THE NEW PATENT EXHAUSTION DOCTRINE OF *QUANTA v. LG* - WHAT IT MEANS FOR PATENT OWNERS, LICENSEES, AND PRODUCT CUSTOMERS

JOHN W. SCHLICHER

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Law Office of John W. Schlicher
304 Lowell Lane W.
Lafayette, CA 94549

Tel: 925-284-7675
Cell: 510-220-2778
Fax: 925-284-7675
E-mail: johnschlicher@comcast.net
www.johnschlicher.com

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I. Introduction

The patent exhaustion doctrine has been a source of confusion and frustration for patent owners, their licensees, and their customers for 160 years. In June 2008, the Supreme Court in *Quanta v. LG* changed the doctrine again.[1] This paper has five parts. Section II is a summary for those who care only about the basics. Section III is for those who wish to understand the policy and the effects of the law. Section IV is a more detailed explanation of the Court's decision. Section V describes the many important errors in the Court's discussion of its prior decisions and the law of patent exhaustion.

Section II summarizes the actual decision. The Court reached a result that is understandable given the language of the license that created the issue. If the only effect of a Supreme Court decision is that other cases involving the same essential facts must be decided in the same way, the *Quanta* decision should have little effect on future licensing. Skilled lawyers should be able to work around it. The decision dooms past licenses written in the same way. The *Quanta* decision is likely to have broader implications, because every sentence of a Supreme Court patent decision is treated as the law. Section II summarizes these changes. Section II also describes something the Court did not address - what the parties were likely trying to accomplish.

Section III describes the economic policy of the law governing the ways patent owners capture the value created by use of their patent rights. The exhaustion and implied license doctrines influence how patented inventions are used and the profits patent owners earn. Properly defined, those doctrines increase the value of patented inventions and improve the efficiency of the patent system. Improperly defined, they limit the value of patent rights, limit use of patented inventions, and impair the system. Section III explains why patent owners should be permitted to sell products and separately license their patent rights to purchasers. Section III explains why the traditional explanations for the exhaustion doctrine are misconceived.

Section IV describes in more detail the facts, the lower court decisions, and the Court's view of the facts, the law, and the result. The Court did not discuss why LG and Intel wrote their license the way they did or why patent owners should not be permitted to do whatever they was trying to do. Section III discusses what the case was probably about.

Section V describes how the Court misunderstood its prior decisions about exhaustion and the law on the ability of a patent owner to limit the rights a buyer receives, when the owner sells a product and separately licenses the patent rights. Section V explains how the Court mistakenly read its decisions in *Bloomer, Mitchell, Adams, Univis Lens, Ethyl Gasoline, General Talking Pictures,* and *Keeler*. This section discusses in more detail how the *Quanta* decision is likely to be read to sweep away important principles that had little or nothing to do with the case. Section V also describes the Court's mistaken view of the policy of exhaustion.

II. Summary

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[1] Quanta Computer, Inc. v. LG Electronics, Inc., __ U.S. __, 128 S.Ct. 2109 (2008).

A. The Actual Decision in *Quanta*

LG Electronics ("LG") owned many patent relating to computer systems, computer components, and computer methods of operation. LG and Intel entered a cross license agreement. LG licensed Intel under all its patents to make, use, and sell any products. The license said no license was granted to third parties to make combination products from licensed products and components acquired from someone other than LG or Intel or to use or sell combination products. The license said nothing in the license altered the effect of patent exhaustion on Intel's sales. LG and Intel entered a separate agreement in which Intel agreed to give a written notice to its customers about patents. The notice said that Intel had a license ensuring that any Intel product was licensed by LG and did not infringe any patent held by LG. The notice also said that a license did not extend, expressly or by implication, to any product that the customer made by combining an Intel product with any non-Intel product.[2]

Intel sold microprocessors and chip sets under the license to computer assemblers and suppliers including Quanta Computer ("Quanta"). Quanta used those microprocessors and chip sets to make computers. In those computers, the Intel microprocessors and chip sets communicated with other components and memory devices over buses that carry data and instructions. Quanta sold those computers. LG sued Quanta and other computer makers for patent infringement under six patents. Only three of those patents were involved in the decision reviewed by the Supreme Court. According to the Court, each of those patents contained claims to computer systems and methods of using computers.

The issue was whether Quanta infringed LG's system and method claims when it sold computers made with microprocessors and chip sets purchased from Intel. The Court said that issue was governed by the exhaustion doctrine. The Court held that the exhaustion doctrine applied to sales of unpatented products that substantially embodied the invention of a patented system or method. The Court said an unpatented product substantially embodies the invention when that product has no non-infringing use and embodies all inventive features of the patented invention. A product embodies all inventive features of a patented invention when use of that product to make and use some larger product or carry out some method involves additional components or steps that are common or standard for use in products or methods of the same type as the patented product or method.

The Court found that the Intel products met those requirements and Intel's the sale of those products to Quanta exhausted LG's rights under its system and method patents. The Court also found that LG's license to Intel authorized Intel to sell components to Quanta for any use, including use to make computers. The Court found that the language in the license about the rights of third parties and the notice Intel gave its customers did not prevent exhaustion.

B. The Language of the *Quanta* Decision

The language of the Quanta decision has three and perhaps four important consequences.

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[2] The Court's description of the notice suggests that the license said that no license was granted expressly or by implication to third parties to make combination products or to use or sell combination products using Intel products.

First, prior to *Quanta*, the Court applied the exhaustion doctrine to preclude a claim of infringement against a purchaser only where the patent owner or its licensee sold a patented product, that is, a product that embodied all the parts and features specified by the claim of a patent. Prior to *Quanta*, the Court applied the implied license doctrine to determine whether a patent owner had a claim against a purchaser where the patent owner or its licensee sold an unpatented component or material and the infringement claim was based on the making a patented product containing that component or using the material to carry out a patented method.

While the Court referred to the implied license doctrine in *Quanta*, the Court said that the implied license doctrine was irrelevant to the exhaustion doctrine and the exhaustion doctrine governed the rights of the purchaser in that action. The effect is that the exhaustion doctrine effectively replaces the implied license doctrine for many sales of unpatented products. When the exhaustion doctrine applies, the implied license doctrine no longer matters.

After *Quanta*, in order to decide whether exhaustion applies to sales involving an unpatented product, the parties to a proposed sale must understand the novel features of each invention of each patent owned by the seller and must make judgments about whether all those novel features are found in the product to be sold and whether there are alternative uses for the product at the time of the sale.

Second, the Court said all post-sale restrictions are invalid. If post-sale restrictions means all limitations in a patent license granted to a purchaser, *Quanta* eliminates the rule that a patent owner may sell a product subject to conditions or restrictions on the scope of the immunity to infringement liability that the purchaser obtains by buying the product. When the exhaustion doctrine applies, patent owners may not sell a product and separately license the patent rights to the buyer in a way the reserves any of the patent rights.

Third, the Court said exhaustion applies only to a licensee's sales the license authorized the licensee to make. The Court said the only issue in applying the exhaustion doctrine to a sale by a licensee is the scope of the license granted to that licensee. The Court found that a licensee granted a license to make, use, and sell any products under all of a patent owner's patents had authority to sell an unpatented product for use by a purchaser to make a patented system or carry out a patented process.

The Court found that the licensee's authority to sell for those uses was not limited by license provisions saying that nothing in the license limited the operation of the exhaustion doctrine and a license was not granted to a purchaser to use a licensed product to make a larger product or system by combining the licensed product with products obtained from others. The Court said the language about a purchaser's license related only to the existence of an implied license.

The Court also found that the licensee's authority to sell for those uses was not limited by the licensee's obligation under a separate agreement to give notice to purchasers that the products purchased were licensed by the patent owner and the license from the patent owner to the seller did not extend to any product the purchaser made by combining the seller's product with products of others.

Fourth, the Court said that a sale may be made subject to contracts with the purchaser at the time of sale. The Court implied that such contracts could not function to reserve to the patent owner any of the rights that would be exhausted by a sale. Taken literally, this also means that a patent owner may not sell, grant a limited license, and enforce the patents against unauthorized activities. However, it is far from clear the Court has precluded selling and licensing separately.

C. What Was This Case About and Should the Law Have Defeated the Purpose of the Intel – LG Agreement

The Court did not discuss why LG and Intel wrote their license the way they did or why patent owners should not be permitted to do whatever they was trying to do. The Court implied that exhaustion existed to prevent a patent owner from capturing the value of one invention twice. The Court said exhaustion applied to the sale of unpatented products to prevent a patent owner from defeating exhaustion by claiming a new product and also claiming a process of using that product and implicitly a system containing the product. The Court apparently thought that was what LG was trying to do.

Computers are made from microprocessors, random access memory devices, disk drives, and other components. Some companies make microprocessors. Other companies make computers from components they buy. Computers sell for higher prices than microprocessors. Assume the average computer sells for $1000 and the average microprocessor for $100. Assume a company owns some patents on microprocessors and other patents on computers. The patent owner wants to license the microprocessor companies to make and sell microprocessors and license the computer companies to make and sell computers. The patent owner may wish to charge the microprocessor companies royalties appropriate to the value of the microprocessor inventions and microprocessor prices and charge computer companies royalties appropriate to the value of the computer inventions and computer prices. The Supreme Court found that the way the patent owner attempted to do this in the case before the Court was ineffective, because sales of some microprocessors give the purchaser the right to make computers free of infringement of computer patents. The Court implicitly assumed the patent owner captured in the royalties paid by the microprocessor licensee the value of the computer inventions to computer companies. If the patent owner hoped to license the computer companies separately, this assumption was most certainly wrong.

III. The Economic Policy of the License, Implied License and Exhaustion Defenses

A. Patent Rights and Personal Property Rights Are Different and May Be Sold Separately

Patent rights are separate from personal property rights. Personal property law controls ownership of tangible products and the rights of an owner to prevent possession and use by other. Patent law controls ownership of intangible inventions and the rights to prevent sale and use of products embodying a patented invention. If someone owns a patent and another person infringes the patent by making and selling products, the patent owner may obtain damages for past sales and an injunction against future sales. The patent owner does not become the owner of the infringing products. Those products continue to be owned by the people who made them or bought them.

Patent rights are distinct from personal property rights and may by transferred separately. For example, an owner of a patented machine may sell the machine and separately license the purchaser under the patent rights to use the machine and pay royalties based on the amount the machine is used. The Supreme Court found this lawful in 1964.[3] The transfer of the personal property rights to the purchaser of a machine does not give the purchaser a free and unlimited right to use or resell the machine under a patent, where the patent owner and purchaser have agreed to license the patent separately. The lower courts approved of this method of exploiting patent rights long before 1964.[4]

B. Three Ways a Patent Owner May Authorize Use of the Patent Rights

There are three ways for a company to obtain the right to make, use or sell some product or use some process covered by a patent without infringement liability. The license doctrine is one way. A company does not infringe a patent when it exercises rights a patent owner has licensed it to use. The implied license doctrine is a second way. The implied license doctrine creates a license a patent owner did not grant expressly. In general, the law creates an implied license when a patent owner has a business transaction with another company and the transaction would not make sense if the other company did not have a license. One such transaction is the sale of an unpatented product whose only use requires a license. The exhaustion doctrine is a third way. In general, the exhaustion doctrine has the effect of a license when a patent owner sells a patented product to another company and that company uses or resells the product. The *Quanta* decision may change how each of these doctrines influence the ways patent owner, their licensees, and their customers do business.

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[3] Brulotte v. Thys Co., 379 U.S. 29, 30, 33 (1964). In *Brulotte v. Thys*, a patent owner sold a patented hop picking machine to farmers and granted them a license to use the machine. Farmers paid about $3000 for title to the machines. Farmers agreed under the license to pay royalties of $3.33 per 200 pounds of dried hops harvested by the machine. The license could not by its terms be assigned. This effectively prevented the farmers from selling the machines without consent of the patent owner. Under the license, the machines could not be removed from Yakima County, Washington. By 1957, all the patents on inventions used in the machines had expired. Some farmers refused to pay royalties for periods before and after those patents expired. The Supreme Court of Washington found that the farmers had to pay the royalties for both periods. The Supreme Court found that the farmers had to pay royalties for the period before those patents expired and not after.

[4] A patent owner may sell a patented product and expressly license the purchaser to use the product in exchange for royalties. Cold Metal Process Co. v. McLouth Steel Corporation, 41 F. Supp. 487, 490 (E.D. Mich. 1941), aff'd in pertinent part, 170 F.2d 369, 370 (6th Cir. 1948); Skee Ball Co. v. Cohen, 286 Fed. 275 (E.D.N.Y. 1922); Porter Needle Co. v. Nat. Needle Co., 17 Fed. 536 (C.C.D. Mass. 1883). A patent owner may also license one group of companies to make and sell a patented product only to another group of companies having express royalty-bearing licenses to use the product. Duplan Corp. v. Deering Milliken, Inc., 444 F. Supp. 648, 661-64, 669-71 (D.S.C. 1977), aff'd in pertinent part, 594 F.2d 979 (4th Cir. 1979); Extractol Process, Ltd. v. Hiram Walker & Sons, Inc., 153 F.2d 264, 268 (7th Cir. 1946); cf. In re Yarn Processing Patent Validity Litigation, 541 F.2d 1127, 1135 (5th Cir. 1976).

C. The Policy of Licensing Law – Improve the Profitability of Inventing and the Efficiency of Use of Patented Inventions

Patent owners authorize others to engage in activities that would otherwise infringe by agreements called licenses. From the inception of the patent system, the law has permitted a patent owner to license. Prior to 1952, the law simply assumed the patent owners, like all other owners of property, could license their rights to others. Since 1952, section 271 of the Patent Act has provided that activities conducted with the authority of a patent owner are not infringement.[5]

Licensing permits patented inventions to be put their most valuable uses by the people best able to use them. People who make inventions are rarely able to supply the entire market with products embodying those inventions. Others are usually able to produce, sell, and service those products better than a patent owner. For that reason, the law permits patent owners to license others. Licensing increases the value of patented inventions and therefore the value of inventing. Licensing permits the patent system to provide better profit incentives for people to try to make inventions.

Licensing also permits the value of inventions to be set by private individuals rather than by people working in the government or the courts. The people who know the most about the potential commercial value of inventions decide which inventions are used and which are not. The people who know the most about how to use inventions to provide the greatest benefits to consumers at the lowest cost decide how inventions are used. People whose financial futures depend on the correctness of their decisions make those decisions.

Licensing also permits private transactions between patent owners and people who could use inventions to determine which people will use which inventions for which purposes at what times in what amounts and at what prices. These transactions and the market forces that constrain them will determine how inventions are used and how much money patent owners make far better the government or a court. People working for the government or the courts have no way to systematically outperform the market.

For these reasons, the law has always provided patent owners with control over licensing. The courts have said a patent owner has the right to refuse to license anyone. If an owner decides to license, the owner has complete control over which people and companies receive a license. The patent owner may grant only one license and agree not to grant additional licenses. The license is then called exclusive. A patent owner has the right to control the scope and terms of a license. A patent owner has the right to authorize a licensee to use some of the patent rights and not others. A patent owner has the right to charge any amount it wishes for granting a license and, with two exceptions, the basis for determining the amount. The amount of the payment obligation is determined solely by the terms of the license.

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[5] 35 U.S.C. § 271(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.").

The only statutory limit on a patent owner's freedom to license is that the owner may not violate the antitrust laws. Since the early 1900s, the courts have limited a patent owner's licensing rights to the extent they believed was required by federal antitrust law. In the 1940s, the courts also created a patent misuse doctrine to supplement the limits of antitrust law. However, the courts did not broadly assert that the law controlled who obtained patent licenses and on what terms. Within the antitrust and misuse limits, the courts left that control with patent owners and the people they licensed.

Given the courts' recognition that a patent owner has the right to control who obtains a license, the scope of the license, and the other terms of a license, one might expect the courts to say that the only way a person obtains immunity from infringement is by a license. One might expect the courts to say the only role for the courts in deciding whether a purchaser has infringement immunity for particular activities is to determine the existence and scope of the purchaser's license. However, this is not what happened.

D. A Sensible Policy for the Implied License and Exhaustion Doctrines – Improve the Profits from Inventing by Reducing the Cost of Licensing

Since as early as 1852, the courts said a purchaser from a patent owner or a licensee could acquire immunity from infringement by virtue of an implied license and what came to be known as the exhaustion doctrine. Until the *Quanta* decision, the Supreme Court did not draw a bright line between the exhaustion and implied license doctrines. The Court presumably did not see the need for two separate rules because there was only one problem – to provide a sensible default rule for patent owners and their customers when the terms of a sale are silent about patents and patent licenses.

The exhaustion and implied license doctrines eliminate infringement liability of people who carry out infringing activities using products purchased from a patent owner or a licensee. There are many situations in which patent owners and potential users of inventions would waste an enormous amount of time and money if the only way for a patent owner to authorize a user to exercise some of the patent rights was by express agreement. If there were no implied license or exhaustion doctrines, patent owners would always be forced to grant licenses to people who purchase products and need a license to use them. No one would buy patented products at prices reflecting their full value without assurance from the seller that use or resale of that product would not infringe a patent the seller owned. Without that assurance, no one would buy unpatented products at those prices if the products were useful only to carry out a patented process or make and use a patented system. Patent owners and their licensees probably sell trillions of products every year. If patent owners had to grant express licenses to these purchasers in all transactions, much of the economic value of patented inventions would be wasted due to the cost of licensing.

The exhaustion and implied license doctrines make it unnecessary for a patent owner to grant a purchaser an express license when the patent owner would have consented to the purchaser's unlimited royalty-free use of the product if the law required that consent.[6] A patent

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[6] Henry v. A.B. Dick, 224 U.S. 1, 23-24 (1912), *overruled on other grounds*, 243 U.S. 502 (1917) ("An absolute and unconditional sale operates to pass the patented thing outside the

owner and purchaser need not bother about a license, because the law provides the purchaser with the rights that would have been granted by an express license. Because the law provides those rights and the patent owner and purchaser know the law, they need not incur the costs or waste the time to license expressly.

When a patent owner sells a patented product, the buyer pays the price, and the patent owner says nothing about the patent or a license at the time of the sale, a patent owner and purchaser must have intended the purchaser to have an unlimited free license. The purchaser's use or resale of a patented product would always infringe the patent, if the purchaser did not have a license. The product necessarily reflects the full value of the invention. If the patent owner says nothing about the patent or a license at the time of the sale, the price of the product will always include the price for a license to use or resell the product. Therefore, the law provides one.

The same considerations apply to sales by a patent owner of an unpatented component useful only to make a patented product or an unpatented material or machine useful only to carry out a patented process. The law provides the purchaser with an implied license to use the component to make the patented product, use it and sell it, and to use the material or machine to carry out the patented process where these were the only possible uses and the circumstances showed that the seller and the purchaser must have intended the purchaser to have a free license to make those uses.[7] When the product was not patented, the law was more cautious about

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boundaries of the patent, because such a sale implies that the patentee consents that the purchaser may use the machine so long as its identity is preserved. This implication arises, first, because a sale without reservation, of a machine whose value consists in its use, for a consideration, carries with it the presumption that the right to use the particular machine is to pass with it."). See also, DeForest Radio Tel. & Tel. Co. v. United States, 273 U.S. 236, 241 (1927)("No formal granting of a license is necessary in order to give it effect. Any language used by the owner of the patent or any conduct on his part exhibited to another, from which that other may properly infer that the owner consents to his use of the patent in making or using it, or selling it, upon which the other acts, constitutes a license and a defense to action for a tort.").

[7] Dawson Chemical Co. v. Rohm & Haas Co., 448 U.S. 176, 186 (1980)("farmers who buy propanil from Rohm & Haas may use it [to carry out a patented process], without fear of being sued for direct infringement, by virtue of an 'implied license' they obtain when Rohm & Haas relinquishes its monopoly by selling the propanil."); B.B. Chem. v. Ellis, 314 U.S. 495, 497 (1942)("Petitioner has not granted to shoe manufacturers, or asked them to take, written licenses. The courts below held that petitioner's sale to manufacturers of the unpatented materials for use by the patented method operated as a license to use the patent with that material alone and thus restrained competition with petitioner in the sale of the unpatented material, as in Carbice Corp. v. American Patents Corp., 283 U.S. 27, 51 S.Ct. 334, 75 L.Ed. 819, and Leitch Mfg. Co. v. Barber Co., 302 U.S. 458, 58 S.Ct. 288, 82 L.Ed. 371."); Leitch Mfg. Co. v. Barber Co., 302 U.S. 458, 461 (1938) ("For any road builder can buy emulsion from it [the patent owner] for that purpose [of employing the patented method], and whenever such a sale is made, the law implies authority to practice the invention."); Lawther v. Hamilton, 124 U.S. 1, 11 (1887); Carborundum Co. v. Molten Metal Equip. Innovations, Inc., 72 F.3d 872, 878, 37 U.S.P.Q.2d 1169, 1172 (Fed.Cir. 1995); Met-Coil Systems Corp. v. Korners Unlimited, Inc., 803 F.2d 684, 686

creating a license. An unpatented product may have many different uses and the available uses may change over time. Therefore, the law always insisted that the circumstances of a sale be considered to make sure that the patent owner and purchaser intended that the purchaser would make the patented use.

By those requirements, the law created an implied license only where the price that the patent owner obtained for a product reflected the value of its use in the patented system or with the patented process. Since the product had only that use, the purchaser would pay a price equal to the value of that use if it had no other payment obligation to the patent owner and had freedom to make that use. If the patent owner and purchaser said nothing else to each other at the time of that transaction and did nothing else to suggest that the purchaser was not entirely free to make that use of the product, the price of the product reflected the value of that use to the purchaser and the patent owner may safely be assumed to have been content with receiving that price and permitting that use.

However, the patent owner and purchaser were entirely free to eliminate the implied license by making an express license or in some other fashion making clear that the patent owner and purchaser knew and understood that the patent owner was reserving its patent rights and the purchaser would have to license them separately.

This freedom to control an implied license is important. The price of a patented product will necessarily include the value of the patented invention, assuming there is no express license. If the invention is a new type of automobile, the price for an automobile will include the value of whatever advantages for consumers the invention provides. There is no risk that the exhaustion doctrine will be erroneously applied to deprive a patent owner of the value of the invention. The price of an unpatented product may or may not include the value of some patented invention. If an unpatented product has two uses – one a low value unpatented use and one a high value patented use – a sale by a patent owner may be at a price acceptable to low value users. If the courts erroneously decide that there was really only one use, the courts may permit buyers to make the high value use even thought the price the patent owner was paid did not reflect that value.

The implied license doctrine may also lead to patent owner's capturing less than the value of their inventions even where the courts do not make mistakes. Where a patent owner sells a component that is used in fixed proportions in a final system, the patent owner's component sales will capture the full value of the invention, assuming the patent owner does not license the system invention separately. This may not happen if the unpatented product may be used in varying proportions in the final system. Where a patent owner sells a component that may be

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(Fed.Cir. 1986); Bandag, Inc. v. Al Bolser's Tire Store, 750 F.2d 903, 924 (Fed.Cir. 1984; Hunt v. Armour & Co., 185 F.2d 722, 729 (7th Cir. 1950); Radio Corp. of Am. v. Andrea, 90 F.2d 612 (2d Cir. 1937); General Elec. Co. v. Continental Lamp Works, 280 F. 846, 849-51 (2d Cir. 1922); Oster v. Grant-Southern Iron & Metal Co., 381 F.Supp. 290, 293 (E.D.Mich. 1975); Trico Products Corp. v. Delman Co., 199 F.Supp. 231, 237-38 (1961); Westinghouse Elec. & Mfg. Co. v. Independent W. Tel. Co., 300 F. 748 (S.D.N.Y. 1924); Stukenberg v. United States, 372 F.2d 498, 504 (Ct.Cl. 1907).

used in variable proportions in the final system, the patent owner's component sales may not capture the full value of the invention, even though the component has only one use.

