entitled to more powerful price discrimination tools than are available to ordinary sellers.

Third, the Federal Circuit's holding threatens to immunize patent owners for conduct that violates antitrust law. As this Court recognized in *General Electric* and *Univis*, a restriction genuinely within the patent monopoly is inherently immune from antitrust scrutiny. *Supra* p. 32. The exhaustion doctrine is therefore critical to maintaining rule of reason scrutiny over vertical restraints. The Federal Circuit's holding opens the door to a new era, like the one that briefly flourished after *A.B. Dick*, of patentees attaching "notices" that eliminate aftermarket competition by specifying "no resale" or "single use only," that monopolize service or parts markets by specifying "repair only by manufacturer" or "only with approved parts," or that expand the scope of the patent monopoly via tying to unpatented supplies. Patentees will try resale price or exclusive territories restrictions that squelch both intra-brand *and inter-brand* price competition. A cooperative patentee would become the perfect enforcement mechanism for a downstream cartel. And both the internal logic of the Federal Circuit's test and past experience indicate that there will be no real scrutiny of competitive effects under either the patent or antitrust laws. *See, e.g.*, Patterson, *supra*, at 176; Kobak, *supra*, at 560–61.

Fourth, the Federal Circuit's holding that method claims can never be exhausted will also wreak havoc with commerce. Almost any device invention can be described as a method of using that device, and most are. If method claims become exempt from exhaustion, there will be an explosion of infringement suits seeking a second round of royalties from persons who (like Quanta) purchased goods and paid full price for them expecting that the patentee's claims were satisfied.

Finally, patentees have quite effective strategies at their disposal, and do not need this radical change in existing law. If LGE had wanted to extract its reward from Quanta rather than Intel, LGE could have come to Quanta and negotiated with it directly. A license granted to Quanta would insulate Intel from liability, because there is no contributory infringement without direct infringement. Or if LGE wanted for some reason to divide its royalty between Intel and Quanta, it could have authorized Intel to sell only to purchasers with a prior license from LGE. A sale in violation of such a restriction would entitle LGE to sue Intel for infringement, and perhaps the buyer as well. *Supra* p. 29. LGE could also build as complex a web of contractual obligations as its lawyers can dream up, and refuse to sell or license its patents until all relevant parties have agreed to be bound.

That flexibility does mean that to some extent the dispute in this case turns on the form of the agreement. But particular legal forms have particular legal consequences, and holding parties to the form chosen does not defeat freedom of contract but enables it. And there are certain substantive limits. No matter how clever the drafter, a seller simply cannot transfer ownership of personal property and then try to enforce post-sale restrictions *under property law*—including the species of property law we call patent. An attempt to do that is not freedom of contract, but an unprecedented power to redefine the substantive scope of property rights and of the patent statutes.

LGE has never explained why it did not employ one of the lawful contracting strategies suggested above, or indeed what the purpose of this "condition" is supposed to be. It seems fatally doomed as a prospective licensing strategy. No rational company would pay LGE any significant royalty for a "license" to make and sell products that did not include the ability to sell those products free and clear of LGE's patent claims—since no rational customer would pay any significant price for a product that cannot be used without infringing. LGE's suggestion that this reservation will facilitate successive negotiations fairly allocating the value of the patent up and down the distribution chain is fanciful. If LGE can do this, then its negotiating leverage is not diminished in any way by the grant of a prior "license" to Intel. As Dell, Hewlett Packard, and Gateway explained in their *amicus* brief supporting certiorari, LGE could still come after Quanta with the full force of the patent laws, and then negotiate a similar non-exhausting "license" with Quanta and do the same thing to Quanta's customers, all the way to end consumers. And none of these pricing decisions are genuinely independent. The value of a license to Quanta depends on whether Quanta's own customers will be free to use and sell their products, and if so at what price. If LGE demands outrageous royalties from the next level down, licenses purchased higher in the chain may be worthless. And indemnities against infringement liability, both contractual and under the U.C.C., are common. *See* U.C.C. §2-312. Exhaustion thus solves intractable multi-party negotiation problems.

Since no one would choose to do business with LGE on the terms it suggests, the only rational explanation for the present situation is the confused state of the law. Intel no doubt believed it was purchasing exhaustion for its customers, Quanta paid Intel full price believing exhaustion had occurred, and LGE hopes to extract a one-time windfall with regard to those past sales.[17] LGE is holding the entire computer industry hostage for billions of dollars in royalties for

[17] LGE argued in its brief in opposition that its position is consistent with the law of damages for past infringement, which allows the patentee to sue every infringer—not just whomever would have been the first purchaser. Of course courts allow the patentee to collect only one reasonable royalty, total, and are also sensitive to attempts by patentees to artificially expand the "base" against which that reasonable royalty is calculated by going after defendants farther down the value chain. *See, e.g., Glenayre Elecs., Inc. v. Jackson*, 443 F.3d 851, 864 (Fed. Cir. 2006); *Lucent Techs. Inc. v. Gateway, Inc.*, 2007 U.S. Dist. LEXIS 57135, at *74 (S.D. Cal. Aug. 6, 2007). The treatment of past damages also reflects the economic reality that if the initial manufacturer *had* paid the patentee for a license, the price would have been passed down and shared by the entire production chain.

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." *Millinger*, 68 U.S. at 350. The core purpose of the exhaustion rule has always been to prevent such vexatious demands.

CONCLUSION

The Federal Circuit's holding that patent exhaustion does not apply should be reversed.

Respectfully submitted,

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APPENDIX

35 U.S.C. § 154. CONTENTS AND TERM OF PATENT; PROVISIONAL RIGHTS

(a) In general.

(1) Contents. Every patent shall contain a short title of the invention and a grant to the patentee, his heirs or assigns, of the right to exclude others from making, using, offering for sale, or selling the invention throughout the United States or importing the invention into the United States, and, if the invention is a process, of the right to exclude others from using, offering for sale or selling throughout the United States, or importing into the United States, products made by that process, referring to the specification for the particulars thereof.

* * *

35 U.S.C. § 261. OWNERSHIP; ASSIGNMENT

Subject to the provisions of this title, patents shall have the attributes of personal property.

* * *

35 U.S.C. § 271. INFRINGEMENT OF PATENT

(a) Except as otherwise provided in this title, whoever 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.

(b) Whoever actively induces infringement of a patent shall be liable as an infringer.

(c) Whoever offers to sell or sells within the United States or imports into the United States a component of a patented machine, manufacture, combination or composition, or a material or apparatus for use in practicing a patented process, constituting a material part of the invention, knowing the same to be especially made or especially adapted for use in an infringement of such patent, and not a staple article or commodity of commerce suitable for substantial noninfringing use, shall be liable as a contributory infringer.

* * *