For example, if the invention is a new type of automobile and a patent owner sells an automobile manufacturer a carburetor, the price of the carburetor may not reflect the full value of the automobile invention, even if the only use of the carburetor is to make a patented automobile. Assume the patented automobile must use a certain type of carburetor. Assume the automobile invention provides better gas mileage depending on how many carburetors are used. The car maker may achieve 12 percent better mileage with one carburetor, 22 percent with two, and 30 with three. Consumers would pay $6000 more for the car with 12 percent better mileage, $11000 more for the car with 22 percent better mileage, $15000 more for the car with 30 percent better mileage. Suppose the patent owner has a carburetor plant and sells carburetors useful only in the patented autos. The patent owner sells carburetor for $5000 each thinking that buyers will use three per car and sell cars having 30 better mileage. However, the automobile makers may use only one per auto because they capture $1000 of the added value of the invention rather than none of that value. If the law permits, the patent owner will sell and separately license the auto makers to use the carburetors in each of these ways with different royalty payment for each use.

The price of a single-use component may not also reflect the value of a final system invention where there is more than one indispensable component. Suppose the patented automobile must use a certain type of carburetor, a certain type of manifold, a certain type of engine block, and a certain type of exhaust system. The patent owner sells each of these components and adds to the price of each component one-fourth of the value of the invention per auto. Again, the price at which the patent owner sells the carburetor will not reflect the value of the automobile invention, even if that is the only use for the carburetor. If a buyer of a carburetor has the right to make the other components itself and sell the resulting car, the patent owner has captured only one-fourth of the value of the invention.

These types of pricing problems also arise when a patent owner sells a material useful to carry out a patent process. The material a patent owner sells will often be used in variable proportions with other materials. The material may also be only one of several necessary materials. In those circumstances, the sale by a patent owner of one material is unlikely to capture the full value of the invention.

For these reasons, the law provided patent owners with control over whether an implied license existed. The law also generally permitted a patent owner to sell an unpatented product and expressly license the buyer to use it, subject to an unbelievably complex set of rules against tying arrangements.

Before *Quanta*, the exhaustion doctrine eliminated the need for an express license when the product was patented and the buyer's use and resale of the product necessarily required a license. Before *Quanta*, the implied license doctrine eliminated the need for an express license when the product was not patented. The law provided the purchaser with an implied license to use a part or component to make a patented system and then use and sell the system, or to use a machine or material to carry out a patented process. However, the law implied that right only where the part, component, machine or material had only the patented use and only where the circumstances showed that the seller and the purchaser intended that the purchaser have a free license.

E. The Proper Results of this Policy

1. Where a Patent Owner Grants a Purchaser an Express License, the Implied License and Exhaustion Doctrines Should Not Operate

If this is the purpose of the exhaustion and implied license doctrines, those doctrines would not operate when a patent owner and a buyer made an express agreement that provided the buyer with different rights or payment obligations than it would have under the exhaustion or implied license doctrine. The exhaustion and implied license doctrines should operate to facilitate sales and licensing transactions between patent owners and their customers and not to dictate the terms of those transactions. If the parties to a particular sale wish to adjust the rights differently by an express license, they should be free to do so.

So long as the law permits patent owners and their customers to control the ultimate disposition of rights and responsibilities, the exhaustion doctrine and implied license doctrine will do no harm. The doctrines will provide the cost savings when the patent owner and purchaser wish to be governed by the law and will not operate when there is something to be gained by making the additional effort to agree to operate under the terms of an express license.

Until *Quanta*, the law permitted patent owners and their customers to control operation of the exhaustion doctrine by the rule that a patent owner could sell and license with express conditions, restrictions or limitations on the patent rights the purchaser received. If the purchaser used the product contrary to some restriction in its license, the purchaser infringed the patent. Until *Quanta*, the law permitted patent owners and their customers to control operation of the implied license doctrine by entering an express license at the time of sale or by the patent owner giving a customer notice that the owner was reserving its patent rights or granting the customer limited rights. The license or the notice permitted the customer to decide whether the total cost of purchasing was less than the value it would receive by buying.

2. Where a Patent Owner Grants a Purchaser an Express License, Conditions, Restrictions or Limitations that Prevent Activities the Patent Does Not Give the Patent Owner the Right to Control and Harm Competition in a Market Should Be Unenforceable

The law limited the patent owner's control of the exhaustion doctrine and implied license doctrine in one way. If a patent owner granted a customer a license having a restriction that violated antirust law or the Court perceived prevented the customer from selling or buying in ways that the patent did not give the patent owner the right to control, the restriction was unenforceable. The customer could ignore the restriction and the customer's activities that the restriction placed outside the scope of its license were not infringement. In some of these cases, the patent owner sold a product with a printed label with a notice defining the restriction in the license the customer received. In those decisions, the Court said the restriction in the notice was unenforceable for one of those reasons. Those decisions did not mean that all restrictions in licenses a patent owner granted a purchaser were unenforceable. The only unenforceable restrictions were those that violated antitrust law or that the Court thought extended the scope of the patent rights in some harmful way. Over time, restrictions that the Court believed extended the scope of a patent came to be known as patent misuse.

It is perfectly sensible for the law to render unenforceable license restrictions that harm competition in some market that the patent did not give the patent owner the right to prevent. In this way, the law helps consumers and does no harm to patent owners' ability to earn profits that reflect the true value of the inventions.[8] Within this limit on a patent owner's licensing options, it was clear prior to *Quanta* that a patent owner or a licensee could limit operation of the exhaustion doctrine by expressly licensing buyers. When a patent owner attempted to do so, the only issues for the law were whether a patent owner or a licensee had granted a purchaser a limited license, whether the limitations were lawful, and whether the purchaser violated a lawful limitation.

3. When a Patent Owner Grants a Manufacturer an Express License to Sell, the Patent Owner May Limit a Licensee's Right to Sell and Unauthorized Sales Are Infringement

The same benefits for the parties to sales and licensing transactions exist when a patent owner has expressly authorized someone else to sell a product. Sales transactions between a licensed seller and a buyer will be facilitated in the same way as sales transactions between a patent owner and a buyer. For that reason, the exhaustion doctrine and implied license doctrine law should apply in the same way.[9]

The only difference is that the seller is a licensee whose rights are governed by an express license. This license reflects the patent owner's desires about how the patent rights are best exploited. The patent owner may have limited the rights granted in a way the owner believed would increase the economic value of the invention and the portion of that value paid to the owner.

When the patent owner has limited the selling rights of a licensee, the patent owner has decided that its patent rights are exploited most profitably by only certain types of sales. If its licensee makes some other type of sale, the law should give effect to the limits on the licensee's authority and allow the patent owner to assert its patent rights against its licensee. Unless those limits violate antitrust law or the patent misuse doctrine, the patent owner's express license terms should be enforced. If the licensee makes a sale not authorized by its license, the sales transaction is patent infringement.

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[8] The problem was that the law came to render unenforceable restrictions used to enhance the profits patent owners earned and that did no harm to competition beyond that the patent owner had the right to control. That problem is beyond the scope of this paper.

[9] A patent owner may authorize a licensee to sell a product made by the licensee or someone else for the licensee. It is often unimportant to a patent owner who manufactures a product. A patent owner may rely on its licensee to have the best product made at the lowest cost. For that reason, whether a licensee made the product should be irrelevant to the exhaustion and implied license doctrines.

Limitations on a licensee's right to sell come in many forms. A patent owner may limit a licensee so that it has the rights to sell only some types of products. If a patented carburetor may be used in automobiles and airplanes, the patent owner may grant a licensee the right to sell only automobiles containing the carburetor. A patent owner may grant a licensee the right to sell to only certain types of customers. A patent owner may grant a licensee the right to sell patented carburetors only to automobile makers. In similar ways, a patent owner may grant the right to sell only in certain geographic areas, only for a limited time, and only in limited amounts. The law respects those limitations.

The law has more difficulty when a patent owner tries to limit the right to sell by the use of the product that a purchaser will make. The law draws fine distinctions based on the precise wording of the seller's license.

For example, if the seller is authorized to make, use and sell in New York, the courts say a buyer in New York may use and resell anywhere. The courts explain why the buyer has broader rights than the seller by saying the license did not limit the seller's right to sell for use anywhere. The courts reason that the patent owner intended to permit buyers to use anywhere. However, if the seller is authorized to make and sell in New York only for use in New York, the courts say a seller is an infringer if it sells to a buyer it knows plans to use outside of New York and a buyer in New York is a patent infringer if it knows the seller had the right to sell only for use in New York and uses outside New York. The law says the buyer has no right to use outside New York, because the patent owner limited the licensee's right to sell for that use and obviously intended that the buyer not use outside New York. The law is less clear about what to do when the seller did not know what the buyer intended to do and the buyer did not know what uses were authorized by the sellers' license.

A famous example involved patents on an electrical component called an amplifier. The patented amplifiers were useful in telephones, radios, public address systems, talking picture equipment, and other types of equipment.[10] The patent owner had subsidiary corporations. The patent owner granted exclusive licenses to its subsidiaries to make and sell equipment in different fields. The licensees had the power to grant additional licenses in their fields. One subsidiary, that came to be known as RCA, had the license for radios. That subsidiary granted a company a license to make and sell amplifiers for use in radio receivers (now simply called radios). Amplifiers useful in radios were also useful in other types of equipment. The licensee sold amplifiers to a company that made talking picture equipment for use in movie theaters. The purchaser used the amplifiers to make taking picture equipment and leased that equipment to theaters.

The problem in this situation is that the limitation on the seller's right to sell is defined by what a purchaser does with the amplifiers after the sale. If the purchaser uses them in radios, there is no issue. The limitation in the license has had the desired effect and the sale is deemed

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[10] General Talking Pictures Corporation v. Western Electric Co., 304 U.S. 175, 176, 58 S.Ct. 849, 850 (1938). *Quanta* cited and expressed no displeasure with the result in *General Talking Picture*. *General Talking Picture* means that limitations in a seller's license on a buyer's use are enforceable and binding on a buyer that knows about them.

authorized. If the purchaser uses them in talking picture equipment, there is an issue – patent owner's purpose has been defeated. In that case, the Court found that the sale was not authorized, because the seller knew the purchaser planned to use the amplifiers in talking picture equipment and the buyer knew the seller had no license to sell for that use. The Court did not say what it would do in other situations.[11]

In this example, a purchaser's infringement liability depended on its use of a product after the sale. The limitation in the seller's license controlled the post-sale use by the purchaser. The Court in that case said it was entirely lawful to license in a way that limited the permissible use of a product by a buyer. However, instead of saying that the purchaser was an infringer

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[11] The courts have allowed a patent owner to license a seller and limited it to sales only for certain uses, in certain areas and for certain times. These limits apply to a buyer that knows about them. What if the buyer does not know? If a buyer without that information is not an infringer, the benefits the patent owner was trying to achieve by limiting the licensee's rights will be lost. If the buyer is an infringer, the patent owner will obtain those benefits.

If the buyer did not know that it would be an infringer and paid a price that assumes total freedom from infringement liability for all uses, the buyer loses the value that it thought it was obtaining. The buyer paid a price based on assumed freedom to use the product in any way and does not have that right. However, a buyer from a licensee without authority to sell for all uses is no worse off than anyone else who uses an infringing product. The law generally places the burden on sellers and buyers of products to avoid patent infringement. The reason is that potential patent infringers may avoid infringement at lower cost than patent owners. Potential infringers know their commercial plans and patent owners do not.

The only apparent reason to treat differently a buyer from a licensee is that the patent owner could have avoided the buyer's loss more cheaply than the buyer. The patent owner could have required its licensee to give its customer notice of any limitations in its license and perhaps even required its licensee to grant customers express licenses containing those limitations. Beyond those steps, it is unclear what more a patent owner could do prevent a licensee from selling in a way that exposed a buyer to infringement liability. If a patent owner undertook to monitor a licensee's sales by requiring its licensee to inform the patent owner of the details of all proposed sales and obtain the patent owner's approval for each sale, this would involve enormous additional expense for patent owners and licensees.

For their part, buyers could avoid unknown liability by requiring their suppliers to guarantee that they had authority to sell and that use would not infringe any known patents, a standard term of commercial sales transactions. This step is likely to be less expensive than those a patent owner could take, except for the notice requirement.

Of course, the lowest cost infringement avoider is the licensee. Therefore, the law should place total responsibility on the licensee to increase its incentives to act only within its authority and inform buyers of limitations on their rights. The law accomplishes this by imposing infringement liability on the licensee and permitting the buyer to recover its loss by a claim against the licensee for breaching the terms of the purchase agreement.

because the limitation on post-sale use in the seller's license applied to the buyer when it knew of that limitation, the Court said the purchaser was an infringer because the sale was not authorized by the license. The Court said that because the sale was not authorized, the seller infringed by selling and the result for the buyer was the same as if it had purchased from someone without a license.

This explanation is pure semantics. There was no way to say at the time of the sale that it was not authorized. If the purchaser had changed its plans and made radios, the Court would have said the sale was authorized. The proper result should not depend on saying a sale is deemed authorized, if a buyer later makes an authorized use, and deemed not authorized if the buyer makes an unauthorized use. The result should depend on whether a patent owner or a licensee may sell a product and limit the patent rights a purchaser receives so that some uses are authorized and some are not.

Assume that the licensee had granted the purchaser at the time of the sale an express license saying the purchaser had the right to use the amplifiers only in radios, the same limitation contained in the seller's license. Assume also that the purchaser did not know that the seller's license limited it to sales for that use. However, the purchaser did know that it was buying subject to a patent license limiting its use of the product. It is almost inconceivable that the Court would have said the purchaser was not a patent infringer when it used the amplifiers in talking picture equipment. If a purchaser's knowledge of a limitation on its use in its supplier's license makes that limitation applicable to the purchaser, surely a purchaser's knowledge of the same limitation in a license granted to it makes that limitation applicable.

Stated more generally, there is no reason for the law to say that a limitation on a buyer's use of a product is effective when the limitation is in a license the patent owner granted to a seller (because a buyer's use contrary to the limitation renders the sales unauthorized) and that the same limitation on a buyer's use of a product is not effective when the limitation is in a license the patent owner granted directly to the buyer. It is little short of complete silliness for the law to say limitations on a buyer's use of a product are enforceable when found in a license granted to a seller and not in a license granted to a buyer.

It would also be grossly inefficient for the law to say that a patent owner may limit the rights a buyer receives when it purchases from a licensee and not when it purchases from a patent owner. If it is important to a patent owner to limit a buyer's rights and the patent owner may not do so if it makes and sells, the patent owner would be forced to grant licenses to other less efficient producers in order limit a buyer's rights. The patent owner would have to sacrifice its ability to make the best products at the lowest cost so that, when a buyer uses in unauthorized ways, the owner is able to say the sale by the licensee was unauthorized and the buyer is therefore an infringer.

4. The Form in Which a Patent Owner Grants an Express License

When a patent owner sells and wishes the buyer to have only a limited patent license or no license by virtue of the sale, the law might limit the ways in which the patent owner informs the buyer of that fact to assure that the buyer considered the scope and terms of the license when it decided to pay the price it paid.

Before *Quanta*, a patent owner could control whether an implied license existed merely by giving notice to a purchaser that there was no such license. Before *Quanta*, it was not entirely clear that a mere notice of a purchaser's license was sufficient to control the extent of exhaustion. The Court in a couple cases founded that a notice found on a label on a product stating the limited terms of a license were ineffective, though in each case the Court did so because the specific limitations were perceived to be against public policy or illegal under antitrust law. In any event, before *Quanta*, it was clear that if a patent owner granted a purchaser an express written license at the time of sale, the terms of the license controlled the extent of exhaustion, unless some restriction or limitation was unlawful.

It is difficult to understand why the law would treat differently a notice stating license rights provided to a purchaser on the product and a written license given to the purchaser and accepted by it. It makes sense to distinguish those different ways of licensing if there is some relationship between the price at which products are sold and the manner in which a patent owner informs a purchaser that its rights are nonexistent or limited. In situations where a buyer is likely to pay a price that assumes complete royalty-free freedom to use the product, the form of granting an express license may matter if one form assures that the buyer adjusted the price it paid based on the patent rights it received and another form does not. A buyer who receives an express written license and agrees to it must have assessed the price of the product accord to its patent rights. A license provided on the label of a product is perhaps less likely to provide the assurance that the buyer took its limited rights into account when it purchased. However, my view and the history of the law is that buyers may be assumed to have taken their patent rights into account, when a license is provided in either of those ways.

F. The Effects of *Quanta* on the Policy of Exhaustion and Implied License

The *Quanta* decision will upset a sensible exhaustion and implied license policy in several ways.

One, *Quanta* says the exhaustion doctrine means all "post-sale restrictions" are invalid. It is not clear what the Court meant by "post-sale restrictions." If the Court meant that a patent owner may not sell and grant a buyer a license limiting the rights a purchaser acquires, a patent owner may not limit operation of the exhaustion doctrine. Purchasers necessarily acquire an unlimited patent license. If this is the result of *Quanta,* patent owners lose the ability to sell patented products and license the patent rights separately, if some limitation in the licensee's rights is important to achieving the benefits of licensing. If this is the result of *Quanta,* the law that a patent owner may sell and separately license the patent rights with lawful conditions, restrictions and limitations on the purchaser's license has been overruled.

Two, the Court said exhaustion applied to unpatented products that are useful only in practicing a patented invention and embody the essential features of the invention, meaning the features providing novelty. For such products, the exhaustion doctrine replaces the implied license doctrine. For these products, the law that an implied license exists only where the circumstances confirm that the patent owner and customer intended that the customer have an unlimited free license no longer matters. For these products, the law that a patent owner may prevent an implied license giving the buyer notice that is receives no patent rights no longer matters. The law that a patent owner may control the rights a buyer possesses by granting the buyer an express license no longer matters to the extent that the exhaustion doctrine prevents licensing by rendering all post-sale restrictions invalid.

The effect of these two changes will depend on their effect on the ability of a patent owner to control what rights a purchaser possesses.

Quanta could mean that patent owners and their customers have no control over the patent rights a purchaser receives when the product is patented and sometimes unpatented. The law controls the market for sales of patented products and some unpatented products. The law dictates that activities of purchasers do not infringe a patent even though, if permitted to agree on whether the purchaser had complete freedom from the operation of the patent, the parties would have agreed that the profits available for them to share from exploitation of the patent would be greater if the purchaser had some freedom from operation of the patent and not unlimited freedom. If this is the result of *Quanta*, the decision is counter-productive. The profits a patent owner and its customers earn if permitted to determine the extent of the purchaser's freedom from infringement will be greater than the profits they earn constrained by the exhaustion doctrine and the rule that post-sale restrictions are unenforceable.

Quanta does not necessarily lead to this result. *Quanta* involved one particular license and one type of notice. Consider the question of the effect of the notice. The lower courts thought a notice to a buyer was sufficient to control the rights a purchaser received. This was a consequence of applying the implied license doctrine. The Court has now says the exhaustion doctrine applies. Under the exhaustion doctrine, it is not clear that providing a purchaser with the notice of what patent rights it possesses and does not possess is sufficient to control those rights. In this action, the Court decided that a notice to a purchaser did not control the rights. However, the Court reached that result by saying a provision requiring notice was not part of the license agreement and that the requirement to give notice was not a limitation on the licensee's authority to sell, meaning that the licensee had the right sell whether or not it gave the notice. Therefore, the actual decision should not necessarily preclude a patent owner or licensee that sells unpatented products of that type from controlling the buyer's rights through a notice.

Consider the question of the effect of an express written license agreement between a patent owner and purchaser. Again, the actual decision should not preclude a patent owner or licensee that sells unpatented products of the type governed by *Quanta* from controlling the buyer's rights by granting the buyer an express written license providing limited rights. The Court said the patent owner might have contract claims against its licensee. If a contract between a patent owner and a seller controls their rights and obligations, a contract between a patent owner and a buyer should also control. Presumably, the Court did not mean to foreclose patent owners and purchasers from making the most important type of contract in this setting, namely a license agreement. Nor should *Quanta* necessarily be read to change the rule that a licensee that acts outside the scope of its license is subject to an action for patent infringement. *Quanta* seems to accept that a sale may be made subject to conditions. If a sale is made subject to a license agreement, there is no reason why a "violation" of lawful limitations in the license should result only in a claim for breach and not a claim for patent infringement. However, after *Quanta*, it is possible that even an express written license is not enough to control exhaustion.

Third, *Quanta* affirmed that some sales by a licensee do not exhaustion the patent owner's rights. However, *Quanta* does not say whether a license to sell only for limited use by the buyer renders a sale unauthorized if a buyer makes some other use. *Quanta* simply says that if a patent owner grants a licensee the unlimited right to make, use and sell, a buyer has the same unlimited rights. *Quanta* says that a provision in the license saying no license is granted to a "third party" (presumably including a buyer) to use a product sold by the licensee make a combination product does not render the sale unauthorized when the buyer does so. The Court's reason was that this provision related only to the issue of implied license and had nothing to do with exhaustion, a conclusion enforced by another provision in the license. This leave open the possibility that the Court would find that a license to sell only for limited use by the buyer is permissible and renders a sale unauthorized if a buyer makes some other use. If this remains true for sales by a licensee, the same result should apply to sales by a patent owner and not all "post-sale restrictions" are invalid.

Finally, prior to *Quanta*, the line between the exhaustion and implied license was clear and easily understood by patent owners and purchasers. One merely had to compare a product to the claims in a patent to decide which of those two doctrines controlled. After *Quanta*, it is much more difficult for patent owners and purchasers to know whether exhaustion or implied license controls. They may decide only after they review each claim of each patent, identify the novel features of the invention of each claim (something they may not learn by simply reading the patent), determine whether a product includes all of those novel features, gather information about all possible uses of the product, and determine at time of a particular sale, whether the only use is the patented one. This greatly complicates transactions between patent owners and purchasers. They may not determine the applicable law without spending an enormous amount of time analyzing patents and the possible uses various products at the time of each sale. As a practical matter, it is rarely going to be possible for patent owners and purchasers to have this information time they are buying and selling particular products.

By this change in the law, the Court has contributed to defeating the basic purpose of these doctrines, namely to provide default rules that the parties would likely have intended for a particular sales transaction, namely purchaser freedom freely to use in any way, unless there is a basis for believing the parties had some other intent. After *Quanta*, patent owners must either spend time and money mapping all its patents on all its products in a way that permits it to know whether exhaustion or implied license controls or adopt the operating assumption the exhaustion will control all sales and try to take the steps necessary to control exhaustion, if it may be controlled at all. Instead of the exhaustion doctrine reducing the costs of transactions in products, the doctrine could increase those costs.

G. The Standard Explanations of the Policy of the Exhaustion Doctrine

The main problem with the exhaustion doctrine is that the courts sometimes view the exhaustion doctrine to operate beyond the control of a patent owner or a licensee and their customers. The law dictates to patent owners and purchasers what "license" rights a purchaser acquires when it buys. Why did the law develop a doctrine that sometimes eliminated a patent owner's rights even when the patent owner desired that buyers have only limited rights?

1. The Forgotten Influence of the Patent Act of 1836

The exhaustion concept arose in the 1850s in actions involving patents that had an original term and extended terms granted by the patent office or Congress. The cases involved the rights of a person who was using a product during the original term to continue using it during the extended term. Some of those users made the products during the original term, because the patent owner gave them an express license to make and use them. Others used products they had purchased during the original term. When the extension was granted by the patent office, there was a provision of the Patent Act defining the effect of the extension. The courts interpreted the provision to say that people had no rights during the extended term, if they had licenses granted during the original term to make and sell under the patent. The patent owner could grant the rights to make and sell to someone else during the extension. The courts said the provision worked differently for those having the right to use granted during the original term; their right to use products placed in use during the original term continued during the extended term. In some of these cases on term extension, the courts talked about the right of a purchaser for use in the ordinary pursuits of life to continue use.

There was one important decision on term extension that made clear that a patent owner could prevent a buyer from have the right to continue to use during the extension, if the patent owner granted licenses with the right language. If the patent owner granted the seller a license to make and sell only during the period of the original term and the right and responsibility to grant a license to buyers to use only during the period of the original term, buyers had no right to continue use during the extended term. The express licenses controlled, not the Patent Act. This decision was *Mitchell v. Hawley,* the decision the Court of Appeals for the Federal Circuit thought controlled the result in *Quanta.*[12]

The Court later applied the same concepts in cases that did not involve extensions of a patent's term and were not controlled by this provision of the Patent Act. However, the distinction lived on. In the decisions not controlled by the Patent Act, the Court gave three explanations for the doctrine.

2. Exhaustion Is the Essential Nature of Things

In these later cases, the Supreme Court's explained the exhaustion doctrine by saying it was in the essential nature of things that purchasers of patented products from a patent owner are insulated from patent infringement liability.[13] This was no explanation at all. This was simply a bald assertion that the result that Court reached was the correct one.

3. A Patent Owner that Sold a Patented Product and Was Paid Has No Interest in a Buyer's Use or Resale

[12] Mitchell v. Hawley, 83 U.S. 544, 550-551 (1872).

[13] *Adams v. Burke*, 84 U.S. 453, 456-457 (1873)("But, 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.").

The Supreme Court offered another explanation. When a patent owner has exercised its patent rights by selling a patented product and been paid, the Supreme Court said the patent owner captured the value of its invention in the product and the patent served its purpose. This explanation first appeared in *Adams v. Burke*.[14] The patent owner is not permitted to use its patent to control the use or resale of that product by its customer, because the patent owner has no legitimate interest in the customer's later use or resale. Having been paid the price, the patent owner will make the same amount of money regardless of what the customer does with the product. Therefore, the law gives the customer the right to do whatever it wants.

This is a perfectly sensible approach where there is no indication that a patent owner was attempting to do something different. It is not where a patent owner, its licensees, and their customers agree to a license that provides a different result. If the law insists that a product sale always exhausts all the patent owner's rights, this will preclude patent owners from exploiting inventions in ways that would lead to greater patent owner profits and greater use of patented inventions by purchasers. If the law permits a patent owner to sell a product and separately license the rights the buyer obtains, the prices at which products are sold will change, the profits of patent owners will change, and the extent of use of patented inventions by purchasers will change – all in desirable ways. I will describe why below.

4. A Patent Owner Should Not Be Permitted to Capture the Value of an Invention Twice, Once by Selling a Patented Product and Again by an Infringement Action against its Customer

There is a third possible explanation. It is possible to read the Supreme Court's decisions to say the exhaustion and implied license doctrines exist to protect purchasers from patent owners who might attempt to capture the value of some invention first by selling a product and again by suing its customers for damages for patent infringement. The Court said early on that a patent owner is entitled to only one royalty.[15] In the exhaustion context, the Court may have

[14] *Adams v. Burke*, 84 U.S. 453, 456-457 (1873)("That is to say, the patentee or his assignee having in the act of sale received all the royalty or consideration which he claims for the use of his invention in that particular machine or instrument, it is open to the use of the purchaser without further restriction on account of the monopoly of the patentee's.").

[15] This concept first appeared in *Bloomer v. Millinger*, 68 U.S. 340, 350-352 (1863)("Patentees acquire the exclusive right to make and use, and vend to others to be used, their patented inventions for the period of time specified in the patent, but when they have made and vended to others to be used one or more of the things patented, to that extent they have parted with their exclusive right. They are entitled to but one royalty for a patented machine, and consequently when a patentee has himself constructed the machine and sold it, or authorized another to construct and sell it, or to construct and use and operate 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 or so authorized to be constructed and operated. Where such circumstances appear, the owner of the machine, whether he built it or purchased it, if he has also acquired the right to use and operate it during the lifetime of the patent, may continue to use it until it is worn out, in spite of any and every extension subsequently obtained by the patentee or his assigns.").

believed that patent owners would be able to sell patented products to customers who unknowingly believe they have freedom to use and resell those products and pay a price based on such freedom, and then sue their customers for patent infringement and recover damages equal to the value of the invention in the product. The Courts may have believed patent owners could capture the value of the invention twice. *Quanta* may have been based on this misconception.

H. Why These Explanations of the Policy of Exhaustion Are Wrong

A patent owner that sold a patented product and was paid has an important interest in a buyer's use or resale. Patent owners may wish to sell a product and separately license the buyer for perfectly legitimate reasons.[16]

1. A Patent Owner that Sold and Was Paid Has an Important Interest in Economic Discrimination and a Purchaser's Activities May Prevent or Limit Discrimination

Where transaction costs permit, it is always in a patent owner's interest to supply an invention to every user having some value for the invention in exchange for a payment proportional to the value of the invention to each user. Such payments permit the patent owner to earn a greater percentage of the value of the invention and in most instances will increase use of the invention. Any rule that limits the ability of a patent owner to supply the invention to different users for payments proportional to the different values of an invention to them is counter-productive.

Economic discrimination enables the primary goal of patent law to be achieved by providing increased incentives for inventing, without any potential user having some value for an invention being deprived of its use due to a patent and the exclusive rights. If economic discrimination is permitted, the prices charged to marginal users may be close to zero, the ideal marginal price in the short-run for use of existing inventions. If economic discrimination is not permitted, the marginal prices must be higher and inventions will not be used as intensively as possible. For this reason, a patent owner should be encouraged to charge different users different amounts.

Patent owners have attempted throughout history to limit the rights their licensees and customers acquire to permit the patent owner the charge different licensees and customers royalties and prices proportional to the different values of the invention to them.

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[16] I discuss only two of those reasons. A patent owner may wish to sell and license separately where a purchaser has market power when reselling that product or some larger product made from it. The patent owner may license in ways that will prevent the buyer from selling at prices higher than those that maximize patent owner profits. A patent owner may also wish to sell and license separately where the patented product is used in variable proportions in some larger product. The patent owner would seek to use the license to force the buyer to use the patented product with others in the most efficient proportions and in that way improve patent owner profits.

For example, patent owners may license territory by territory because licensees in one territory may have greater value for the invention than licensees in another territory. Assume the licensees in one territory may be able to make and sell a product for $100 per unit and licensees in another territory for only $50 per unit. A patent owner may require its licensees in the low value territory to sell with an express license that buyers use the product only in that territory and not resell it. If exhaustion renders that license ineffective, buyers from licensees in the $50 territory may resell in the $100 territory. The licensees in the high value territory will make fewer sales at $100, and the patent owner will earn lower royalty revenue than it otherwise would. Again, the patent owner still makes some money on each sale by the licensees selling at $50. However, the patent owner's profits from use of the invention are lower because the $100 sales by licensees in the high value territory are lost.

Patent owners have attempted throughout history to sell and license use separately where a patented product has different values in different uses. The amplifier case discussed earlier is an example. Suppose a product has a value in some use of $50 and in another use of $1000. A patent owner may grant one licensee the right to make and sell for use by customers in the $50 use (radios) and another licensee the right to make and sell the same product for use by customers in the $1000 use (theater equipment). The same problems arise in the same way and with the same consequences as in the example of the previous paragraph.

The same problem exists where a patent owner make and sells the product. The patent owner would sell a patented product to some customers for slightly less than $50 and grant them an express license to use the product only in the use worth $50. The patent owner would sell a patented product to other customers at slightly less than $1000 and grant them an express license to use the product in the use worth $1000. If the exhaustion doctrine says that a purchaser who bought for less than $50 may resell to a user valuing the product at $1000 or may make the $1000 use instead of the $50 use, this method of exploiting the rights will not work.

In both of these situations, the patent owner may decide not to license or sell for the $50 use. The patent owner may decide to license or sell the product only for $1000 use. The $50 use will never be satisfied as it would have been if the patent owner could license or sell and limit the rights of the $50 customers.

Patent owners have attempted throughout history to sell and license use separately where the value of a product to each user depends on the amount of use. For example, if the product is a machine the buyer will use to make other products, the buyer captures the value of the machine when it sells the products made with the machine. The patent owner and the buyer may not know in advance of the machine sale how valuable the machine will prove to be to a particular potential buyer. To solve that problem, the patent owner may sell the machine at its manufacturing cost and license the buyer to use it and pay royalties based on a percentage of the buyer's revenue from sales of products made with the machine.[17] For this approach to work, the buyer must be liable for patent infringement if it resells the machine separately from the license or uses the machine and does not pay the royalty.

[17] *Quanta* does not involve a license made in this context. Patent owner have attempted to do the same thing through tying arrangements.

If the patent owner may not sell to all machine users for a low price and license for royalties proportional to the value the machine to each user, the patent owner will sell machines at some higher price. The machine price will not accurately reflect the value, because it will be set before the patent owner and users know the value. If the patent owner sells to all users at a single price, some users that would have bought under the sale and licensing method will no longer be able to buy.

The patent owner may consider attempting to charge higher prices to users who expect to have higher value and lower prices to those expecting lower value. However, if the exhaustion doctrine permits low price buyers to resell to potential high price buyers, the patent owner will decide not to do this because low price buyers will supply the high value buyers and not the patent owner. For these reasons, the exhaustion doctrine will cause the price for the machines to go up, the quantity sold to go down, patent owner profits from exploiting the invention to go down, and the value of the machine captured from its use to go down.

In these examples, the patent owners were attempting to sell and license in a way that achieves economic discrimination. The law should encourage patents to be exploited in this way. If the law insists that, when a patent owner or its licensee sells a patented product to a customer, the customer obtains freedom from all infringement liability for all future use and resale, the law imposes a barrier to the most desirable way for patents to be exploited.

While other examples exist, these should suffice to show why the Supreme Court was wrong if it believed that the exhaustion doctrine would not affect the value of patented inventions to patent owners, the prices at which patented products were supplied to users, and the amount of use of patented products by consumers. Stated generally, patent owners will be able to increase the value of patented inventions and increase the use of those inventions by others, if the patent owner is permitted to sell and license separately. If a patent owner or its licensee may sell a patented product to customers and at the same time enter express licenses with the customers that limit the rights they acquire, the law should enforce the limitations of those licenses, unless those licenses violate sensible antitrust and misuse laws. If customers may ignore the licenses due to exhaustion doctrine, patent owners will not do business in this way and will use alternatives leading to lower sales and profits.

2. A Patent Owner that Sold and Was Paid Has an Important Interest in the Investments Made by Its Licensees and a Purchaser's Activities May Prevent or Limit those Investments

There is another important reason patent owner should be permitted to sell a license separately. Patent owners have throughout history attempted to limit the rights their licensees acquire to induce the licensees to behave in ways that enhance the value of the rights. For example, in the early cases that gave rise to the exhaustion doctrine, patent owners assigned the rights to make and sell products to different assignees in different territories or granted exclusive licenses to make and sell to different licensees in different territories. One reason for patent owners to do so is that an assignee or licensee with an exclusive territory will make investments in product development, marketing or customer service that enhance the value of the invention and that it would not make if it were merely one of many licensees selling in that territory. These investments will change product prices and patent owner profits.

Consider an example. Assume that if the exclusive assignees or licensees make the desired investments, a patented product will sell for $250 per unit with 150 units sold and, given licensee costs of $150 per unit, yield licensee profits of $15,000. If they do not make the investments, the product will sell for $125 per unit with 125 units sold and, given licensee costs of $75 per unit, yield licensee profits of $6250. The patent owner desires higher licensee profits, since this permits higher royalty revenue. The desired higher prices and profits depend on what buyers do with the products they buy.

If a buyer from a licensee in one territory may resell in a different territory, this will undermine the incentives the patent owner is attempting to create. Some licensee may not make the desired investments and sell for $125. If that licensee's customers may resell in other territories, the other licensees will not make the desired investments and the patent owner will earn lower profits than it otherwise would. The patent owner still makes money on each sale by an assignee or licensee. However, the patent owner's profits from use of the invention are lower, because exhaustion caused lower prices, lower profits, and lower royalties.

3. A Patent Owner that Sells and Licenses Purchasers Is Not Able to Capture the Value of an Invention Twice

What about the Court's concern about the need to protect purchasers from patent owners who attempt to capture the value of some invention first by selling a product and again by suing its customers for damages for patent infringement?

The short answer is the law on damages and implied license will prevent a patent owner from capturing the value of an invention twice.[18] Even if the law did not have these rules, the

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[18] See Aro Mfg. Co. v. Convertible Top Co., 377 U.S. 476, 510 (1964)(the Court found that it would be inconsistent with public policy to allow a patent owner to collect damages from a component supplier, Aro, after the patent owner received the equivalent of a royalty from the seller, Ford, of the product using the component; "To allow recovery of a royalty on Aro's sales after receipt of the equivalent of a royalty on Ford's sales, or to allow any recovery from Aro after receipt of full satisfaction from Ford, would not only disregard the statutory provision for recovery of 'damages' only, but would be at war with virtually every policy consideration in this area of the law."). See also *Birdsell v. Shaliol*, 112 U.S. 485, 487-88, 5 S.Ct. 244, 246 (1884)(where the owner of a patent on a product obtains a judgment for infringement against a seller that constitutes the entire compensation for the infringement and the judgment is paid, purchasers are deemed to have an implied license to use the product, and the patent owner may collect not further damages from them based on use.); *Odetics, Inc. v. Storage Tech. Corp.*, 14 F. Supp. 2d 785, 787-80 (in an action against a seller of infringing systems and two of its customers who purchased such systems, damages were awarded against the seller based on a reasonable royalty on its sales, and no further damages awarded against the customers), *aff'd,, Odetics, Inc. v. Storage Tech. Corp.*, 185 F.3d 1259 (Fed. Cir. 1999); *Goodyear Tire & Rubber Co. v. Overman Cushion Tire Co.*, 95 F.2d 978 (6th Cir. 1937)(damages awarded based on a reasonable royalty against a subsidiary who resold tires purchased from its parent company, a tire manufacturer, precludes recover of further damages against the manufacturer for its sale of those tires; "Accordingly, if the decree had been against the manufacturer for a reasonable royalty and had been satisfied, its vendee would be immune from suit. Although here the vendee was sued

exhaustion doctrine is not needed to prevent patent owners from capturing the value of some invention twice. Patent owners could not succeed in business in that way on a significant scale. Any business that attempted to exploit its patent rights in that way would be out of business one day after its first threat to file an action for infringement against a customer. One day after that threat, no one else would buy from it. Because it is so unlikely that patent owners could successfully engage in business in that way on any significant scale for even a short period of time, the exhaustion doctrine is not justified to protect purchasers from patent owners.

If a patent owner is permitted to sell and license separately, the value of an invention will be captured only once, because the terms of the license will affect the price. The price at which a patent owner sells a product will be influenced by the rights the customer obtains and the additional payment obligations it bears in the future. For example, if a patent owner sells a patented product to a customer and enters an express license requiring payment of royalties of $10 when the customer uses or resells the product, the price for the product must be reduced by $10 below the price the customer would pay if the customer acquired the right to use as part of the purchase. A buyer will not pay more for a product and an express license with a lump sum royalty obligation than it would pay for a product and a right to use it created by law.

Other limitations will have a similar affect on the price. For example, if a patent owner sells a patented product to a customer and at the same time enters an express license with the customer giving the buyer the right to use it only in Montana, the buyer will pay less than it would have with a right to use the product anywhere.

If exhaustion requires that a patent owner always include the value of a license to use and resell the product in the purchase price, the law requires that the royalty be a lump sum payment made at the time of sale. There are often other and better pricing options that will lead to more efficient use of inventions and larger patent owner profits.

IV. The *Quanta* Decision

A. The Facts

LG Electronics ("LG" or "LGE") owned many patents relating to computer systems, computer components and computer methods of operation. Intel also owned patents. LG and Intel entered a cross license agreement. The Court treated the license as one from LG to Intel. Under that agreement, LG licensed Intel apparently under all LG patents. The license authorized Intel to "make, use, sell (directly or indirectly), offer to sell, import or otherwise disposed of" Intel products.[19] The Intel products included microprocessors and chip sets. The license provided 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

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first, since it has paid a reasonable royalty for the manufacture and all sales, defendant's manufacture and sale to its subsidiary are deemed to have been licensed ab initio.").

[19] Quanta Computer, Inc. v. LG Electronics, Inc., __ U.S. __, 128 S.Ct. 2109, 2114 (2008).

like acquired ... from sources other than a party hereto, or for the use, import, offer for sale or sale of such combination."[20] The Court did not include some language from that provision because the agreement was filed under seal. Other portions of the opinion suggest that the provision provided in that "no license is granted by either party hereto expressly or by implication to any third party" for the combination of licensed products with components from other sources or for the use or sale of combination products.[21]

The license contained an unusual provision. That provision said, "Notwithstanding 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."[22] The Court interpreted that language to mean that the agreement "purports not to alter the usual rules of patent exhaustion." In other words, the Court understood the parties to intend that the language regarding combination products did not limit in any way the operation of the exhaustion doctrine.

At the time they entered the cross license, LG and Intel also entered a so-called Master Agreement. The Master agreement said that a breach of the Master agreement would have no effect on the license agreement and would not be a basis for terminating the license agreement.[23] One provision of the Master agreement was that Intel agreed to give written notice to its customers that while Intel had obtained a broad license "'ensur[ing] that any Intel product that you purchase is licensed by LGE and thus does not infringe any patent held by LGE,'" the license "'does not extend, expressly or by implication, to any product that you make by combining an Intel product with any non-Intel product.'"[24] The Court did not discuss what it purchaser would have understood that notice to mean with respect to the purchaser's possible infringement liability to LG. A customer could understand it to mean that Intel products were licensed under any LG patent for any use. A customer could also understand it to mean that the license under LG patents did not extend to products the customer made by combining Intel products with non-Intel products.

Intel sold microprocessors and chip sets under the license to computer assemblers and suppliers including Quanta Computer ("Quanta'). Quanta used those microprocessors and chip set to make computers. In doing so, Quanta made computers in which those microprocessors and chip sets operated with the buses connecting them to other components and with main memory devices containing data and instructions on which those microprocessors and chip sets operated. Quanta sold those computers to original equipment manufacturers for resale to computer users. LG sued Quanta and other computer makers for patent infringement under six patents. Only three of those patents were involved in the decision reviewed by the Supreme

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[20] Id. at 2114.

[21] Id.

[22] Id.

[23] Id.

[24] Id.

Court. According to the Court, each of those three patents contained both system and method claims. The general nature of those patents and claims is discussed later.

B. The District Court's Decisions

In the District Court, Quanta moved for summary judgment of noninfringement based on exhaustion and implied license. The District Court initially granted Quanta's motion on the grounds that Intel's sale of microprocessors and chip sets to Quanta exhausted LG's patent rights under five LG patents, including the three involved in the Supreme Court's decision.[25] The District Court found that the law governing exhaustion included the Supreme Court's decision in *United States v. Univis Lens*.[26] The District Court did not cite *Univis Lens* as providing the law on implied license. The District Court did not decide the issue of implied license, because it was moot. The District Court issued a second decision on Quanta's motion based on LG's motion for reconsideration. The District Court said LG raised two new arguments. LG's new arguments were that exhaustion did not apply because Intel's sales to Quanta were conditional and exhaustion did not apply to method claims in any circumstances.[27]

On the first new argument, the District Court agreed that exhaustion arises only from unconditional sales and that LG was entitled to impose conditions on the sale of patented products or the essential components of patented products, citing the Court of Appeal's decisions in *B. Braun Medical, Inc. v. Abbott Lab* and *Mallinckrodt, Inc. v. Medipart, Inc.* LG argued the sales were conditional because the customer were informed by the notice that their purchase of components from Intel did not grant them a license to infringe LG patents by combining those components with other non-Intel parts.[28] However, the District Court rejected the view that the sales by Intel to Quanta were made conditional on Quanta having no license to make combination products from Intel products and non-Intel products. The District Court said Quanta did no agree not to combine the Intel microprocessors and chipsets with other non-Intel parts and that a notice in a letter to a purchaser did not make the statements in the letter a condition of the purchase agreement or transaction. The District Court said the notice in the letter was sufficient to negate the implication of a license to practice the LG patent from the purchase of essential components of LG's patented devices from a licensed source. However, the letter did not make the sale of the microprocessors and chipsets conditional, and therefore Intel's unconditional sale of the essential components of the patented devices exhausted LG's patent rights[29]

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[25] LG Electronics, Inc. v. Asustek Computer, Inc., 65 USPQ 2d 1589, 1593, 1600 (N.D.Cal.2002).

[26] United States v. Univis Lens Co., 316 U.S. 241, 62 S.Ct. 1088 (1942).

[27] LG Electronics, Inc. v. Asustek Computer, Inc., 248 F.Supp.2d 912, 915 (N.D.Cal.2003).

[28] Id. at 916.

[29] Id. at 916-17.

On the second new argument, the District Court agreed that exhaustion did not apply to method claims, relying on decisions of the Court of Appeals for the Federal Circuit.[30] The District Court said that Quanta's motion therefore depended on the doctrine of implied license. The District Court looked to the law of implied license in decisions of the Court of Appeals and denied summary judgment on the grounds that the notice to the purchasers precluded Quanta from proving that the circumstances of the sale clearly indicated that a license should be implied.[31]

C. The Court of Appeals' Decision

The Court of Appeals for the Federal Circuit reviewed the District Court's decisions on implied license and exhaustion. Apparently only some of the defendants appealed the judgment that there was no implied license. Quanta was one of those defendants. The Court of Appeals affirmed the District Court's decision that there was no implied license. The Court of Appeals' explanation was slightly different. The Court of Appeals said that there could be no implied license because Intel informed its customers that the license LG granted to Intel did not extend to the defendants' products made by combining the Intel products with non-Intel products.[32]

The Court of Appeals reversed the District Court's decision that Intel's sales exhausted LG's patent rights on claims to computer systems. The Court of Appeals said there were two types of sales that might give rise to exhaustion. The Court of Appeals said that exhaustion might arise merely from LG's license to Intel. For that novel proposition, the Court of Appeals cited *United States v. Masonite*, an antitrust decision not involving patent licenses.[33] The Court of Appeals also said that exhaustion might arise from Intel's sale of products to Quanta and the other defendants.

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[30] Id. at 918.

[31] Id. at 918.

[32] LG Electronics, Inc. v. Bizcom Electronics, Inc., 453 F.3d 1364, 1369 (Fed. Cir. 2006)("The trial court found, and we agree, that Intel's sales of its licensed products to defendants do not warrant the inference of a license with respect to the asserted patents. Regardless of any noninfringing uses, Intel expressly informed them that Intel's license agreement with LGE did not extend to any of defendants' products made by combining an Intel product with non-Intel products. In light of this express disclaimer, no license can be implied.").

[33] United States v. Masonite Corp., 316 U.S. 265, 278, 62 S.Ct. 1070, 86 L.Ed. 1461 (1942). In that case, a manufacturer and seller of hardwood panels appointed its former competitors agents to sell the patent owner's hardwood panels. The patent owner and those formerly competing companies sold the hardwood panels at agreed prices. The Court found this arrangement to violate the antirust laws as an agreement to fix prices. The manufacturer owned patents. However, its agents were not patent licensees. The Court did not say that granting a patent license exhausts patent rights.

For both types of "sales", the Court of Appeals said that exhaustion arises only from an unconditional sale, citing *Mitchell v, Hawley*.[34] The Court of Appeals said there could be no exhaustion because the license from LG to Intel was conditional. The reason was that the license did not grant a license to Intel customers to combine the Intel products with other products. The Court of Appeals noted that the Master Agreement also required Intel to give its customers notice that the license did not extend to combination products. The Court of Appeals said the sale from Intel to defendants was conditional, because Intel's customers were expressly prohibited from infringing LG combination patents.[35]

The Court of Appeals cited only the Supreme Court's decision in *Mitchell v. Hawley* and two of the Court of Appeals' decisions on the exhaustion doctrine. The Court of Appeals did not discuss the Supreme Court's decision in *United States v. Univis Lens* that the District Court had looked to as the controlling decision on exhaustion.[36]

The Court of Appeals said the theory of exhaustion was that the unconditional sale of a patented device exhausts the rights because the patent owner had received a price equal to the full value of the product and that, when the sale of the product was conditional, it was more reasonable to infer that the price reflected only the value of the use rights conferred by the patentee. This is an important insight. Unfortunately, the Court of Appeals did not explain it any further in this opinion. The relation of product prices to conditions of sale depends of course

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[34] Mitchell v. Hawley, 83 U.S. 544 (1872).

[35] LG Electronics, Inc. v. Bizcom Electronics, Inc., 453 F.3d 1364, 1370 (Fed. Cir. 2006)("The LGE-Intel license expressly disclaims granting a license allowing computer system manufacturers to combine Intel's licensed parts with other non-Intel components. Moreover, this conditional agreement required Intel to notify its customers of the limited scope of the license, which it did. Although Intel was free to sell its microprocessors and chipsets, those sales were conditional, and Intel's customers were expressly prohibited from infringing LGE's combination patents. *Cf.*N.Y. U.C.C. Law § 2-202 (allowing contracts to be supplemented by consistent additional terms unless the writing is intended to be complete and exclusive). The "exhaustion doctrine ... does not apply to an expressly conditional sale or license,"*B. Braun Med. Inc.,* 124 F.3d at 1426, so LGE's rights in asserting infringement of its system claims were not exhausted.").

[36] Id. at 1369-70 (Fed. Cir. 2006)("It is axiomatic that the patent exhaustion doctrine, commonly referred to as the first sale doctrine, is triggered by an unconditional sale. *See Mitchell v. Hawley,* 16 Wall. 544, 83 U.S. 544, 547, 21 L.Ed. 322 (1873). "[A]n *unconditional* sale of a patented device exhausts the patentee's right to control the purchaser's use of the device thereafter. The theory behind this rule is that in such a transaction, the patentee has bargained for, and received, an amount equal to the full value of the goods. This exhaustion doctrine, however, does not apply to an expressly conditional sale or license. In such a transaction, it is more reasonable to infer that the parties negotiated a price that reflects only the value of the 'use' rights conferred by the patentee." *B. Braun Med. Inc. v. Abbott Labs.,* 124 F.3d 1419, 1426 (Fed.Cir.1997) (discussing *Mallinckrodt, Inc. v. Medipart, Inc.,* 976 F.2d 700, 708 (Fed.Cir.1992)) (emphasis added and citations omitted).").

on the nature of the conditions under which the sale is made. If the condition is to reserve all or some of the patent rights, the Court of Appeals was correct. The price of a sale in which a buyer obtains complete freedom from future infringement liability is likely to be higher than the price of a sale conditioned on an agreement by the buyer that the patent owner is reserving some of its patent rights. The buyer or its customers must then purchase those rights separately.

In any event, the Court of Appeals concluded that both the license from LG to Intel and the sales from Intel to Quanta and the other defendants were conditional. The Court of Appeals disagreed with the District Court's conclusion that the notice from Intel to Quanta and the others did not constitute an agreement by those customers that they had no license under LG patent to make, use, or sell patented computer systems using the Intel products. The Court of Appeals also affirmed the District Court's decision that the exhaustion doctrine did not apply to method claims.[37] The Court of Appeals said nothing about the Supreme Court's decision in *United States v. Univis Lens,* on which the District Court relied.

D. The Supreme Court's View of the Patents and the Lower Court Decisions

Quanta sought review from the Supreme Court. The Supreme Court opened its opinion by saying that "[f]or over 150 years this court has applied the doctrine of patent exhaustion to limit the patent rights that survived the initial authorized sale of a patented item."[38] The Court said it was deciding "whether patent exhaustion applies to the sale of components of a patented system that must be combined with additional components in order to practice the patented methods."[39] The Court said that the Court of Appeals held that the exhaustion doctrine did not apply to method patents and that the doctrine did not apply in this situation because "the sales were not authorized by the license agreement." The Court of Appeals had not said that exhaustion did not apply because the sales were not authorized by the LG license to Intel. The Court of Appeals said the issues were whether the license from LG to Intel was "conditional" and whether the sale from Intel to Quanta was "conditional."

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[37] LG Electronics, Inc. v. Bizcom Electronics, Inc., 453 F.3d 1364, 1370 (Fed. Cir. 2006)("Conversely, the trial court declined to find LGE's asserted method claims exhausted. Several defendants contest this ruling on cross-appeal, and we reject their challenge. Based on the above reasoning, even if the exhaustion doctrine were applicable to method claims, it would not apply here because there was no unconditional sale. However, the sale of a device does not exhaust a patentee's rights in its method claims. *Glass Equip. Dev., Inc. v. Besten, Inc.,* 174 F.3d 1337, 1341 n. 1 (Fed.Cir.1999) (citing *Bandag, Inc. v. Al Bolser's Tire Stores, Inc.,* 750 F.2d 903, 924 (Fed.Cir.1984)). The court was correct.").

[38] Quanta Computer, Inc. v. LG Electronics, Inc., __ U.S. __, 128 S.Ct. 2109, 2113 (2008).

[39] Id.

The Court said it disagreed with the Court of Appeals. The Court said the exhaustion applies to method patents and that a licensee's authorized sale of components that substantially embodied the inventions of LG patents exhausted the LG's patent rights.[40]

The Court described generally the inventions disclosed in three LG patents. For some reason, only three of the LG patents were involved in the decision reviewed by the Supreme Court. According to the Court, each of those three patents contained both system and method claims. The Court described the '641 patent as disclosing a system to ensure that the most current data was retrieved from main memory by updating main memory with more recent data from cache memory before data was sent in response to a data request.[41] The Court described the '379 patent as a method of organizing and coordinating requests to read from and write to main memory so that read and write requests are executed in an order that assures that the most up-to-date data are retrieved in response to a read request.[42] The Court described the '733 patent as a method of establishing a priority system that managed data traffic on a bus connecting computer components in a way that permitted the computer to operate more efficiently by allowing components requiring a larger number of computer cycles to have greater access to time on the bus.[43]

The Court implied that the system claims were directed to a computer having a microprocessor, main memory, buses, and perhaps other components. The Court found that components such as main memory and buses were standard components of a computer system and provided none of the novelty of the inventions of the LG patents.[44] The Court found to that, "Everything inventive about each patent is embodied in the Intel products."[45] The Court also found that the Intel microprocessors and chipsets would be useless without being connected to buses and memory.[46] The Court found that there was no reasonable use for the Intel microprocessors and chipsets other than to incorporate them into computer systems that practiced the LG patents and that the only apparent purpose of Intel's sales to Quanta was to permit Quanta to incorporate those Intel products into computers practicing the LG patents.[47] The

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[40] Id.("The Court of Appeals for the Federal Circuit held that the doctrine does not apply to method patents at all and, in the alternative that it does not apply here because the sales were not authorized by the license agreement. We disagree on both scores. Because the exhaustion doctrine applies to method patents, and because the license authorizes the sale of components that substantially embody the patents in suit, the sale exhausted the patents.").

[41] Id.

[42] Id.

[43] Id.

[44] Id. at 2120-21.

[45] Id. at 2120.

[46] Id. at 2119.

[47] Id.

Court did not discuss the method claims. However, the Court said that the District Court had held that exhaustion did not apply to claims that describe operations to make or use a product. [48] Presumably, the method claims included method of use claims that would be infringed when the owner of a computer used it.

As had the District Court and the Court of Appeals, the Court ignored that the District Court had found that two of the patents were not infringed. The District Court found that the '379 patent on reading and writing to memory and the '733 patent on bus priority were not infringed. If the District Court's decision was corrected, the Intel products had no infringing use and several of the Supreme Court's finding were necessarily incorrect. The Court was wrong to find that, "Intel all but practiced the patent itself by designing it products to practice the patent, lacking only the addition of standard parts." [49] The Court was wrong to conclude that the Intel products "substantially embodied the LGE Patents because they had no reasonable noninfringing use and included all the inventive aspects of the patented methods." [50] The Court was wrong that "... Quanta manufactured computers using Intel parts in combination with non-Intel memory and buses in ways that practice the LGE Patents." [51] This curiosity will not reduce the impact of the Court's decision in future cases where a product sold by patent owner or a licensee in fact may be used by a purchaser to infringe a patent.

After describing the pertinent terms of the LG-Intel license, the sale by Intel of microprocessors and chipsets to Quanta, and Quanta's use of those products to make computers, the Court briefly described the decisions of the District Court and the Court of Appeals. [52] The Court noted that the District Court had based its finding of exhaustion on the Court's decision in *United States v. Univis Lens*. The Court said the District Court had found that even though the products Quanta purchased from Intel did not fully practice any of the patents, those products had no reasonable noninfringing use and therefore the sale exhausted patent rights in the completed computers.[53] The Court noted the District Court's second decision that exhaustion did not apply to process or method claims. The Court said the Court of Appeals had agreed that exhaustion did not apply to method claims and had concluded "that exhaustion did not apply

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[48] Id. at 2115.

[49] Id. at 2120.

[50] Id. at 2122.

[51] Id. at 2114.

[52] Id. at 2114-15.

[53] Id. at 2114-15 ("The court found that, although the Intel Products do not fully practice any of the patents at issue, they have no reasonable noninfringing use and therefore their authorized sale exhausted patent rights in the completed computers under *United States v. Univis Lens Co.,* 316 U.S. 241, 62 S.Ct. 1088, 86 L.Ed. 1408 (1942). *Asustek, supra,* at 1598-1600.").

because the LGE did not license Intel to sell the Intel Products to Quanta for use in combination with non-Intel products."[54]

E. The Supreme Court's View of the Law

1. The Controlling Decisions on Exhaustion

The Court then turned to its earlier decisions. The Court ignored the decisions on exhaustion by Court of Appeals for the Federal Circuit and other Courts of Appeals. The Court found the law on exhaustion in *Bloomer v. McQuewan, Adams v. Burke, Henry v. A. B. Dick, Bauer & Cie v. O'Donnell, Motion Picture Patents Co. v. Universal Film Mfg. Co., United States v. Univis Lens Co.,* and *Ethyl Gasoline Corp. v. United States.*

From those decisions, the Court found the law of patent exhaustion to be that the initial authorized sale of a patented product terminates all patent rights to that product. The Court found that the initial authorized sale of an unpatented product that substantially embodies a patented invention (namely a product that has no reasonable noninfringing use and includes all inventive aspects of the patented invention) also terminates all patent rights to those inventions, whether those inventions are systems or methods.[55] The Court did not look to its most important decision on exhaustion, *General Talking Pictures*, for an explanation of the exhaustion doctrine. The Court discussed that decision only at the end of its opinion. The Court also ignored *Mitchell v. Hawley.*

2. The Controlling Decisions on Enforceability of Post-Sale Restrictions

The Court discussed whether "post-sale restrictions" on use of a patented product were permissible. The Court looked to its decisions in *Henry v. A.B. Dick, Bauer & Cie v. O'Donnell,* and most importantly *Motion Picture Patents.* The Court said that *Henry v. A.B. Dick* permitted "post-sale restrictions" on use of a patented article and *Motion Picture Patents* condemned them.[56]

3. Exhaustion, Not Implied License, Governs Sale of Some Unpatented Products

The particular issue before the Court was whether LG's patent rights in its system and method claims ceased to exist, where LG licensed Intel under all its patents and all its claims to make, use, and sell any products, provided that no license was extended expressly or by implication to third parties to make combination products or to use or sell combination products using Intel products, provided that nothing in that license limited or altered the effect of patent exhaustion on Intel's sale of those products, and entered a separate agreement requiring notice to purchasers.

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[54] Id. at 2115.

[55] Id. at 2115-16, 2122.

[56] Id. at 2115-2116.

The District Court and the Court of Appeals had understood the law to deal with the rights of a purchaser from a patent owner or its licensee by two different rules. One rule was the exhaustion doctrine that applied only if the product sold was itself patented, that is, the product sold embodied all the parts and features set out in the claim. The other rule was the implied license doctrine that applied where the product sold was not patented and was useful in making or using a patented product or carrying out a patented method. The earlier decisions of the Supreme Court were entirely consistent with that distinction as were countless decisions by the Courts of Appeals dating from at least 1900. The Court in *Quanta* wrote as if the implied license doctrine did not exist to provide a purchaser in some situations with a license under a system or method patent based on its purchased from a patent owner or its licensee of an unpatented product. One may only guess at the reasons.

The Court looked to its decision in 1942 in *Univis Lens* for the law governing that issue. The *Univis Lens* decision was pivotal, because that decision could be understood to say something about the exhaustion doctrine, something about the implied license doctrine or nothing about either. Without so much as a word of explanation, the Court concluded that *Univis Lens* involved exhaustion, not implied license. Without so much as a word of explanation, the Court concluded that *Univis Lens* held that sale of an unpatented product gave a purchaser immunity from a claim of infringement based on making the patent product. The Court said *Univis Lens* "held that 'the authorized sale of an article which is capable of use only in practicing the patent is a relinquishment of the patent monopoly with respect to the article sold.'" The Court found in *Univis Lens* an exhaustion rule that sales of products that did not embody a patented invention exhausted rights to that invention, where the product sufficiently embodies the patent that its only and intended use is to be finished so that it does embody the invention.

4. Exhaustion, Not Implied License, Governs Sale of Products Useful in Patented Methods

Having concluded that *Univis Lens* was an exhaustion decision and applied to infringement actions, the Court turned to the issues. The Court turned first to the patent owner's argument that the exhaustion doctrine was inapplicable to method claims. LG apparently argued that the method claims could never be exhausted through a sale because method claims are not "linked to a tangible article" but to a process carried out when article is used. LG apparently did not argue that method claims were not subject to the exhaustion doctrine because the rights a purchaser obtains by buying a product for use in the method is governed by the implied license doctrine and that this doctrine sometime provided rights and sometimes did not. Quanta argued that the Court and the Federal Circuit had applied exhaustion to method claims and that if exhaustion did not apply to method claims, the exhaustion doctrine would have no effect because any inventor of a new product could include in its patent a claim to a method of using the new product and defeat exhaustion.

The Court found Quanta's arguments better.[57] The Court said it had "repeatedly held that method patents were exhausted by the sale of an item that embodied the method" citing *Ethyl Gasoline Corp* and *Univis Lens.* The Court also thought it important to prevent an "end

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[57] Id. at 2117-18.

run" around the exhaustion doctrine through use of method claims. The perceived danger was that even though Intel had the right to sell complete computer systems, Intel customers for computer systems could be liable for patent infringement under LG method claims when they used the systems. The Court cited a law review article implying that economic harm would result if the inventor of a machine obtained both machine and method claims so that the force of the patent "intruded deeply into the stream of commerce" as the rights would survive multiple transactions.[58]

5. Unpatented Products that Embody Essential Features of a Patented Invention Trigger Exhaustion

The Court then turned to the issue of the extent to which a product must embody a patent can trigger exhaustion. The Court looked *Univis Lens* for guidance and found that a product sufficiently embodies the patent, when it embodies essential features of the patented invention. A product embodies essential features of a patented invention when (1) the product has no reasonable noninfringing use other then being incorporated into a patented system or used to carry out a patented method and (2) all of the features of the patent that are inventive, namely that are new, are found in the product sold, so that using the product to make a patented system involves combining it only with old and standard parts and using that product carry out a patented method involves only application of old and common process steps. The Court found these requirements in *Univis Lens.*[59]

The Court said that exhaustion arose from the sale of an unpatented product when the additional steps needed to make that product into an infringing one involved merely common and non-inventive steps. Common steps are presumably old ones. The Court said exhaustion applied to the sale of the Intel microprocessors and chipsets because all that was left to be done was combine them with a standard bus and standard memory, presumably arranged in exactly the way microprocessors, chipsets, buses, and memory had been arranged in earlier computer systems. The Court believed that all of novel features of the invention were found in and performed by the microprocessor and the chipsets, and that none of those features depended in any way on modifying the design of buses or memory in computer systems. The Court said that a different result might have been reached if the invention required use of a bus or memory design that was some way different from standard old designs.

F. Intel's Sales Were Authorized by the License and Exhaustion Necessarily Follows

The Court turned to whether LG's license to Intel authorized Intel to sell microprocessors to Quanta and others for use to make and sell computers. The Court concluded that LG had done so because the license included all LG patents, the grant did not limit Intel's right to sell purchasers who intend to combine the Intel products with others to make computers, and nothing limited Intel's right to sell its products for any use under any LG patent.[60]

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[58] Id.

[59] Id. at 2118-20.

[60] Id. at 2121 -2122.

The Court said in the LG - Intel license was not governed by *General Talking Pictures* because Intel's license was not limited to sales for use in combining the Intel products with other products. Given the language of the license, the Court was right. The intent was likely different. However, the language controls. The Court noted that the grant from LG to Intel gave Intel the right to make, use, and sell products under LG patents. The Court found that Intel's authority to sell products was not limited by the separate provision of the Master Agreement requiring Intel to give notice to its customers that LG had not licensed those customers under LG's patents. The Court said that LG's authority to sell was not conditioned on giving that notice to customers. Again, given the language of the license, the Court was right.

The Court said that the provision in the license disclaiming any license to third parties to practice the patents by combining Intel products with other components was irrelevant. The Court said exhaustion turns only on Intel's own license to sell products practicing the LG patents. The Court said that license was unlimited. Intel had a license to make, use, and sell any kind of products. That license included the right to make, use, and sell patented systems and the use patented methods. Because Intel had those rights, the Court viewed the sales by Intel to its customers to exhaustion those rights. Again, given the language, it is difficult to quarrel with the Court's conclusion.

The Court also said the provision of the license disclaiming a license to third parties related only to the issue of implied license. The Court said that was not the issue because Quanta based its immunity on exhaustion, not on implied license. The Court did not refer to the provision of the license saying that it did not alter exhaustion in any way. However, the Court had noted that language earlier in its decision. The Court seemed to view the exhaustion doctrine and the implied licensed doctrine to operate entirely independent of one another, and perceived no problem in applying exhaustion to eliminate a patent owner's infringement claims when the implied license doctrine may have led to a different result. Again, the language of the license could lead the Court to that view. As discussed earlier, it is here that the *Quanta* departed from its earlier decisions.

The Court also said there were no conditions limiting Intel's authority to sell products substantially embodying the patents, meaning presumably that there was no limitation on Intel's license to sell microprocessors useful only in making patented system or in carrying out patented method. Because there was no such condition, Intel's sales products of that kind gave rise to exhaustion because they were products Intel was license to sell. Again, the language of the license is consistent with that view.

The Court also dismissed LG's argument that exhaustion did not applied to the making right. The Court did so by saying that Intel made a computer system for exhaustion purposes when it made a component that substantially embodies the patented system.

The Court said that nothing in the LG Intel license limited Intel's right to sell Intel products "practicing" the LG patents. Because the Court concluded that Intel products did practiced the LG patents, Intel's first sale took those products outside the scope of the patent and LG could not assert patent rights against Quanta.

G. The Conclusion

The Court summarized its conclusions:[61]

> The authorized sale of an article that substantially embodies a patent exhausts the patent holder's rights and prevents the patent holder from invoking patent law to control postsale use of the article. Here, LGE licensed Intel to practice any of its patents and to sell products practicing those patents. Intel's microprocessors and chipsets substantially embodied the LGE Patents because they had no reasonable noninfringing use and included all the inventive aspects of the patented methods. Nothing in the License Agreement limited Intel's ability to sell its products practicing the LGE Patents. Intel's authorized sale to Quanta thus took its products outside the scope of the patent monopoly, and as a result, LGE can no longer assert its patent rights against Quanta. Accordingly, the judgment of the Court of Appeals is reversed.

H. What Was *Quanta* About and Should the Law Have Defeated the Purpose of the Intel – LG Agreement

The Court did not discuss why LG and Intel wrote their license the way they did or why patent owners should not be permitted to do whatever they was trying to do. The Court implied that exhaustion existed to prevent a patent owner from capturing the value of one invention twice. The Court said exhaustion applied to the sale of unpatented products to prevent a patent owner from defeating exhaustion by claiming a new product and also claiming a process of using that product and implicitly a system containing the product. The Court apparently thought that was what LG was trying to do. This was highly unlikely to have been LG's goal. LG was probably not trying to trick Intel and its customers into paying twice for a license under the same patent rights.

We may only make an educated guess about the real reason.

Intel and LG likely owned patents relating to individual components of computers, such as microprocessors and other special purpose data processing devices called chip sets. Intel and LG also likely owned patents relating to computer systems having a number of components and methods of using computers when they contained those components. Intel and LG were licensing in a market setting where individual computer components were made and sold by some companies and complete computers were made and sold by other companies.

LG and Intel probably wanted to license each other to sell components and reserve their patent rights on sales of computers. LG and Intel wanted to pay each other amounts appropriate to the value of the component inventions and the prices at which components are sold. Those payments may have been royalties or other things of equal value. LG and Intel probably wanted to license the computer rights to computer sellers. LG and Intel probably wanted to obtain from licensed computer makers royalties appropriate to the value of the computer inventions and the higher prices of computers. In this way, component sellers would pay only for the rights whose

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[61] Id. at 2122.

value they captured and computer sellers would pay only for the rights whose value they captured.

If this was their purpose, there is no reason for the law to interfere and every reason for the law to assist LG and Intel to exploit their rights in this way. If this was their purpose, the Court gave Quanta and the other computer makers a license under LG patents for which Intel did not pay LG. Quanta may use the systems and methods patents for free, since the price they paid Intel for the components did not include the value of those computer patents. LG probably wanted to license Quanta and the other computer companies separately; hence the lawsuit. The Court gave them the license for nothing. The Court also gave the same free license to every other purchaser lucky enough to have bought from a company with a license written in the same way.

There is only one other apparent option. It is that Intel and LG were attempting to license in a way that forced their customers to purchase unpatented products from them. Intel and LG may have been attempting some form of tying arrangement. To simplify the situation, assume this was merely a license granted by LG to Intel, and not a cross license. Assume that LG owned no patents on individual computer components such as microprocessors and chipsets. LG owned only patents on computer systems and methods of using computers. The microprocessors, chipsets, and other components sold by Intel to computer companies were not covered by any patents owned by LG. LG included language of the license saying that no license was granted to a third party to combine products obtained from Intel (called licensed products) with components acquired from other sources or to use or sell combination products made with components from others. The notice Intel gave to customers said Intel's license from LG did not extend to any product the customer made by combining an Intel product with non-Intel products. If the customers understood that they had a license to make computers only if they bought all the additional components from Intel, LG would have effectively tied the granting of licenses under its system and method patents to computer makers to the purchase by those computer makers of unpatented microprocessors, chipsets and other components from Intel. For its part, Intel would have effectively tied the sale of some unpatented components (microprocessors and chipsets) to the purchase of other unpatented components for use in computers covered by LG patents. The legality of those two types of tying arrangements would have raised difficult issues under antitrust and patent misuse laws. If those two types of tying arrangements violated antitrust law or constituted patent misuse, the limitation in the license should be unenforceable, and purchasers would have the right to use licensed products under the system and method patents with components purchased from others. If the notice from Intel to its customers was also deemed a license, customers would be free of the limitation in that license requiring use of the Intel products only when other Intel products.

However, it seems unlikely that LG were attempting to force computer makers to buy unpatented computer components from Intel. Intel not LG would benefits from the agreement. LG would be worse off to the extent the tying arrangement would successfully raise the price of components. As the price of computer components goes up, the value of LG's computer patents goes down. In addition, Intel and LG would be able to successfully force computer makers to buy components from Intel only if Intel was able to supply computer companies with all of the components needed to make a computer. If computer makers believed that they had to acquire all components from Intel in order to have a license under the LG computer patents, the license would be valuable to computer makers only if Intel sold all of the components needed to make a computer. Since it is unlikely that Intel could supply all of those components, it is unlikely that the purpose of this license was to achieve tying.

There is another possible variation of the same tying option. It is that Intel and LG owned only patents on microprocessors and chipsets and were trying to license those patents to microprocessor and chipset customers in a way that forced those customers to purchase other unpatented components from Intel and LG. In other words, Intel and LG would sell patented microprocessors and chipsets to customers and license those customers to use those products only with other unpatented computer components also purchased from Intel or LG. This seems unlikely because the facts are that at least LG owned computer system and method patents, and those were the patents licensed to Intel.

V. The Court's Strange Discussion of the Law

When the Court described five of its earlier decisions, the Court described the facts incorrectly. This section describes these and more important errors.

A. Exhaustion

1. *Bloomer v. McQuewan* – There Were No Purchasers Who Bought; There Was No License to Sell and Use; *Bloomer* Held that a Person with a License to Make and Use a Product under a Patent Has the Right to Continue Use When The Patent Office Extend the Term Because the Patent Act Provided that Right

The Court was correct that the first decision containing words that led to the exhaustion doctrine was *Bloomer v. McQuewan.* The Court said:[62]

> This Court first applied the doctrine in 19th-century cases addressing patent extensions on the Woodworth planing machine. Purchasers of licenses to sell and use the machine for the duration of the original patent term sought for the duration of the original patent term sought to continue using the licenses through the extended term for the duration of the original patent term sought to continue using the licenses through the extended term. The Court held that the extension of the patent term did not affect the rights already secured by purchasers who bought the item for use "in the ordinary pursuits of life." *Bloomer v. McQuewan,* 14 How. 539, 549, 14 L.Ed. 532 (1853); see also *ibid.* ("[W]hen the machine passes to the hands of the purchaser, it is no longer within the limits of the monopoly"); *Bloomer v. Millinger,* 1 Wall. 340, 351, 17 L.Ed. 581 (1864).

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[62] Id. at 2115.

Bloomer did involve the Woodworth planing machine patent. *Bloomer* did not involve the rights of "purchasers who bought" planing machines. The defendants were not purchasers. They made the machines during the original term of a patent. They continued to use those machines during the term extended by a special act of Congress. Therefore, *Bloomer* did not hold that the extension of the patent term did not affect rights already secured by a purchaser of a machine (or as the Court called it, an "item") for use in the ordinary pursuits of life, such as planing trees into boards and molding. *Bloomer* had nothing to do with the rights of a purchaser of a patented machine.

Bloomer also did not involve the rights of "purchasers of licenses to sell and use a machine during the duration of the original term of the patent." The defendants "purchased" an exclusive license to make and use machines in Pittsburgh. The defendants did not purchase the right to sell machines and never sold machines. The Court in *Bloomer* said that if the defendants had purchased a license to make and sell machines, the "purchaser" would have had no right to make or sell additional machines after the original term, because that person had not purchased or paid for that right.

Bloomer also did not involve the rights of "purchasers" of licenses to make and use machines "for the duration of the original patent term … to continue using the licenses through the extended term." The defendants in *Bloomer* did not assert that they had a continued license to make and use additional machines. The defendants in *Bloomer* simply asserted the right to continue to use two machines they made and began to in use during the original term. The Supreme Court said only that the defendants had the right to continue to use those two machines. However, the license alone was not the source of that right; the license together with the intent of the special act of Congress was the source of that right.

What actually happened in *Bloomer*? The planing machine patent issued in about 1828 for a 14-year term. In 1830, the patent owner conveyed to Collins and Smith the right to construct, use and sell planing machines in Pennsylvania. In 1831 or 1832, Collins and Smith transferred to Barnet the exclusive right to construct and use "during the residue of the aforesaid fourteen years" no more than 50 machines in Pittsburg County, Pennsylvania. Pursuant to this agreement, the defendants made and used two planing machines. In 1842, the patent expired and was extended for seven additional years as provided in the Act of 1836. In 1845, Congress enacted a special law further extending the patent from 1849 to 1856.

In 1845, the patent owner assigned to Bloomer the exclusive right to construct and use machines in Pittsburg County during the first and second extensions. In 1850, Bloomer brought an action to enjoin the defendants' use in Pittsburg during the term of the second extension the two machines they had made during the original term. The Supreme Court held that the special act of Congress granting the second extended term did not prevent the defendants' continued use of the two machines.

The Court said the defendants were not infringers, because the defendants' license contained no limitation on the time the machines could be used and the special act of Congress extending the patent term was not intended to limit the right to use machines being used prior to the extension.[63] A majority said the special act of Congress was not intended to limit the rights "purchased" prior to the extension and the defendants purchased the right to use the machines as long as they lasted, because the license did not limit the time of use. The majority said this was the proper result under the second extension granted by the special act, because this would have been the result under the first extension granted under the Patent Act of 1836, as the Court had decided in *Wilson v. Rousseau.*[64] Therefore, the right to use the machines continued free of infringement liability.

Bloomer said the defendants would be infringers if they claimed the continued right to make and sell machines. The Court said a purchaser of an exclusive license to make and sell had no claim to the extended rights, because the licensee did not "purchase or pay for it." However, a purchaser of a license to make and use a machine has the right to continue use regardless of extensions, because the right to continued use "had been purchased and paid for without any limitation as to the time for which they were to be used."[65] The Court did not say what the result would have been if the defendant's license authorized use only during the original term.

Bloomer started the confusion about the rights of a purchaser, because the Court also said a purchaser of a machine for the purpose of using it in the ordinary pursuits of life "exercises no rights created by the act of Congress." Why did the Court assert that a purchaser of a product

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[63] Bloomer v. McQuewan, 55 U.S. 539, 553-554 (1852)("The right to construct and use these planing machines, had been purchased and paid for without any limitation as to the time for which they were to be used. They were the property of the respondents. Their only value consists in their use. And a special act of Congress, passed afterwards, depriving the appellees of the right to use them, certainly could not be regarded as due process of law. ... But we forbear to pursue this inquiry, because we are of opinion that this special act of Congress does not, and was not intended to interfere with rights of property before acquired; but that it leaves them as they stood during the extension under the general law. And in this view of the subject, the appellant was not entitled to the injunction he sought to obtain, and the Circuit Court were right in dismissing the bill.").

[64] Wilson v. Rousseau, 45 U.S. 646, 670-74, 676-85 (1846)(*Wilson* was based the language in section 18 of the Patent Act of 1836 providing for the extension. Section 18 said the Patent Office could extended the original fourteen year term by seven years "and thereupon the said patent shall have the same effect in law as though it had been originally granted for the term of twenty-one years and the benefit of such renewal shall extend to assignees and grantees of the right to use the thing patented, to the extent of their respective interests therein." The Court in *Wilson* said the language in section 18 distinguished between the assignment of the right to make and sell and an assignment of the right to use. The Court said the effect of a renewal was that prior assignees of the right rights to make and vend had no such rights during the renewal term and assignees of the right to use had the right to continue to use the machines during the renewal term.).

[65] Bloomer v. McQuewan, 55 U.S. 539, 553-554 (1852)("The right to construct and use these planing machines, had been purchased and paid for without any limitation as to the time for which they were to be used.").

has the right to use it free of rights created by Congress? The most likely explanation is that the Court thought, as it said, that section 18 of the Patent Act of 1836 established that principle for rights extended by the Patent Office. Section 18 meant that a purchaser had the right to continue to use a machine in spite of an extension, as the Court said in *Wilson v. Rousseau.* A purchaser exercises no patent rights, because the Patent Act provides that a patent grants no such rights.

The Act of 1836 did not say that a purchaser of a machine always had the right to use the machine free of all infringement liability. The Act of 1836 did not preclude a patent owner from selling a machine and separately granting the purchaser a license to use the machine in limited ways or for a limited time or in a limited place or for a specified royalty. The Patent Act of 1836 addressed only the rights granted by an extension.

Bloomer held that a licensee granted the right during the original term of a patent to make and use a limited number of machines in a limited place had the right to continue to use the machines notwithstanding the extended term the patent owner acquired through a special act of Congress. *Bloomer* did not hold that the sale of a patented machine to a purchaser exhausts the patent rights.

The Court in *Quanta* thought the only significant part of *Bloomer* was the famous *dicta* that the Court in *Quanta* took to be the law:[66]

> But the purchaser of the implement or machine for the purpose of using it in the ordinary pursuits of life, stands on different ground. In using it, he exercises no rights created by the act of Congress, nor does he derive title to it by virtue of the franchise or exclusive privilege granted to the patentee. The inventor might lawfully sell it to him, whether he had a patent or not, if no other patentee stood in his way. And when the machine passes to the hands of the purchaser, it is no longer within the limits of the monopoly. It passes outside of it, and is no longer under the protection of the act of Congress.

We know the Court in *Bloomer* did not mean that a patent owner could not control use of a machine after it was sold, because twenty years later the Court found a purchaser to be a patent infringer.

2. *Mitchell v. Hawley – Bloomer v. McQuewan* Does Not Mean that a Purchaser Always Has the Right to Continue Use During the Extended Term; The Patent Owner May Control Use During the Extended Term By

[66] Id. at 549. The *Bloomer* language was repeated in later cases on the effect of term extensions. In *Chaffee v. Boston Belting* in 1859, the Court said in *dicta* that *Bloomer* meant that a person who had purchased a patented machine from a patent owner, and was using it during the original term for which the patent was granted, might continue to use the machine during the extended term. Chaffee v. Boston Belting Co., 63 U.S. 217, 222-224 (1859). The Court said the same thing a few years later in *Bloomer v. Millinger*. Bloomer v. Millinger, 68 U.S. 340, 350-352 (1863).

Expressly Licensing Purchasers During the Original Term to Use Only During the Original Term

Twenty years after *Bloomer v. McQuewan*, the Court in *Mitchell v. Hawley* found that a purchaser of a patented machine did not always have the right to use it during the extended term of a patent.[67] The Court of Appeals thought the Court's decision in *Mitchell* was important and that the real issue was whether Intel sold the products conditional on a limited license to use the Intel components only with other Intel components to make combination products. The *Quanta* Court ignored *Mitchell.*

The patent covered a machine for making felt hats. The patent owner, James Taylor, granted to a Mr. Bayley "the exclusive right to make and use, and to license to others the right to use the said machines, in the states of Massachusetts and New Hampshire, during the remainder of the original term of said letters patent . . . ."[68] The license provided that "the licensee shall not . . . sell or grant any license to use the said machines beyond the 3d day of May, A.D. 1867." May 3, 1867 was the expiration date of the original term of the patent. The licensee Bayley had the right to obtain a similar license if the patent was extended upon paying further compensation.

The licensee Bayley built four machines and sold them to How and Mitchell with a written license authorizing use of the machines in limited ways. The purchasers paid $1200 for the machines. At the time of the sale, the Bayley executed a license "authorizing the purchasers, as such licensees, 'to run and use two sets (four machines) for felting hats, in said town of Haverhill, under Taylor's patent, bearing date as specified in the original letters-patent.'"[69] The only issued in *Mitchell* was that Bayley granted the purchasers a license that was different from the license Bayley received and different from the license Bayley was authorized to grant to others. Bayley did not grant the purchasers a license to use the machines "during the remainder

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[67] Mitchell v. Hawley, 83 U.S. 544 (1872).

[68] Id. at 545("The exclusive right to make and use, and to license to others the right to use the said machines in the said States of Massachusetts and New Hampshire, and in no other place or places, during the remainder of the original term of said letters-patent. *Provided, that the said Bayley shall not in any way or form dispose of, sell, or grant any license to use the said machines beyond the* 3d *day of May, A.D.* 1867.").

[69] See Hawley v. Mitchell, 11 F.Cas. 883 (C.C.Mass. 1871)("The defendants were the successors in business of the firm of How & Mitchell; and it was admitted at the hearing that the machine complained of had been purchased by How & Mitchell of one A. L. Bayley in the year 1864, being made by him under a joint license from the patentee Taylor and one Sturdevant, who at the time when the license was executed owned an undivided interest in the patent. This license gave Bayley 'the exclusive right to make and use, and to license to others the right to use,' the patented machine in the states of New Hampshire and Massachusetts during the remainder of the original term of the patent, but provided that said Bayley should not 'in any way or form dispose of, sell, or grant any license to use the said machines beyond the 3d day of May, 1867.' The sale of the machines was accompanied with a written license from Bayley to How & Mitchell, giving them 'the right to run and use' the same in the town of Haverhill, Massachusetts.").

of the original term of [the] letters patent." Bayley granted the purchasers a license to use the machines "under Taylor's patent." If the purchasers had a license granted during the original term to use machines under the patent, *Bloomer v. McQuewan* controlled and they had the right to continue use.

How and Mitchell used the machines to make hats. The patent expired and was extended under Section 18 of the Act of 1934. The original licensee Bayley did not buy a license for the extended term. The patent owner granted that license to Hawley. The defendants were successors to the How and Mitchell business. The defendants continued to use the machines during the extended term. Hawley sued for patent infringement and sought an injunction against continued infringing use of the machines.[70] Hawley did not sue under state law for breach of contract, conversion of the machines, title to the machines, or to compel the defendants to convey the machines to Hawley or the patent owner.

The Court held that continued use exceeded the purchaser's right to use and was patent infringement. Contrary to everything the Court had said in *Bloomer v. McQuewan*, the sale by the licensee did not take the machines outside the patent monopoly and the purchaser of a machine who had paid for the machine and was granted the right to use the machine under the patent did not have a right to use the machine during the extended term.

The Court opened its opinion by qualifying when the patent owner's rights no longer apply to a purchaser in two important ways. One was that the purchaser had paid the patent owner all the royalties required. If a purchaser had ongoing royalty obligations, the patent owner could reserve its patent rights against the purchaser's use in unauthorized ways and against all use if the purchaser ceased paying and its license is terminated. The second was that the patent owner is deemed to waive all its rights against future infringement by a purchaser only when the sale is without any conditions. The purchaser acquires the right to use the machine free of infringement only in those circumstances.[71]

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[70] Mitchell v. Hawley 83 U.S. 544, 549-550 (1872)(" … the exclusive assignees of the right, title, and interest in the renewed letters-patent for those two States, instituted the present suit to restrain the respondents from using the four machines which they or their grantors purchased of the licensee under the original letters-patent. They appeared to the suit and filed an answer setting up as a defence to the charge of infringement that they are by law authorized to continue to use the four machines just the same under the extended letters-patent as they had the right to do under the original patent, when the purchase was made by those under whom they claim, which is the only question in the case.").

[71] Mitchell v. Hawley 83 U.S. 544, 546-547 (1872)(" Patentees acquire by their letters-patent the exclusive right to make and use their patented inventions and to vend the same to others to be used for the period of time specified in the patent, but when they have made one or more of the things patented, and have vended the same to others to be used, they have parted to that extent with their exclusive right, as they are never entitled to but one royalty for a patented machine, and consequently a patentee, when he has himself constructed a machine and sold it without any conditions, or authorized another to construct, sell, and deliver it, or to construct and use and operate it, without any conditions, and the consideration has been paid to him for the thing

The Court then recounted the law about the effect of an extension of patent under the Act of 1836 and the rights of licensees and purchasers who obtain their licenses and products during the term of the original patent. As before, the Court explained that a licensee of the right to make and use a machine during the original term had a license to continue using during the extended term. Like licensees of the right to use machines, a purchaser of a machine for the purpose of using it in the ordinary pursuits of life during the original term also had the right to use it during the extended term. These rights existed under the terms of section 18 of the Act of 1836.[72]

However, the Court said a purchaser had those rights only when the sale was absolute and without conditions.[73]

> Patented implements or machines sold to be used in the ordinary pursuits of life become the private individual property of the purchasers, and are no longer specifically protected by the patent laws of the State where the implements or machines are owned and used. Sales of the kind 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 implement or machine purchased 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.

The Court was deciding an action for patent infringement.[74] The Court was clearly talking only about patent infringement liability of a purchaser. The Court said a purchaser has no liability for patent infringement when it uses a machine until it is worn out and repairs the

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patented, the rule is well established that the patentee must be understood to have parted to that extent with all his exclusive right, and that he ceases to have any interest whatever in the patented machine so sold and delivered or authorized to be constructed and operated. Where such circumstances appear, the owner of the machine, whether he built it or purchased it, if he has also acquired the right to use and operate it during the lifetime of the patent, may continue to use it until it is worn out, in spite of any and every extension subsequently obtained by the patentee or his assigns." [Citing Bloomer *v.* Millinger, 1 Wallace, 350 in a footnote]).

[72] Id. at 547-48.

[73] Id. at 548.

[74] Hawley v. Mitchell, 11 F.Cas. 883 (C.C.Mass. 1871)("This was a suit in equity for an injunction and an account brought against Eben Mitchell, Charles Butters, and Henry Rust, copartners under the firm-name of Mitchell, Butters & Rust, by the complainant Robert B. Hawley, assignee by mesne assignment, under date of March 19, 1870, of the extended term of letters patent No. 9,700, for certain new and useful improvements in machinery for sizing and felting hats, granted to James S. Taylor on the 3d day of May, 1853.').

machine. The Court was not saying that, if a sale was made with conditions, those conditions may be enforced by actions under state law, such as by an action for breach of contract.

The question is what sort of conditions the Court was referring to. The condition in the action before the Court was that the licensed seller had a license to use only during the original term and the right to granted additional licenses to use only during the original term. The only problem was that the licensee had granted the defendants a license to use under the patent. Under the Court's earlier decisions, a user of a machine had the right to use during the extended term if it had a license to make and use under the patent during the original term or had purchased a machine from someone having a license to make and sell under the patent during the original term.

The Court said the patent owner licensed Bayley subject to certain limitations and restrictions. These were that Bayley had the right to make and use machines and to license to others the right to use machines in Massachusetts and New Hampshire during the remainder of the original term of the patent. The Court also noted that Bayley agreed not in any way to sell or grant any license to use the said machines beyond the expiration of the original term. The Court described how Bayley made machines, sold them for $1200 to the defendants, and gave the purchasers a license to use under Taylor's patent. The Court noted that the license to the purchasers referred to the Taylor patent by the "date as specified in the original letters-patent." The Court said this showed "conclusively that the purchasers were referred to the original letters-patent as the source of his [Bayley's] authority."[75]

The Court then described how the infringement action came about. The Court described the defendant's answer to the complaint and said the only question the case was whether the defendants "are by law authorized to continue to use the four machines just the same under the extended letters-patent as they had the right to do under the original patent, when the purchase was made by those under whom they claim."[76]

The Court answered that question by looking to the license the patent owner had granted to Bayley, the seller, and the license Bayley had granted to the purchasers. The Court decided that the patent owner had the right to control the term during which a purchaser could use a patented machine, even if that purchaser bought a machine during the original term from a licensee authorized to sell the machine, paid for the machine, and began use during the original term. *Bloomer v. McQuewan*, *Chaffee v. Boston Belting* , and *Bloomer v. Millinger* did not control.[77] The Patent Act of 1836 did not control. The patent owner's license with its licensee and the circumstances of the licensee's sales to the purchasers controlled.[78]

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[75] Mitchell v. Hawley, 83 U.S. 544, 548-550 (1872).

[76] Id. at 548-550.

[77] Bloomer v. Millinger, 68 U.S. 340 (1863); Chaffee v. Boston Belting Co., 63 U.S. 217 (1859); Bloomer v. McQuewan, 55 U.S. 539 (1852).

[78] Mitchell v. Hawley 83 U.S. 544, 550-551, 1872 WL 15359, 5 (1872).

The defendants were patent infringers, because the patent owner granted a license with a lawful limitation, restriction or condition. It was that the licensee had only the right to make and use machines during the original term and to license others to use machines during the original term. If the licensee had granted the purchasers a license to use only during the original term at the time of the sale, the purchasers were patent infringers when they used during the extended term.

The only issue was that the licensee sold machines with a license under the patent. The issue was whether the limitation on time of use in the license granted to Bayley controlled the purchasers' rights even thought they were granted a license without that limitation. The Court found that the limitation controlled. The Court said the license to the purchasers was sufficient to put them on notice that their supplier Bayley did not have the right to use machines beyond the original term. If the purchaser had inquired they would have learned that their supplier had no right to use machines beyond the original term or to grant them the right to use machines beyond the original term. Their supplier never had the "power" to sell machines and license use for an indefinite period, so the defendants did not have that right.

The only apparent alternative explanation for the Court's decision is that the licensee had no right to sell machines and therefore the defendants did not acquire title to the machines. Because the defendants did not acquire title to the machines and the accompanying right of an owner of personal property to use the machines, the defendants' use of the machines infringed the patent. This is not how the Court explained its reasoning. The Court said the "...grantor under whom the respondents claim never acquired the right to sell the machines and give their purchasers the right to use the same in the ordinary pursuits of life beyond the term of the original patent ...". The Court said the defendants' "grantor could not give them any title to use the machines beyond the period of fourteen years from the date of the original letters-patent, as he 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." The Court believed that the licensee Bayley did have the right to sell machines and license their use during the original term.[79] The purchasers had title to the machines as a matter of personal property law. The defendants owned the machines. However, title to the machines did not give the purchasers an unlimited right to use them. The purchasers' patent rights were controlled by the license. The

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[79] The District Court believed that the sales by Bayley were infringing sales and therefore the purchaser had no right to use them at any time by virtue of the sale. Hawley v. Mitchell, 11 F.Cas. 883, 884 -885 (C.C.Mass. 1871)("Bayley was only a licensee, and not an assignee for a particular territory of the whole monopoly of the patent. He never acquired the right to sell a single machine. By the terms of the license to him to make and use, and to license to others the right to use, the patented machines, it is expressly provided that he shall not, in any way or form, dispose of any license to use the machines beyond the third day of May, 1867. He was only a licensee. His title was carefully restricted. He had no power to sell a machine so as to take it out of the monopoly of the patent. *** The very act of sale was a violation of the contract and an act of infringement. The purchasers were bound to examine the title of their grantor. The most cursory examination of the nature of his interest would have shown them he had no right to do more than license them to use the machines, and that not beyond the third day of May, 1867. Decree for complainant.").

purchasers had only the right to use within the scope of the limitations, restrictions or conditions of the patent owner's license to their supplier – use only during the original term.

Legal jargon aside, why did the Court give the patent owner the ability to control the rights its licensee and the rights purchasers from its licensee possessed? Taylor's patent on machines for making hats had some value during the original term and some additional value during the extended term. Taylor wanted to sell the right to use the machines during the two periods separately. Taylor sold the rights for the original term to Bayley for a certain price. Bayley did not pay for the rights for the extended term. Hawley paid for those rights. In order to make Hawley's rights valuable, Hawley could enjoin use of all machines during the extended term, even machines purchased from Bayley. The Court was not willing to limit the value of Hawley's rights by permitting continued use of machines placed in use during the original term. The rights everyone possessed and did not possess were clear enough to everyone involved and the rights the defendants did not possess were enforced by patent infringement liability. In short, the Court let the parties determine who had what rights by the terms of their agreements and those agreements controlled, even if patent law would have provided a different result without those agreements.

Mitchell v. Hawley established that a patent owner may give a licensee the right to sell a patented product and separately license its use for a limited time. A patent owner could presumably also give its licensee the right sell a product and separately license its use in a limited area, in a limited amount, for a limited purpose, and with any other limitation that was not itself unlawful. If a patent owner may authorize a licensee to do these things and the law will enforce the patent rights when a purchaser uses in ways not authorized by its license, it would be nothing short of bizarre for the law to deny a patent owner the same ability. A patent owner must be able to sell and license purchasers to use during a limited time period and separately license use during a second later time period. If a patent owner is the most efficient supplier of machines, and the patent owner has to license a less efficient company to supply machines in order to sell and license separately, the law needlessly penalizes efficiency to the detriment of patent owners and machine users.

Following the decisions in *Bloomer v. McQuewan* and *Mitchell v. Hawley*, a number of Supreme Court decisions held that an unrestricted sale by an "assignee" or licensee in its territory gave the purchaser the right to use and sell the article anywhere.[80] In each of these situations, the seller had the right to sell in a limited geographic area by assignment or license. In each decision, the Court found that the sale by the assignee or licensee occurred in the territory in which it was authorized to sell. In each, the Court concluded that the purchaser did not infringe when it used or resold the product in another territory. In each, the patent owner did not limit the right of the assignee or licensee to sell only for use or resale in their territory. The patent owner gave the assignee or licensee an unlimited right to sell. The assignee or licensee exercised that right. The patent owner did not require the assignee or licensee to sell and separately license purchasers to use and resell only in the limited territory. The assignee or licensee did not sell and separately license purchasers to use and resell only in the limited

[80] Keeler v. Standard Folding Bed Co., 157 U.S. 659 (1895); Hobbie v. Jennison, 149 U.S. 355 (1893); Adams v. Burke, 84 U.S. 453 (1873).

territory. In those circumstances, the Court said the purchasers received the right to use or resell anywhere. *Adams v. Burke* and *Keeler v. Standard Folding Bed* were two of these cases.

3. *Adams v. Burke* – Where a Patent Owner Grants an Assignee or Licensee the Right to Make, Use and Sell in a Limited Territory and the Assignee or Licensee Sells in its Territory, a Purchaser who Bought in the Territory May Use the Product outside the Territory; This Is True where There Are No Post-Sale Restrictions on Territory of Use

The Court in *Quanta* said of *Adams v. Burke*: [81]

> In *Adams v. Burke,* 17 Wall. 453, 21 L.Ed. 700 (1873), the Court affirmed the dismissal of a patent holder's suit alleging that a licensee had violated postsale restrictions on where patented coffin-lids could be used. "[W]here a person ha[s] purchased a patented machine of the patentee or his assignee," the Court held, "this purchase carrie[s] with it the right to the use of that machine so long as it [is] capable of use." *Id.,* at 455.

Again, the Court misunderstood the facts. *Adams v. Burke* did not involve an action by a patent owner alleging infringement by its licensee. *Adams v. Burke* also did not involve a licensee that had violated a post-sale restriction on where patented coffin lids could be used. The only thing the *Quanta* Court understood correctly was that *Adams v. Burke* involved a patent on coffin lids.

The patent owner assigned to the Lockhart & Seelye company all of its interest in the patent for the area within ten miles of Boston. An undertaker traveled to Boston and purchased a coffin lid from Lockhart & Seelye "without condition or restriction." The undertaker took the coffin lid outside the ten-mile limit and used it to bury one of his customers. The patent owner brought an action against the undertaker for patent infringement.

The patent owner did not allege that its territorial assignee, Lockhart & Seelye, had violated the patent or any terms of the assignment. The territorial assignee had done what its agreement with the patent owner permitted, sell coffin lids in Boston. The only issue was whether the patent owner had a claim for infringement against a purchaser who bought in Boston in a transaction authorized by the patent owner and used the coffin lids outside the territory in which its seller owned the patent rights. The patent owner did not assert that there were any post-sale restrictions on the buyer. Apparently, the seller said nothing to the undertaker about the patent, the territorial limits of its assignment, and sold the product without any conditions or restrictions on where the product could be used. The Court in *Adams v. Burke* was fully aware that there were no restrictions or conditions imposed on the buyer at the time of sale.

The issue in *Adams v. Burke* was, where a patent owner grants an assignee or a licensee the right to make, use and sell in a limited territory, and that assignee or licensee sells a product in its territory, does a patent owner have an infringement claim against a purchaser who bought

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[81] *Quanta Computer, Inc. v. LG Electronics, Inc.*, __ U.S. __, 128 S.Ct. 2109, 2115 (2008).

in the territory when that purchaser uses the product outside the territory? The Court in *Adams v. Burke* simply said that there was nothing in the contract that the patent owner made with its assignee or licensee that limited the right of a purchaser to use a product purchased in the territory anywhere it wanted. The Court said that no restriction on where a purchaser could use a product would be implied in favor of a patent owner when its assignee or licensee sells a product in an authorized and unrestricted sale.

Adams v. Burke did not involve post-sale restrictions on use of a patented product. *Adams v. Burke* said that, where there were no post-sale restrictions, the law would not imply such restrictions of favor of a patent owner.[82] The Court in *Adams v. Burke* did not say that a patent owner could not lawfully impose such restrictions on a purchaser. As far as one can tell from *Adams v. Burke*, if the patent owner had granted its assignee the right the sell for use within ten miles of Boston, required the assignee to grant its customers an express license to use only within ten miles of Boston, and the assignee had done so, the Court would have declared the undertaker an infringer under *Mitchell*. After *Adams v. Burke*, the lower courts thought a patent owner could do business in that way.[83]

For the *Quanta* Court, the only significance of *Adams v. Burke* was this language.[84]

> We have repeatedly held that where a person had purchased a patented machine of the patentee or his assignee, this purchase carried with it the right to the use of that machine so long as it was capable of use, and that the expiration and renewal of the patent, whether in favor of the original patentee or of his assignee, did not

[82] Adams v. Burke, 84 U.S. 453, 456-457 (1873)("It seems to us that, although the right of Lockhart & Seelye to manufacture, to sell, and to use these coffin-lids was limited to the circle of ten miles around Boston, that a purchaser from them of a single coffin acquired the right to use that coffin for the purpose for which all coffins are used. That so far as the use of it was concerned, the patentee had received his consideration, and it was no longer within the monopoly of the patent. *It would be to engraft a limitation upon the right of use not contemplated by the statute nor within the reason of the contract to say that it could only be used within the ten-miles circle*. Whatever, therefore, may be the rule when patentees subdivide territorially their patents, as to the exclusive right to make to to sell within a limited territory, we hold that in the class of machines or implements we have described, when they are once lawfully made and sold, *there is no restriction on their use to be implied for the benefit of the patentee or his assignees or licensees*." (emphasis added)).

[83] Where an express agreement is made with the purchaser limiting its use to a certain area, the lower courts have enjoined use by a purchaser outside the area. See Skeeball Co. v. Cohen, 286 Fed. 275 (E.D.N.Y. 1922)(the patentee sold an amusement device, conveying title to the purchaser and licensing use only within a certain area; the defendant bought a device from the purchaser and used it in another area; the court held that the restriction was valid and the patentee was entitled to an injunction.).

[84] Adams v. Burke, 84 U.S. 453, 455 (1873).

> affect this right. The true ground on which these decisions rest is that the sale by a person who has the full right to make, sell, and use such a machine carries with it the right to the use of that machine to the full extent to which it can be used in point of time.

B. Exhaustion Applies to Sales of Unpatented Products

The particular issue before the Court was whether LG's patent rights in its system and method claims ceased to exist due to Intel's sales of microprocessors and chip sets that could be used to make patented systems that would carrying out the patented processes. As discussed earlier, the District Court and the Court of Appeals understood the law to deal with the rights of a purchaser by applying the exhaustion doctrine if the product sold was itself patented and the implied license doctrine if the product sold was not patented and was useful in making or using a patented product or carrying out a patented method. The earlier decisions of the Supreme Court were entirely consistent with that distinction as were countless decisions by the Courts of Appeals dating from at least 1900.[85]

The Court based its decision that exhaustion applied to the sale of unpatented products on the Court's decisions in *Univis Lens* and *Ethyl Gasoline.* If there is anything to the notion that courts decide only the issues before them, those decisions have nothing to do with the law of exhaustion or implied license. Those decisions did not involve actions for patent infringement in which a purchaser of a product sought to defend on the basis of exhaustion or implied license.

Univis Lens and *Ethyl Gasoline* involved actions for violation of the antitrust laws. The purchasers in those cases could not possibly have been patent infringers. In both cases, the patent owners had given the purchasers express licenses to do exactly what they did. There was no exhaustion or implied license issue in those cases. *Univis Lens* and *Ethyl Gasoline* simply decided that the price fixing provisions in the licenses the patent owner granted to purchasers violated antitrust law. If the purchasers had been accused of infringement by selling at different prices, the Court would have said the price fixing provisions of the licenses were unenforceable and there would be no infringement. If the purchasers had done something not authorized by their licenses, the Court would have found the purchasers to be a patent infringer. The Court said the law permitted a patent owner to sell and license separately. However, the patent owner could not use the licenses to fix prices in those situations.

Even if these antitrust decisions have something to say about a patent infringement action, there is no reason to believe *Univis Lens* and *Ethyl Gasoline* were based on the exhaustion doctrine rather than the implied license doctrine. The distinction did not matter to the Court in *Univis Lens* and *Ethyl Gasoline.* The defendants violated antitrust law either way. To the extent the Court in *Univis Lens* and *Ethyl Gasoline* invoked one doctrine rather than the other

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[85] Dawson Chemical Co. v. Rohm & Haas Co., 448 U.S. 176, 186 (1980); B.B. Chem. v. Ellis, 314 U.S. 495, 497 (1942); Leitch Mfg. Co. v. Barber Co., 302 U.S. 458, 461 (1938); Lawther v. Hamilton, 124 U.S. 1, 11 (1887); Edison Electric Light Co. v. Peninsular Light, Power & H. Co., 101 F. 831, 832-37 (6 Cir. 1900); Edison Electric Light Co. v. Peninsular Light Power & H. Co., 95 F. 699, 678-79 (W.D. Mich. 1899).

to decide the antitrust issue, the Court relied on the implied license doctrine. Therefore, the Court in *Quanta* was wrong to assert that those decisions described the law of exhaustion.

Univis Lens and *Ethyl Gasoline* involved the extent to which patent owners could fix prices through licensing. In 1902 and again in 1926, Supreme Court found that a patent owner did not violate antitrust law by fixing the prices for a manufacturing licensee's sale of patented products.[86] In one of those cases, *United States v. General Electric Co.,* the patent owner, General Electric, made and sold patented electric light bulbs and granted a license to Westinghouse to make and sell light bulbs. The license provided that Westinghouse would sell at prices and terms of sale specified by General Electric and would use the type of distribution system as General Electric. General Electric distributed its patented light bulbs only through agents who agreed to sell at prices fixed by General Electric. The Court stated the following test:[87]

> Conveying less than title to the patent, or part of it, the patentee may grant a license to make, use and vend articles under the specification of his patent for any royalty and upon any condition the performance of which is reasonably within the reward which the patentee by the grant of the patent is entitled to secure....The patentee may make and grant a license to another to make and use the patented articles, but withhold its right to sell them....If the patentee goes further, and licenses the selling of the articles, may he limit the selling by limiting the method of sale or price? We think he may do so, provided that the conditions of sale are normally and reasonably adapted to secure pecuniary reward for the patentee's monopoly. (citations omitted)

The Court found it reasonable for a patent owner selling a patented product to fix the prices at which a licensee sells, because the licensee's price will necessarily affect the price at which the patent owner could sell. Therefore, the patent owner should be permitted to control licensee prices. The courts limited *General Electric Co.* in a variety of ways in the 1940s.[88] *Univis Lens* and *Ethyl Gasoline* were two such cases.

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[86] United States v. General Electric Co., 272 U.S. 476, 478-79, 488-94 (1926); Bement v. National Harrow Co., 186 U.S. 70, 72, 93 (1902).

[87] United States v. General Electric Co., 272 U.S. 476, 489-90 (1926).

[88] In 1948 in *United States v. Line Material,* the Court found that two patent owners violated antitrust law by cross-licensing each other under complementary patents relating to a single product and licensed other under both patents to manufacturer and sell at prices fixed by those licenses. United States v. Line Material Co., 333 U.S. 287, 293-97, 305-15 (1948). The courts limited *General Electric* in other ways. One lower court interpeted *General Electric* to permit price restrictions only where the licensed patent completely covers the product. United States v. General Electric Co., 82 F.Supp. 753, 767-78, 776-77, 813-17, 873-76, 881-83, 901-905 (D.N.J. 1949). Some lower courts have found that *General Electric* did not permit a patentee to fix the

1. *Univis Lens* – There Was No Exhaustion Issue; Patent Owner Violates Antitrust Law by Licensing One Company to Sell an Unpatented Product to Another Licensee with a License to Make and Sell the Patented Product at Prices Set by the Patent Owner; Sales of the Unpatented Product Would Give the Purchaser an Implied License to Make and Sell The Patented Product

The *Quanta* Court looked to its decision in 1942 in *Univis Lens* for the law governing whether exhaustion applied to the sale of unpatented products useful in making patented systems or carrying out patented processes. Without so much as a word of explanation, the Court concluded that *Univis Lens* governed actions for patent infringement and was based on exhaustion, not implied license. The Court said:[89]

> This Court most recently discussed patent exhaustion in Univis, 316 U.S. 241, 62 S.Ct. 1088, 86 L.Ed. 1408, on which the District Court relied. Univis Lens Company, the holder of patents on eyeglass lenses, licensed a purchaser to manufacture lens blanks [FN3] by fusing together different lens segments to create bi- and tri-focal lenses and to sell them to other Univis licensees at agreed-upon rates. Wholesalers were licensed to grind the blanks into the patented finished lenses, which they would then sell to Univis-licensed prescription retailers for resale at a fixed rate. Finishing retailers, after grinding the blanks into patented lenses, would sell the finished lenses to consumers at the same fixed rate. The United States sued Univis under the Sherman Act, 15 U.S.C. §§ 1, 3, 15, alleging unlawful restraints on trade. Univis asserted its patent monopoly rights as a defense to the antitrust suit. The Court granted certiorari to determine whether Univis' patent monopoly survived the sale of the lens blanks by the licensed manufacturer and therefore shielded Univis' pricing scheme from the Sherman Act.
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> FN3. Lens blanks are "rough opaque pieces of glass of suitable size, design and composition for use, when ground and polished, as multifocal lenses in eyeglasses." Univis, 316 U.S., at 244, 62 S.Ct. 1088.

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price of unpatented products of patented machines or processes. Cummer-Graham Co. v. Straight Side Basket Corp., 142 F.2d 646 (5th Cir. 1944); Barber-Colman Co. v. National Tool Co., 136 F.2d 339 (6th Cir. 1943); Sylvania Industrial Corp. v. Visking Corp., 132 F.2d 947 (4th Cir. 1943).

[89] Quanta Computer, Inc. v. LG Electronics, Inc., __ U.S. __, 128 S.Ct. 2109, 2216-17, 2119 (2008).

> The Court assumed that the Univis patents containing claims for finished lenses were practiced in part by the wholesalers and finishing retailers who ground the blanks into lenses, and held that the sale of the lens blanks exhausted the patents on the finished lenses. Univis, 316 U.S., at 248-249, 62 S.Ct. 1088. The Court explained that the lens blanks "embodi[ed] essential features of the patented device and [were] without utility until ... ground and polished as the finished lens of the patent." Id., at 249, 62 S.Ct. 1088. The Court noted that:
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> > "where one has sold an uncompleted article which, because it embodies essential features of his patented invention, is within the protection of his patent, and has destined the article to be finished by the purchaser in conformity to the patent, he has sold his invention so far as it is or may be embodied in that particular article." Id., at 250-251, 62 S.Ct. 1088.
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> In sum, the Court concluded that the traditional bar on patent restrictions following the sale of an item applies when the item sufficiently embodies the patent--even if it does not completely practice the patent--such that its only and intended use is to be finished under the terms of the patent.
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> First, *Univis* held that "the authorized sale of an article which is capable of use only in practicing the patent is a relinquishment of the patent monopoly with respect to the article sold." *Id.*, at 249, 62 S.Ct. 1088.

Again, the Court misunderstood the facts, though in this instance not in a significant way for the decision in the action before the Court. The Court in *Quanta* said that the Univis Lens Company owned patents on eyeglass lenses. The Univis Lens Company owned no patents. The Univis Corporation owned the patents. The Court in *Quanta* said that the owner of the patents licensed "a purchaser" to manufacture lens blanks and sell them to other Univis licensees. In fact, the Univis Corporation granted Univis Lens Company a license under the patents to make lens blanks and to sell them to other licensees. The Univis Lens Company purchased nothing from its licensor, Univis Corporation.

This is what gave rise to *Univis Lens*. The Univis Corporation owned patents on eyeglass lenses. The patents apparently covered a lens having pieces of glass with different refractive indexes fused together arranged in a particular way and suitable for use as a lens in eyeglasses. The Univis Corporation granted Univis Lens Company a license under the patents to make lens blanks and to sell them to other licensees. The Univis Lens Company made lens blanks by fusing different pieces of glass in a particular arrangement. The lens blanks were not useful as eyeglass lenses, because they were opaque and did not have the shape needed for use as an eyeglass lens. The lens blanks needed to be finished by grinding to fit a particular eyeglass prescription and polishing to make them clear. Lens blanks became useful as eyeglass lens only when processed by other licensees. The District Court found that the patents covered a lens only in finished form, meaning that some of the features of the claimed lens were satisfied only after lens blanks were ground and polished into eyeglass lenses. A lens blank itself was an unpatented product. The patented product was a finished eyeglass lens, not a lens blank.

The Univis Corporation licensed the Univis Lens Company to sell lens blanks only to two other types of licensees, finishing wholesalers and finishing retailers. Univis Corporation separately granted licenses under the same patents to these companies to make lens blanks purchased from Univis Lens Company into eyeglass lenses and to sell the finished eyeglass lenses. Finishing retailers were licensed to make the finishes lenses and to sell eyeglasses to consumers at prices set by Univis Corporation. Finishing wholesalers were licensed to make finished lenses and sell them to licensed prescription retailers at prices set by Univis Corporation. Univis Corporation granted licenses to prescription retailers to sell eyeglasses to consumers at prices fixed by Univis Corporation.

The United States government asserted that Univis Corporation violated the antitrust laws by setting the prices at which the finishing retailers sold eyeglasses with finished lenses to consumers, finishing wholesalers sold finished lenses to prescription retailers, and prescription retailers sold eyeglasses to consumers. The Univis Corporation said there was no antitrust violation because the Court in *United States v. General Electric* said that a patent owner could grant a license to make and sell a patented product and set the price at which the licensee sold.[90] In 1913, the Court in *Bauer & Cie*[91], said a patent owner could not sell a patented product and license purchasers to sell the product at no less than a stated price. The Court said the price restriction was unenforceable and the purchaser did not infringe by selling below the stated minimum price. The basic reason the Court refused to enforce resale price restrictions was that it had condemned them with respect to unpatented products in 1911in *Dr. Miles*[92] and copyrighted books in 1908 in *Bobbs Merrill.*[93]

The issue in *Univis* was whether sales by the finishing licensees were the first sale of a patented product so that price fixing was lawful or the resale of a patented product so that the price fixing was unlawful. The sales by prescription retailers to consumers were resales of patented products and unlawful in either event.

The Court concluded after a lengthy discussion that the sale by the Univis Lens Company of a lens blank to the finishing licensees gave the finishing licensees a license to make the completed patented product. The sale that eliminated the patent rights was the sale by the Univis Lens Company of lens blanks to the wholesale and finishing licensees. The sales that violated

[90] United States v. General Electric, 272 U.S. 476, 478-79, 488-94 (1926); Bement v. National Harrow Co., 186 U.S. 70, 72, 93 (1902).

[91] Bauer & Cie v. O'Donnell, 229 U.S. 1, 8-9 11, 18 (1913)

[92] Dr. Miles Medical Co. v. Park's Sons Co., 220 U.S. 373 (1911).

[93] Bobb-Merrill Co. v. Straus, 210 U.S. 339 (1908).

the antitrust laws were sales by the wholesale and finishing licensees of finished lenses to consumers. The Court's opinion cited both exhaustion and implied license decisions in reaching that result, and the language of the decision blurred the distinction between two doctrines.

Whichever doctrine the *Univis Lens* Court thought applied, there is no reason to infer that the Supreme Court in *Univis Lens* decided that the exhaustion doctrine should govern infringement liability of purchasers of all unpatented products and not the implied license doctrine. *Univis Lens* simply held that where a patent owner granted one company a license to make an unpatented product and to sell that unpatented product to another company licensed to make and sell the patented product, the patent owner violates antitrust law by fixing the price at which the second company sells. Whether the second company's right to make the patented product would have existed due to implied license or exhaustion, the patent owner violated the antitrust laws by setting the purchaser's price for sales of the patented product. The Court wanted to find that the price fixing was unlawful, so the Court found that the express license granted to the seller to make the patented product did not really provide that right. The Court viewed the license to make the product as a sham agreement used only to fix prices. The Court also viewed the license as a sham because the manufacturer of the patented product paid no royalties.

The Supreme Court decided in *Univis Lens* that patent owners could not set the price for sales of patented products by companies that purchased from the patent owner unfinished products whose sole use was to make them into patented products. The Supreme Court did not decide that patent owners could not sell unfinished products whose sole use was to make them into patented products and reserve its patent rights to prevent unlicensed sales of the patented products by its customers. Indeed, the Supreme Court in *Univis Lens* said that it was not deciding whether a patent owner could sell an unfinished product and license its customers to make and sell the patented product and pay the patent owner royalties on those sales.[94] The Court was not holding that sales always exhausted the patent rights or created an implied license. If it was, the patent owner could not effectively license in this way, because the prospective licensees would not agree to pay royalties when the law provided them freedom from infringement liability under the exhaustion or implied license doctrines.

In any event, the Court in *Quanta* said *Univis Lens* "held that the sale of the lens blanks exhausted the patents on the finished lenses" and "held that 'the authorized sale of an article which is capable of use only in practicing the patent is a relinquishment of the patent monopoly with respect to the article sold.'" The Court in *Quanta* did not cite or discuss the decisions the Court in *Univis Lens* used to support this position or to mention the sentence in which the *Univis Lens* Court explained why the sale relinquished the patent rights. In the pages the *Quanta* Court cited for this view, *Univis Lens* said:[95]

> An incident to the purchase of any article, whether patented or unpatented, is the right to use and sell it, and upon familiar

[94] U.S. v. Univis Lens Co., 316 U.S. 241, 249-50 (1942).

[95] U.S. v. Univis Lens Co., 316 U.S. 241, 249-250, 62 S.Ct. 1088, 1093 (1942).

> 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. Leitch Mfg. Co. v. Barber Co., 302 U.S. 458, 460, 461, 58 S.Ct. 288, 289, 82 L.Ed. 371; B. B. Chemical Co. v. Ellis, 314 U.S. 495, 62 S.Ct. 406, 86 L.Ed. 367. Sale of a lens blank by the patentee or by his licensee is thus in itself both a complete transfer of ownership of the blank, which is within the protection of the patent law, and a license to practice the final stage of the patent procedure.

When the *Univis Lens* Court stated the applicable legal principle, the Court cited its implied license decisions, not its exhaustion decisions. *Leitch* and *B.B. Chemical* do stand for the "familiar" principles that the authorized sale of an article which is capable of use only in practicing the patent is a relinquishment of the patent monopoly with respect to the article sold. Those principles are the implied license doctrine, not the exhaustion doctrine.[96] When the *Univis Lens* Court explained the theory, the Court said the sale gave the purchaser "a license", not that the sale exhausted the patent.

The Court in *Univis Lens* did refer to its exhaustion decisions to support the Court's conclusion that the Univis Corporation violated the antirust laws. The Court said its exhaustion decisions meant that sale of a "patented article" exhausts the monopoly in that article and the patentee may not thereafter, by virtue of the patent, control the use or disposition of the article. The Court did not say its exhaustion decisions applied to the sale of an unpatented article.

In any event, by ignoring the importance of the implied license doctrine to the *Univis* result and ignoring that *Univis Lens* was an antitrust decision and not a decision on a purchaser's infringement liability, the Court in *Quanta* found in *Univis Lens* an exhaustion rule that sales of products that did not embody a patented invention exhausted rights to that invention, where the product sufficiently embodies the patent that its only and intended use is to be finished so that it does embody the invention.

The Court addressed one additional argument based on the fact that *Univis Lens* involved a patent owner that owned only one patent.[97]

> With regard to LGE's argument that exhaustion does not apply across patents, we agree on the general principle: The sale of a device that practices patent A does not, by virtue of practicing patent A, exhaust patent B. But if the device practices patent A *while substantially embodying* patent B, its relationship to patent A

[96] B.B. Chem. v. Ellis, 314 U.S. 495, 497 (1942)(sale of chemicals useful only in patented process implies a license to do so); Leitch Mfg. Co. v. Barber Co., 302 U.S. 458, 461 (1938) ("For any road builder can buy emulsion from it [the patent owner] for that purpose [of employing the patented method], and whenever such a sale is made, the law implies authority to practice the invention.").

[97] *Quanta Computer, Inc. v. LG Electronics, Inc.*, __ U.S. __, 128 S.Ct. 2109, 2120-21 (2008)

> does not prevent exhaustion of patent B. For example, if the Univis lens blanks had been composed of shatter-resistant glass under patent A, the blanks would nonetheless have substantially embodied, and therefore exhausted, patent B for the finished lenses. This case is no different. While each Intel microprocessor and chipset practices thousands of individual patents, including some LGE patents not at issue in this case, the exhaustion analysis is not altered by the fact that more than one patent is practiced by the same product. The relevant consideration is whether the Intel Products that partially practice a patent-by, for example, embodying its essential features-exhaust *that* patent.

This part of the Court's decision says that exhaustion does not depend on whether the claims asserted to be exhausted are in one patent or in several patents. If the LG owned and licensed Intel under a microprocessor patent, a system patent, and a method of use patent, the Court implied the result would have been no different. The Court said the issue of the relationship of a product that is sold to some patented invention is not depend on whether that product includes other patented inventions, it depend solely on whether that product embodies essential features of the patent to which exhaustion might apply.

2. *Ethyl Gasoline* – There Was No Exhaustion Issue; Patent Owner Violates Antitrust Law by Licensing One Company to Sell One Patented Product to Another Licensee with a License to Make and Sell Another Patented Product at Prices Set by the Patent Owner

The Court found that the exhaustion doctrine applied to products useful in carrying out patented methods based on *Univis Lens* and *Ethyl Gasoline Corp. v. United States.*[98]

> Our precedents do not differentiate transactions involving embodiments of patented methods or processes from those involving patented apparatuses or materials. To the contrary, this Court has repeatedly held that method patents were exhausted by the sale of an item that embodied the method. In *Ethyl Gasoline Corp. v. United States,* 309 U.S. 436, 446, 457, 60 S.Ct. 618, 84 L.Ed. 852 (1940), for example, the Court held that the sale of a motor fuel produced under one patent also exhausted the patent for a method of using the fuel in combustion motors.[FN4] Similarly, as previously described, *Univis* held that the sale of optical lens blanks that partially practiced a patent exhausted the method patents that were not completely practiced until the blanks were ground into lenses. 316 U.S., at 248-251, 62 S.Ct. 1088.
>
> FN4. The patentee held patents for (1) a fluid additive increasing gasoline efficiency, (2) motor fuel produced by mixing gasoline

[98] *Quanta Computer, Inc. v. LG Electronics, Inc.*, __ U.S. __, 128 S.Ct. 2109, 2117-18 (2008).

> with the patented fluid, and (3) a method of using fuel containing the patented fluid in combustion motors. *Ethyl Gasoline Corp.,* 309 U.S., at 446, 60 S.Ct. 618. The patentee sold only the fluid, but attempted to control sales of the treated fuel. *Id.,* at 459, 60 S.Ct. 618. The Court held that the sale of the fluid to refiners relinquished the patentee's exclusive rights to sell the treated fuel. *Id.,* at 457, 60 S.Ct. 618.
>
> These cases rest on solid footing. Eliminating exhaustion for method patents would seriously undermine the exhaustion doctrine. Patentees seeking to avoid patent exhaustion could simply draft their patent claims to describe a method rather than an apparatus. (footnote omitted).

The Court did not say where it had "repeatedly held that method patents were exhausted by the sale of an item that embodied the method." The Court had repeatedly held that an implied license to carry out patented methods arose from the sale of an unpatented product useful in carrying out the methods.[99]

The Court said that "... *Univis* held that the sale of optical lens blanks that partially practiced a patent exhausted the method patents that were not completely practiced until the blanks were ground into lenses." The Court was wrong. The Court in *Univis Lens* described the Univis Lens patents.[100] The Court said that of Univis Lens' sixteen patents, three are unrelated to the issues of the case. The Court said five were for methods of producing lenses utilized by the Lens Company in making lens blanks and did not concern any method or process employed by the licensees who finished the lens blanks. In other words, those patents also had nothing to do with the case. The Court said "each of the remaining eight patents relates to the shape, size, composition and disposition of the pieces of glass of different refractive power in the blanks into which they are fused." The Court said these eight product patent on finished lenses were the basis for the District Court's decision. These were the patents that the Court said were partially practiced by the sale of the lens blanks. The Court in *Univis Lens* knew it was dealing with patents on finished lenses and repeatedly said so.[101]

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[99] Dawson Chemical Co. v. Rohm & Haas Co., 448 U.S. 176, 186 (1980)("farmers who buy propanil from Rohm & Haas may use it [to carry out a patented process], without fear of being sued for direct infringement, by virtue of an 'implied license' they obtain when Rohm & Haas relinquishes its monopoly by selling the propanil."); B.B. Chem. v. Ellis, 314 U.S. 495, 497 (1942); Leitch Mfg. Co. v. Barber Co., 302 U.S. 458, 461 (1938).

[100] U.S. v. Univis Lens Co. 316 U.S. 241, 246-47, 62 S.Ct. 1088, 1090-92 (1942).

[101] E.g., U.S. v. Univis Lens Co. 316 U.S. 241, 249, 62 S.Ct. 1088, 1092 (1942)("But merely because the licensee takes the final step in the manufacture of the patented product, by doing work on the blank which he has purchased from the patentee's licensee, it does not follow that the patentee can control the price at which the finished lens is sold. [new paragraph] Notwithstanding the assumption which we have made as to the scope of the patent, each blank,

The *Quanta* Court also said that in *Ethyl Gasoline,* "for example, the Court held that the sale of a motor fuel produced under one patent also exhausted the patent for a method of using the fuel in combustion motors." In *Ethyl Gasoline,* licensees under motor fuel patents did sell motor fuel and that fuel might have been useful to practice a patented method of using the fuel. However, the Court in *Ethyl Gasoline* said not a word about whether the sale of motor fuel exhausted patent rights for a method of using motor fuel, because the issue had nothing to do with that question. *Ethyl Gasoline* also does did not hold any such thing, because the result in *Ethyl Gasoline* did not depend on whether the sale of fuel exhausted method patent rights.

If *Ethyl Gasoline* says anything about exhaustion, *Ethyl Gasoline* shows that the sale of a product useful only in practicing the invention of a patent does not exhausted the rights under that patent. *Ethyl Gasoline* points to the conclusion that the sale of motor fuel covered by one patent does not exhausted a patent owner's rights under a patent for a method of using the that fuel in a motor.

Ethyl Gasoline involved inventions useful to increase the octane rating of gasoline and diesel fuel. Motor fuels with higher octane ratings improved the performance of high compression engines. The inventions relied on the use of a chemical, tetraethyl lead. Ethyl Gasoline Corp. ("Ethyl Corp.") owned two patents claiming a fluid containing tetraethyl lead. The fluid was useful as a gasoline additive. Those two patents also claimed a motor fuel containing gasoline and the tetraethyl lead fluid. Ethyl Corp. also owned a separate patent on a motor fuel containing gasoline and the tetraethyl lead fluid. Presumably due to these patents, the Court referred to the fluid and motor fuel products sold as the patented fluid and the patented motor fuel. Ethyl Corp. also owned a patent on a method of using fuel containing the tetraethyl lead fluid in combustion motors. The Court noted the existence of that patent, and then said not another word about it.

Ethyl Corp. sold the patented tetraethyl lead fluid to licensed oil refiners. The oil refiners produced motor fuel. The refiners were licensed to make motor fuel containing the tetraethyl lead fluid and to sell and distribute fuel to other licensed refiners, licensed jobbers, and retail dealers and consumers. With one exception, every leading oil company in the United States was a licensed refiner. The license provided that Ethyl Corp. would sell the refiner licensees their requirements of the patented fluid. The refiner licenses specified the amount of fluid to be used in two classes of fuel, regular fuel and premium fuel. Regular fuel contained less fluid then premium fuel. Regular fuel therefore had a lower octane rating then premium fuel. The license required that premium fuel be called "Ethyl" fuel.

The licensed refiners paid Ethyl Corp. for the fluid. The licensed refiners did not pay royalties to Ethyl Corp. Ethyl Corp. was content to receive payments for the motor fuel licenses as part of the purchase price for the fluid. Since a set amount of fluid was used in every gallon of gasoline, Ethyl could adjust the price of fluid to include a royalty of some amount per gallon of

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as appellees insist, embodies essential features of the patented device and is without utility until it is ground and polished as the finished lens of the patent.").

fuel. The refiners would not care whether they paid the royalty for their licenses separately or as part of the price of fluid.

The refiner licenses specified the price differential for the refiners' sales of their best non-premium or regular motor fuel and their premium or Ethyl fuel. The licenses required that the refiners sell premium or Ethyl fuel at a certain price above the average net sales price of their best non-premium or regular fuel. The refiners were presumably free to price their non-premium or regular fuel as they wished. The Government did not attack this price fixing provision of the refiner licenses. The Court did not say it was unlawful. However, if Ethyl Corp.'s sale of the fluid to refiners exhausted Ethyl Corp's rights under its motor fuel patents, these price fixing provisions were *per se* unlawful as resale price fixing.

Ethyl Corp. also granted licenses to jobbers to sell regular and Ethyl gasoline made and sold by designated licensed refiners. The licensed jobbers were authorized to sell to retail dealers and customers within specified territories. The jobber licenses did not specify the price at which jobbers could sell gasoline. A jobber would apply for a license through a refiner. The jobber's license would specify that the jobber was licensed to sell only motor fuel from that refiner. Jobbers would buy fuel from their designated refiners. The jobber licenses did not require payment of royalties to refiners or Ethyl Corp. Ethyl exercised some control over the companies that received jobber licenses. Eleven thousand of the twelve thousand jobbers in the United States received jobber licenses.

The government brought an action against Ethyl Corp. alleging that Ethyl Corp. employed its licensing system to fix the prices at which jobbers sold motor fuel. The government contended that this was resale price fixing, because jobbers purchased fuel from the licensed refiners and resold that fuel at fixed prices. The Supreme Court found that, while Ethyl Corp. did not fix the prices at which jobbers sold through any agreement or understanding with the jobbers, Ethyl Corp. did exercise control over jobbers' prices by the manner in which it decided which jobbers would receive licenses and monitored the activities of licensed jobbers, including their pricing practices. The government sought and obtained from the District Court an order preventing Ethyl Corp. from licensing jobbers, canceling Ethyl Corp.'s existing licenses with jobbers, and precluding enforcement of the provision in the refiners' licenses that they sell only to licensed jobbers. The government sought and obtained an injunction to eliminate the alleged price-fixing at the jobber level by eliminating the jobber licenses and the restriction that licensed refiners sell only to licensed jobbers. The Supreme Court approved that relief.

The Supreme Court said that Ethyl Corp. could not have lawfully contracted with the jobbers to fix the prices at which jobbers resold the patented motor fuel, because the antitrust law prohibited fixing the resale price of even a patented article after it has been sold by a patent owner or its licensee. The Court said that Ethyl Corp. used its system of licensing to control jobbers' resale prices so that the effect was the same as a contract with the jobbers to fix resale prices. For that reason, the licensing system was unlawful.

The Court considered and rejected Ethyl Corp.'s argument that its system of licensing refiners and jobbers and the restrictions placed on the refiners and jobbers in those licenses were reasonably necessary for the development of Ethyl Corp.'s patents and ensuring a financial return for them. The Court concluded that Ethyl Corp. could not lawfully control the price at which jobbers sold patented motor fuel, because the jobbers had purchased the fuel and their subsequent resale of the fuel was not within the limits of the patent monopoly. Throughout its analysis, the Court referred to the motor fuel resold by jobbers as the patented motor fuel or the patented fuel. The Court regarded the only patents to potentially justify the licensing system as the one patent that covered the tetraethyl lead fluid and the three patents that covered motor fuel containing the tetraethyl lead fluid. The Court decided the case by asking only whether the owner of a patent on the fluid and a patent on motor fuel containing the fluid had the right to limit the price at which purchasers from motor fuel licensees could resell that motor fuel.

The Court made no reference to the method of using patented fuel carried out by consumers when driving automobiles with the fuel. The Court presumably made no reference to the method patent, because the jobbers did not practice the patented method. The jobbers simply resold the patented motor fuel. The Court did not say that the sale of motor fuel by licensed refiners exhausted the rights in the method of use patent, because the Court did not regard that patent as having anything to do with the action. There was, of course, no issue of whether an automobile owner was a patent infringer or whether a jobber was a contributory infringer by selling the fuel to consumers.

The *Quanta* Court thought that *Ethyl Gasoline* meant that the sale of an unpatented component could exhaust the rights to make and sell a patented product if the only use for the component was to make the product and the component embodied the novel features of the invention. If the sale of an unpatented component useful only to make a patented product exhausts the rights to make, use, and sell the patented product, the Court would presumably have said that Ethyl Corp.'s sale of the patented fluid to refiner licensees exhausted its rights to use or resell the fluid and also to make use and sell motor fuel containing the fluid. However, the Court did not do that. The Court assumed that Ethyl Corp. plainly had the right to sell the patented fluid itself and separately license purchasers of the patented fluid to make and sell the separately patented motor fuel. The sale of the patented fluid did not exhaust rights to the patented motor fuel.

The Court in *Ethyl Gasoline* explained why Ethyl Corp. had done more than simply exercise its right to refuse to sell or permit its licensees to sell a patented product to price cutters. The Court said Ethel Corp. had used the manner in which it licensed jobbers to control of the prices at which they sold. Throughout that discussion, the Court discussed the action as involving a patented product or a patented fuel.[102] The Court said nothing whatsoever about the method patent. Again the reason is presumably that the jobbers did not carry out the patented method. Also, Ethyl Corp. did not attempt to separately license the method patent to consumers

[102] Ethyl Gasoline Corporation v. U.S., 309 U.S. 436, 457-458 (1940)("The picture here revealed is not that of a patentee exercising its right to refuse to sell or to permit his licensee to sell *the patented products* to price-cutters. [citations omitted] A very different scene is depicted by the record. It is one in which appellant has established the marketing of *the patented fuel* in vast amounts on a nationwide scale through the 11,000 jobbers and at the same time, by the leverage of its licensing contracts resting on the fulcrum of its patents, it has built up a combination capable of use, and actually used, as a means of controlling jobbers' prices and suppressing competition among them." (emphasis added)).

to carry out the method when they drove their automobiles. Insofar as the opinion reveals, Ethyl Corp also did not attempt to license jobbers to sell motor fuel for use in carrying out the patented method or attempt to justify setting jobber prices due to the existence of that separate method patent. The patent owner did not contend that the method patent separately permitted it to fix the price at which jobbers sold motor fuel, because the patent owner had not attempted the license jobbers under that patent to sell only at prices set by the refiners or Ethyl Corp. The method patent was simply irrelevant to the issue before the Court.

In *Ethyl Gasoline,* the Court said that Ethyl Corp's control over the price at which jobbers sold went beyond Ethyl Corp.'s legitimate interests in its patents because the restrictions on the jobbers prices were restrictions set by the refiners and not by Ethyl Corp.[103] The Court had explained earlier how jobbers were evaluated to determine whether as they could obtain a license. Jobbers were evaluated based on whether they followed the marketing policies and posted prices of the major oil companies. The major oil companies were refiner licensees. Therefore jobbers were evaluated based on whether they followed the pricing and marketing practices specified by the refiner licensees and not by Ethyl Corp. Because Ethyl Corp. did not specify the prices and marketing practices desired to be followed by jobbers, the Court said that those prices and practices had nothing to do with Ethyl Corp's efforts to exploit its motor fuel patent.

The Court also said that Ethyl Corp did not sell motor fuel and did not require its refiner licensees to pay royalties on their sales of the patented motor fuel. For that reason, the Court reasoned that any benefit arising from restricting the prices at which jobbers resold fuel accrued primarily to the refiners and only indirectly to Ethyl Corp by influencing Ethyl Corp's sales of tetraethyl lead fluid to refiners. While the Court did not say so, if the only effect of requiring jobbers to resell at prices set by the refiners was to raise the price at which jobbers sold motor fuel to retailers and consumers and also, due to the lack of competition from jobbers, the price at which refiners sold to retailers and consumers, the requirement is contrary the Ethyl Corp.'s interests. If motor fuel prices go up, motor fuel sales go down. Lower motor fuel sales result in lower tetraethyl lead fluid sales by Ethyl Corp. and lower Ethyl Corp. revenue and profits.

Because the Court perceived that Ethyl Corp. was not employing restrictions on jobber prices to earn financial returns to Ethyl Corp.'s motor fuel patent, and was merely using the restrictions to enhance the financial returns of the refiner licensees, Ethyl Corp.'s motor fuel patent did not justify the restrictions. The Court said that because the licensing conditions imposed on the jobbers were not used by the patent owner to earn financial returns on the motor fuel patent and rather were used solely to enhance the business of the refiners and indirectly to exploit the tetraethyl lead fluid patent, the licensing conditions under which the motor fuel patent was licensed could not be justified as related to Ethyl Corp.'s legitimate desired to exploit the separate motor fuel invention of that patent. The Court concluded that the licensing restrictions were not used to stimulate "the commercial development and financial returns of the patented invention which is licensed [the motor fuel patent], but for the commercial development of the business of refiners and the exploitation of a second patent monopoly [the fluid patent] not

103 Id. at 458-459.

embraced in the first." The Court said that the restrictions in the motor fuel license could not be justified as a means for promoting the fluid patent.

If the Court believed that Ethyl Corp's sale of the tetraethyl lead fluid exhausted its rights in the motor fuel patent, as the *Quanta* Court thought, the Court in *Ethyl Gasoline* would not have had to go through this exercise. The Court would have said that Ethyl Corp's fluid sales exhausted its rights in its motor fuel patent. If the Court also believed that all post-sale restrictions and conditions are invalid, as the *Quanta* Court thought, the Court in *Ethyl Gasoline* would have said that the licenses to the refiners were themselves invalid and that all restrictions and conditions in them were similarly invalid. The Court would not have had to explain why the patent owner had no legitimate interest in separately exploiting its motor fuel patent because the law would have prevented the patent owner from separately exploiting the motor fuel patent, if it wished to sell tetraethyl lead fluid.

C. The Court's View of the Policy of Exhaustion

1. Exhaustion Eliminates Liability for Infringement of Method of Use Claims to Prevent an End Run Around the Exhaustion Doctrine and Permit a Patent Owner to Capture the Value of the Same Invention Twice

The *Quanta* Court thought it important to prevent an "end run" around the exhaustion doctrine through use of method claims. The perceived danger was that even though Intel had the right to sell complete computer systems, Intel customers for computer systems could be liable for patent infringement under LG method claims when they used the systems. The Court cited a law review article implying that economic harm would result if the inventor of a machine obtained both machine and method claims so that the force of the patent "intruded deeply into the stream of commerce" because the rights would survive multiple transactions.[104]

> This case illustrates the danger of allowing such an end-run around exhaustion. On LGE's theory, although Intel is authorized to sell a completed computer system that practices the LGE Patents, any downstream purchasers of the system could nonetheless be liable for patent infringement. Such a result would violate the longstanding principle that, when a patented item is "once lawfully made and sold, there is no restriction on [its] *use* to be implied for the benefit of the patentee." *Adams,* 17 Wall., at 457, 21 L.Ed. 700. We therefore reject LGE's argument that method claims, as a category, are never exhaustible.

The Court did not explain why it feared that purchasers of computer systems from Intel under license from LG would be liable for patent infringement under an LG method claim when they used those computers. Under the implied license doctrine, those purchasers would have the right to use those computers free of infringement claims, unless at the time they purchased those computers, they were informed that they had no right to use them without a separate license from LG under the method claims. Under the implied license doctrine, if purchasers were not

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104 *Quanta Computer, Inc. v. LG Electronics, Inc.,* __ U.S. __, 128 S.Ct. 2109, 2217-18 (2008).

informed that they required a separate license, purchasers effectively acquired that license when they purchased the system, and the price they paid for the system included a payment for a method license. If the purchasers were informed that they required a separate license at the time of purchase, purchasers would have purchased only if the total of the price for the system and the royalty for the method license was less than the value of the system and the ability to use it.

The operation of the implied license rule permits commerce to operate exactly as it should. Purchasers may buy products without concern about patents owned by their suppliers. They may use the products free of claims of infringement that would otherwise arise from their use of those products. The price they pay for products provides them with freedom from infringement claims. Purchasers must address the patent issues only if they are informed of them at the time they purchase. Purchasers may then make a decision whether to buy based upon the combined prices for the products and for the patent license, and may buy the product only with the assurance that they have a patent license.

In any event, the LG - Intel license did not purport to prevent an implied license arising for an Intel customer who purchased an entire system. The LG-Intel license only attempted to prevent an implied license when a purchaser bought something less than a complete system and used the components to build a system. The license attempted to reserve LG's patent rights only in that setting. Unless LG is permitted to reserve its patent rights to systems in that way, LG will not license component makers to make and sell components of those systems. Intel will have no license and Intel's customers will not have Intel available as a microprocessor supplier. LG will license only makers and sellers of systems so that its revenue from exploiting its patent is derived from the full value of systems. Intel's customers must now acquire a license under the system and method of use claims to make and sell systems and also pay for a license under the claims to microprocessors to enable them to have Intel make microprocessors for them.

2. Sales of Products that Have Only One Use and Embody the Essential Features of a Patented Invention Create Exhaustion to Prevent a Patent Owner from Capturing the Value of the Invention Twice

The Court also said that exhaustion must apply to unpatented products to prevent a patent owner from extending "their rights through each downstream purchaser all the way to the end user."[105]

> If, as in *Univis,* patent rights are exhausted by the sale of the incomplete item, then LGE has no postsale right to require that the patents be practiced using only Intel parts. Quanta also argues that exhaustion doctrine will be a dead letter unless it is triggered by the sale of components that essentially, even if not completely, embody an invention. Otherwise, patent holders could authorize the sale of computers that are complete with the exception of one minor step-say, inserting the microprocessor into a socket-and

[105] *Quanta Computer, Inc. v. LG Electronics, Inc.*, __ U.S. __, 128 S.Ct. 2109, 2118-20 (2008).

> extend their rights through each downstream purchaser all the way to the end user.

The Court said that if patent rights are exhausted by the sale of an incomplete item, "LGE has no post sale right to require that the patents be practiced using only Intel parts." In other words, the Court thought that LG was attempting to impose a tying arrangement for the benefit of its licensee Intel. The Court apparently thought that the provision stating that no license existed for combining the Intel products with non-Intel products was a tying arrangement, because it meant that a license under the system and method claims existed for component purchasers only if they also purchased Intel products for use in making patented systems. On its face, the Court was certainly correct. However, that was unlikely to have been LG and Intel's purpose. Intel and LG likely wanted to license their component patents to component suppliers and their computer system and method of use patents to computer companies.

The Court also was receptive to Quanta's argument that the exhaustion doctrine would be dead if the law permitted the owner of a patent on a system to license someone to sell a complete system with the exception of one minor step, such as selling a computer and a microprocessor so that the complete system would be made only when the microprocessor is plugged into the computer socket. If the sale of a computer and a microprocessor separately did not create exhaustion, the Court said the patent owners could "extend their rights through each downstream purchaser all the way to the end user." Ignoring the implied license doctrine, the Court is entirely correct.

However, the Court is entirely wrong to say that, if the exhaustion did not operate in a way, the patent owner would have somehow extended their rights. A patent on a system is infringed whether the system is made by a computer company or a computer user. A patent on a system is infringed when a computer user uses the system. A patent on a system is infringed when it is sold by a manufacturer, the distributor, a retailer, or an end user who sells to some other end user. A patent owner could not capture any amount greater than the value its invention creates for all end-users of products embodying that invention or used in processes covered by that invention.

The value of an invention is derived from the demand for products by end-users. The value of that invention may be captured by patent owner only once. If the value of an invention to end-users is $1000 per product, a patent owner may capture no more than $1000 per product no matter how it tries to exploit the invention or how the law permitted the invention to be exploited. For example, if a patent owner owned a patent on a computer system that was worth $1000 more to consumers than competing computer systems, a patent owner could not capture more than $1000 per computer by licensing a company to sell a computer and a microprocessor separately in exchange for royalties of $1000 per transaction.

If a patent owner did so, and the law had no exhaustion doctrine or implied license rule, so that purchasers of the computer and microprocessor were liable for patent infringement when they plugged in that processor, the patent owner would earn nothing because no computer supplier would agree to sell on those terms and no consumer would buy on those terms. A computer supplier would not agree to sell, because when one customer learned that it required a patent license to be able to make and use the computer, no other customer would ever buy. The supplier would sell one unit. Customers would not buy because the price from the computer supplier included the $1000 payment to the patent owner. If a patent owner attempted to extract an additional payment from the end user, the end user would not pay a cent more, because the price of the computer plus one cent is greater than what the invention is worth to that user. All computer users would buy from someone else.

The economic value of a patented invention may only be captured once. Patent rights are not extended in any legal or economically rational sense by permitting patent owners to select which persons in the chain of component makers and suppliers, system makers and suppliers, distributors, retailers, and end users pay the value of some invention to the owner, directly or indirectly. If the owner of a patented system decides to collect the value of its patent from a system supplier, and there were no exhaustion doctrine, the result would not be that end-users would be patent infringers. The result would be that the owner of the patent on the system and its licensees would agree that the patent owner would not assert a claim for infringement against the licensee's customers and that the licensee could, if it wished, assure any customer that it would not have infringement liability.

The exhaustion doctrine does not exist to prevent patent rights from being extended to include activities that did not capture the value of the patented invention. Sensibly applied, the exhaustion and implied license doctrine operate to permit commercial transactions involving products and patents to be conducted most efficiently. The exhaustion and implied license doctrine operate to permit a patent owner to capture the value of its invention in the most efficient way by selling and licensing in a way that results in payments to the patent owner reflecting the value of the invention to product sellers and users and provides authorization under patents for sellers and users in the lowest cost manner. If the exhaustion and implied license doctrine are not permitted to operate in a way, patent owners must turn to less efficient ways of exploiting their inventions and must use mechanisms that provide licenses to users in more expensive ways.

D. Post-Sale Restrictions Are Invalid; Why Did the Court Discuss Post-Sale Restrictions?

The Court then turned to a discussion of whether "post-sale restrictions" on use of a patented product were permissible. The Court looked to its decisions in *Henry v. A.B. Dick*, *Bauer & Cie v. O'Donnell*, and most importantly *Motion Picture Patents*. The Court said that *Henry v. A.B. Dick* permitted "post-sale restrictions" on use of a patented article and *Motion Picture Patents* condemned them. The Court said:[106]

> Although the Court permitted postsale restrictions on the use of a patented article in Henry v. A.B. Dick Co., 224 U.S. 1, 32 S.Ct. 364, 56 L.Ed. 645 (1912), [FN2] that decision was short lived. In 1913, the Court refused to apply A.B. Dick to uphold price-fixing

[106] *Quanta Computer, Inc. v. LG Electronics, Inc.*, __ U.S. __, 128 S.Ct. 2109, 2115-2116 (2008).

provisions in a patent license. See Bauer & Cie v. O'Donnell, 229 U.S. 1, 14-17, 33 S.Ct. 616, 57 L.Ed. 1041 (1913). Shortly thereafter, in Motion Picture Patents Co. v. Universal Film Mfg. Co., 243 U.S. 502, 518, 37 S.Ct. 416, 61 L.Ed. 871 (1917), the Court explicitly overruled A.B. Dick. In that case, a patent holder attempted to limit purchasers' use of its film projectors to show only film made under a patent held by the same company. The Court noted the "increasing frequency" with which patent holders were using A.B. Dick-style licenses to limit the use of their products and thereby using the patents to secure market control of related, unpatented items. 243 U.S., at 509, 516- 517, 37 S.Ct. 416. Observing that "the primary purpose of our patent laws is not the creation of private fortunes for the owners of patents but is 'to promote the progress of science and useful arts,' " id., at 511, 37 S.Ct. 416 (quoting U.S. Const., Art. I, § 8, cl. 8), the Court held that "the scope of the grant which may be made to an inventor in a patent, pursuant to the [patent] statute, must be limited to the invention described in the claims of his patent." 243 U.S., at 511, 37 S.Ct. 416. Accordingly, it reiterated the rule 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 upon it." Id., at 516, 37 S.Ct. 416.

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2. The A.B. Dick Company sold mimeograph machines with an attached license stipulating that the machine could be used only with ink, paper, and other supplies made by the A.B. Dick Company. The Court rejected the notion that a patent holder "can only keep the article within the control of the patent by retaining the title," A.B. Dick, 224 U.S., at 18, 32 S.Ct. 364, and held that "any ... reasonable stipulation, not inherently violative of some substantive law" was "valid and enforceable," id., at 31, 32 S.Ct. 364. The only requirement, the Court held, was that "the purchaser must have notice that he buys with only a qualified right of use," so that a sale made without conditions resulted in "an unconditional title to the machine, with no limitations upon the use." Id., at 26, 32 S.Ct. 364.

This part of *Quanta* is very important. Taken literally, the opinion says patent owners have no control over the exhaustion doctrine. This part of the opinion is also odd. The issue of "post-sale restrictions" seems to have nothing to do with the issue before the Court. Intel did not grant its customers a license under either LG or Intel patents that limited the rights the customer received. One may only speculate about why the Court talked about post-sale restrictions. There are three possibilities.

One is that the Court viewed the notice letter sent to customers as an attempted restriction on their use of the Intel products and thought it necessary to determine whether such a restriction would be enforceable. However, the Court did not say the notice letter attempted to impose a restriction on use of the Intel products and was unenforceable as a "post-sale restriction." The issue of post-sale restrictions might also have been raised, if Intel had been licensed to sell only to customers who received the notice letter and agreed to be bound by the limitation on its license rights. However, the Court found that the requirement to give notice did not limit Intel's right to make, use and sell, meaning Intel had a license to sell to customers who did not receive the notice and agreed to its limitations. For that reason, the Court found that the Intel sales exhausted LG's patent rights.

The second is that the Intel license provided that no license was granted to any third party for the making, use or sale of combination products containing licensed Intel products and components acquired from someone other than LG and Intel. The Court may have viewed that provision as a restriction limiting Intel's right to sell Intel products only for use by customers with other Intel or LG products. Again, the Court did not say that this provision restricted Intel's license to sell in any way. The Court found that Intel's license to make, use, sell was unlimited and that nothing in the license limited Intel's right to sell to purchasers who intended to combine the Intel products with non-Intel parts. Since the Court concluded that the there was no restriction on Intel's right to sell, there is no apparent reason to discuss whether a restriction limiting the right to sell for certain post-sale uses would have been enforceable.

If the Court viewed the provision saying that no license was granted to third parties to combine Intel products with non-Intel or LG products to be a limitation on Intel's right to sell only to customers who used the Intel products in that way, the restriction was a tying arrangement. It would then have been necessary to consider that enforceability of that restriction. If that provision restricted the license rights of a purchaser, the purchaser had a license only to use Intel products only with other Intel or LG products. The Court's discussion of *A.B. Dick* and *Motion Picture Patents* would have mattered to result. The manner in which Intel and LG attempted to reserve their rights under their system and method patents looked like a tying arrangement and for that reason the Court was suggesting, without saying so, that this attempted restriction would have been unenforceable. However, the Court did not say this provision was binding on purchasers and was unenforceable as a tying arrangement.

Third, the Court may have used the phrase "post-sale restriction" to refer to the infringement liability of a purchaser for activities using a product after the purchase. The Court may have regarded infringement liability itself to be a "post-sale restriction", because that liability would restrict what a purchaser could lawfully do with a product. If that is what the Court meant by "post-sale restriction," the Court believed that *Motion Picture Patents* declared unenforceable all ways a patent owner might attempt to limit the operation of the exhaustion doctrine. The Court did not believe that *Motion Picture Patents* merely rendered unenforceable a restriction in a license accompanying the sale of some product that the product be used only with unpatented products also purchased from the patent owner. The Court believed *Motion Picture Patents* was more basic.

Whatever the reason, the Court misunderstood the three decisions it said rendered "post-sale restrictions" invalid. *A.B. Dick* and *Motion Picture Patents* addressed the enforceability of one type of restriction accompanying the sale of a patented product. The restriction limited use of the patented product to use only with other unpatented products purchased from the patent owner or the patent owner's specified supplier. These restrictions are commonly called tying restrictions. *A.B. Dick* held that tying restrictions were lawful and enforceable. *Motion Picture Patents* held that tying restrictions were unenforceable. *Bauer & Cie v. O'Donnell* addressed another type of restriction, one that limited resale of a patented product to prices set by the patent owner. Those decisions did not address the enforceability of all restrictions on a purchaser's use or resale of a patented product.

1. *A.B. Dick* – Post-Sale Restrictions Are Enforceable if They Are Lawful; Tying Restrictions Are Lawful and Enforceable

In 1912 in *A.B. Dick Co.*,[107] the patent owner A.B. Dick had two patents covering a stencil-duplicating machine known as the "Rotary Mimeograph."" As the *Quanta* Court said, A.B. Dick made and sold mimeograph machines. Each machine bore this notice:

License Restriction

> 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.

The defendant, Sidney Henry, sold the owner of a machine, Miss Skou, a can of ink suitable for use in the machine. Henry knew about the license notice and expected that the ink would be used in the A.B. Dick machine. A.B. Dick sued Henry for contributing to infringement by Miss Skou. A majority of the Court said that Miss Skou did not acquire an unlimited right to use the machine, when she bought the machine. For that reason, Henry was contributing to patent infringement.

The Court said that the machine purchase's rights depended on the nature of the license under the patent that was express or implied from the circumstances of the sale. Justice Lurton, for the majority, said everyone agreed that a patent owner may effectively restrict the time, place and manner of use of a patented machine. He said the "books abound in cases upholding the right of a patentee owner of a machine to license another to use it, subject to any qualification in time, place, manner, or purpose of use which the licensee agrees to accept." Justice Lurton said the contention was that a patent owner could not do the same thing if it sold the machine.

The Court said it had long been settled by cases such as *Mitchell* and *Adams* that a patent owner's sale of a patented machine "subject to no conditions" gives the purchaser the right to "use it where, when, and how he pleases," and to "dispose of the same unlimited right to another." The Court explained that an unlimited license was implied from an unconditional sale, because such a sale "implies that the patent owner consents" to unlimited use by the purchaser. This is the presumed or "implied" intent of the patent owner and the purchaser. However, the patent owner and purchaser may have a different intent that will control if a restricted license accompanies the sale. They may intend that the purchaser acquire all the property rights to the

[107] Henry v. A.B. Dick Co., 224 U.S. 1, 17-25 (1912).

"materials composing a patented product" and only "some of" the uses included in the patent rights. The physical machine and the license are "separate things" and may be transferred separately. The Court then asked whether the type of restriction imposed was "lawful" and concluded that it was lawful.

A.B. Dick said the rights of a purchaser of a patented product depend on whether an express or implied license accompanies the sale, whether that license is subject to restrictions or conditions limiting the purchaser's use, and whether any restrictions or conditions are lawful. *A.B. Dick* seemed to clarify when a sale exhausted the patent rights and when it did not. *A.B. Dick* said that an unlimited license was implied unless the patent owner imposes conditions or restrictions at the time of sale. *A.B. Dick* said restrictions imposed by a notice on a patented machine requiring use only with other products purchased from the patent owner were lawful.

2. *Bauer & Cie* – Resale Price Restrictions Are Unlawful and Unenforceable

Based on the Court's earlier decisions in *Bobbs-Merrill Co. v. Straus* and *Dr. Miles Medical Co. v. Park and Sons Co.*, the Court in 1913 in *Bauer & Cie v. O'Donnell* declared void a patent owner's attempt to fix the resale price of a patented article.[108] The Bauer & Cie company of Germany owned a United States patent covering a certain water soluble chemical sold in packages for ultimate use by consumers.[109] Bauer & Cie granted a license to the Bauer Chemical Company of New York City to sell the product in the United States and made Bauer Chemical its sole agent for sales in the United States. Bauer & Cie apparently made the product and supplied it to Bauer Chemical at manufacturing cost for sale in the United States. Bauer & Cie and Bauer Chemical shared the net profits from United States sales. In some fashion, the agreement contemplated that Bauer Chemical should fix the price of sale to wholesalers, distributors, retailers, and the public. Bauer Chemical sold the product in packages bearing the patent number and the following:

'Notice to the Retailer.

> 'This size package of Sanatogen is licensed by us for sale and use at a price not less than one dollar ($1). Any sale in violation of this condition, or use when so sold, will constitute an infringement of our patent No. 601,995, under which Sanatogen is manufactured, and all persons so selling or using packages or contents will be liable to injunction and damages.
>
> 'A purchase is an acceptance of this condition. All rights revert to the undersigned in the event of violation.

The defendant was a retail drug store that purchased the product in the packages from jobbers. The jobbers purchased from the Bauer Chemical. The defendant resold the product to

[108] Bauer & Cie v. O'Donnell, 229 U.S. 1 (1913).

[109] Id. at 8-9.

consumers for less than one dollar. Bauer & Cie sued for patent infringement. The patent owner argued that the notice gave a purchaser only a limited right to use the product and the notice was effective under *A.B.Dick*. The Court said the notice in *A.B.Dick* did limit the use of a patented machine to use with other products from the patent owner. The Court said a notice attempting to limit resale to certain prices was not a limitation on use of a product and for that reason *A.B.Dick* did not apply. The Court said it was "a perversion of terms to call the transaction in any sense a license to use the invention."[110]

The Court expressed no dissatisfaction with the *A.B.Dick* rule that a patent owner could sell a patented product for a limited use and noted that *A.B. Dick* permitted sales for limited use.[111] The Court said the real issue was whether the Patent Act was intended to give a patent owner the right to control the price of resale. The Court concluded that "it was the intention of Congress to secure an exclusive right to sell, and there is no grant of a privilege to keep up prices ... by notice restricting the price at which the article may be resold." The Court said the patent owner had exercised the right to sell by the sales to jobbers and the added restriction was "beyond the protection and purpose of the [patent] act." Because the notice had no effect under patent law, the infringement liability of a purchaser was governed by the exhaustion doctrine and there was no infringement by reselling at any price. [112]

3. *Motion Picture Patents* – Tying Restrictions Are Unlawful and Unenforceable; *A.B.Dick* No Longer Controls Tying Restrictions

In 1917, *Motion Picture Patents* held that restrictions imposed by a notice on a patented machine requiring use only with other products purchased from the patent owner were unlawful.[113] In *Motion Picture Patents*, the Motion Picture Patents Company owned several patents. One patent number 707,934 covered a part of motion picture projectors that fed the film through the machine. Projectors using the patented part had improved picture quality and exposed films to less wear. This permitted a single reel of film to be used more times. For a time, Motion Picture Patents also owned a patent that related in some way to motion picture films, Edison reissue patent number 12,192.

In 1912, Motion Picture Patents granted a license to the Precision Machine Company authorizing that company to make and sell projecting machines under the 707,934 and other patents. The Precision Machine Company agreed to sell machines only "under the restriction and condition that such exhibiting or projecting machine shall be used solely for exhibiting or projecting motion pictures containing the inventions of reissued letters patent No. 12,192, leased by a licensee of the licensor while it owned said patents and upon other terms to be fixed by the licensor and complied with by the user while said machine is in use and while the licensor owned said patents (which other terms shall only be the payment of a royalty or rental to the licensor

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[110] Id. at 15-16.

[111] Id. at 14-15.

[112] Id. at 16-17.

[113] Motion Picture Patents Co. v. Universal Film Mfg. Co., 243 U.S. 502, 508, 516-18 (1917).

while in use)."[114] The Court of Appeals said the restriction was part of the grant. The Court of Appeals said Motion Picture Patents granted a license to the Precision Machine Company to make and sell projecting machines "with the further restriction that each machine put out by the licensee shall be used (1) solely for exhibiting or projecting motion pictures containing the invention of reissued letters patent No. 12,192, leased by a licensee of the licensor while it owns said patent ...."[115]

The Precision Machine Company also agreed to attach a plate to every machine showing the numbers of the licensed patents and containing the words:[116]

> The sale and purchase of this machine gives only the right to use it solely with moving pictures containing the invention of reissued patent No. 12,192, leased by a licensee of the Motion Picture Patents Company, the owner of the above patents and reissued patent, while it owns said patent, and upon other terms to be fixed by the Motion Picture Patents Company and complied with by the user while it is in use and while the Motion Picture Patents Company owns said patents. The removal or defacement of this plate terminates the right to use this machine.

The license also provided that Precision would not sell a machine for less than the list price set by the Motion Picture Patents Company, except for sales to jobbers or others for resale, and that Precision would require jobbers and others to sell for not less than the list price.

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[114] Id. at 506 ("This agreement contains a covenant on the part of the grantee that every machine sold by it, except those for export, shall be sold 'under the restriction and condition that such exhibiting or projecting machine shall be used solely for exhibiting or projecting motion pictures containing the inventions of reissued letters patent No. 12,192, *leased by a licensee of the licensor while it owns said patents and upon other terms to be fixed* by the licensor and complied with by the user while the said machine is in use and *while the licensor owns said patents* (which other terms shall only be the payment of a royalty or rental to the licensor while in use).'"(emphasis original)).

[115] Motion Picture Patents Co. v. Universal Film Mfg. Co., 235 F. 398, 399 (2d Cir. 1916)("This cause comes here on an appeal from a decree dismissing the complainant's bill. The complainant is the owner of the patent in suit (No. 707,934) for motion picture projecting machines, and on June 12, 1912, granted to the Precision Machine Company a license to manufacture and sell these machines for not less than $150 per machine, and at a royalty of $5 to the licensor each, with the further restriction that each machine put out by the licensee shall be used (1) solely for exhibiting or projecting motion pictures containing the invention of reissued letters patent No. 12,192, leased by a licensee of the licensor while it owns said patent; and (2) upon other terms to be fixed by the licensor and complied with by the user while the said machine is in use and while the licensor owns said patents (which said other terms shall only be the payment of a royalty or rental to the licensor while in use).").

[116] Motion Picture Patents Co. v. Universal Film Mfg. Co., 243 U.S. 502, 506-07 (1917).

Precision agreed to pay a royalty of $5 on some machines and a percentage of selling price on others.[117]

Motion Picture Patents apparently granted a license to some other company under the film patent to make and lease motion picture films to purchasers of projectors made and supplied by Precision. Precision sold a projector to the 72nd Street Amusement Company, which operated a playhouse in New York City. The projector had the required plate. In August, 1914, the reissue patent 12,192 related to films expired. Later that year, the Prague Amusement Company leased the 72nd Street Playhouse and began showing films.

After the film patent expired, the Universal Film Manufacturing Company made two films, sold them to the Universal Film Exchange, which in turn supplied them to the Prague Amusement Company for use on the projector. The patent owner sent a letter to the 72nd Street Amusement Company and to the Universal Film Exchange notifying them that they were infringing the patent on the projector. The patent owner then commenced an action against Prague, the theater operator, the Universal Film Exchange, the film supplier, and Universal Film Manufacturing Company, the maker of the films.

The Second Circuit Court of Appeals found that there was no infringement by any of the defendants. The Second Circuit found that restrictions on the use of the projectors to films obtained from the film licensee were void because they violated section 3 of the Clayton Act. The Second Circuit said that, because the restrictions were invalid, Prague had the right to use the projector free of infringement as a leasee from a purchaser of the projector, 72nd Street Playhouse. The Second Circuit said on rehearing that the purchase of the projector without any restriction gave purchaser an implied license to use it under *Mitchell v. Hawley*, and the attempted restriction on use with certain films was illegal.[118] Therefore, Prague had an unlimited implied license to use the projector with any films. Motion Picture Patents also argued before the Second Circuit that Prague infringed because it failed to pay royalties or rentals imposed by Motion Picture Patents on projector users. The Second Circuit said Prague had no obligation to pay royalties or rentals, because Prague had no notice that it had any specific payment obligation and the statement in the projector plate giving the right to use it on "other terms to be fixed" by Motion Picture Patents was too vague and indefinite to be enforceable.[119]

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[117] Id. at 507.

[118] Motion Picture Patents Co. v. Universal Film Mfg. Co. 235 F. 398, 402 (2d Cir. 1916)("The sale of the projecting machine carried with it, in the absence of any restriction, an implied license of use. Mitchell v. Hawley, 16 Wall. 547, 21 L.Ed. 322. The notice which was attached attempted to impose the condition that it should only be used with films containing the invention of a patent which had expired 'and upon other terms to be fixed by the Motion Picture Patents Company.' The condition as to use only with the specified films we have held illegal for the reasons given in our opinion heretofore rendered.").

[119] Id. at 402 ("The condition as to which a reargument is desired relating to a continuing royalty was not brought to the notice of the defendants and cannot, therefore, be regarded as limiting the implied license which accompanied the sale of the machine. Cortelyou v. Johnson,

The Court said there were two questions. The first was whether the owner of a patent on a machine could license someone to make and sell the machine "and by a mere notice attached to it limit its use by the purchaser or by the purchaser's lessee, to films which are no part of the patented machine, and which are not patented?" The other question was whether a patent owner could license someone to make and sell the patented machine and "by a mere notice attached to such machine, limit the use of it by the purchaser or by the purchaser's lessee, to terms not stated in the notice, but which are to be fixed, after sale, by such assignee [the patent owner], in its discretion?"[120]

In other words, the Court said it was limiting its decision to whether the two restrictions in the notice (that is limiting use of a projector to showing unpatented films and to other limits the patent owner imposed in the future) were to be given effect or ignored. The Court declared the restrictions in the notice "invalid," as had the Second Circuit. Because the restrictions limiting authorized use by a purchaser were "invalid," the purchaser's use of the machines with films supplied by anyone did not constitute direct infringement. Accordingly, there was no infringement by Prague, and was no infringement by the Universal Film Exchange or the Universal Film Manufacturing Company for supplying films.

The Court said the restriction in the notice on the projector regarding films was ineffective, because its effect would be to "extend the scope of its patent monopoly" and "to create a monopoly in the manufacture and use of moving picture films."[121] The Court said the restriction was not a limitation on use of the projection machine invention claimed in the patent, and rather was a limitation only on the use of unpatented films that were no part of that invention. Because the restriction was not a limitation on use of the patent machine, the patent

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207 U.S. 196, 28 Sup.Ct. 105, 52 L.Ed. 167; Lovell-McConnell Mfg. Co. v. Waite Auto Supply Co. (D.C.) 198 Fed. 133. The clause 'upon other terms to be fixed' in no way specified the nature of these terms and in particular in no way mentioned a continuing royalty, or the amount thereof. There is no evidence, moreover, that any 'other terms' were ever fixed or demanded. We think such a vague condition insufficient to limit the implied right of user passing to the vendee of the machine, and consequently unenforceable. [new paragraph] The appellant offered evidence at the trial, which was excluded, that the Prague Amusement Company had knowledge of the terms upon which the Motion Picture Patents Company was accustomed to grant permission to use a machine put out by its licensed manufacturers; but this evidence, had it been allowed, would not have obviated the difficulty with the form of the notice. If the terms that were customary had been known, there was nothing in the notice or elsewhere to prevent the appellant from varying the royalty as to nature or amount. Such a condition is too indefinite for enforcement, though a notice of a precise amount to be paid might be perfectly good. The notice affixed to the machine was so broad as to allow the patentee to fix any terms he might choose and to be repugnant to all rights which the owner of the machine might have obtained by his purchase and implied license

[120] Motion Picture Patents Co. v. Universal Film Mfg. Co. 243 U.S. 502, 508-509, 37 S.Ct. 416, 417 (1917).

[121] Id. at 515-517, 518-519.

law provided no basis for the restriction.[122] Based on that assertion, the Court said the exclusive rights granted by a patent must be limited to the claimed invention and a patent owner may not extend the scope of the rights by restricting the use of the invention to materials which are no part of the patented invention. The Court said the restriction in the notice regarding additional obligation the patent owner may impose in the future films was ineffective, because patent law did not provide for this practice and its cost and annoyance to the public forbid it.

The Court cautioned that it was deciding only the ineffectiveness of the notice, and not whether a patent owner could accomplish the same result by agreements with machine purchasers.[123]

In the course of its opinion, the Court said:[124]

> *The exclusive right to 'vend' a patented article is derived from the same clause of the section of the statute which gives the exclusive right to 'use' such an article, and following the decision of the Button-Fastener Case, it was widely contended as obviously sound, that the right existed in the owner of a patent to fix a price at which the patented article might be sold and resold under penalty of patent infringement. But this court, when the question came before it in Bauer v. O'Donnell, supra, rejecting plausible argument, and adhering to the language of the statute from which all patent right is derived, refused to give such a construction to the act of Congress, and decided that the owner of a patent is not authorized by either the letter or the purpose of the law to fix, by notice, the price at which a patented article must be sold after the first sale of it, declaring 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 upon it.* 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,' and, looking to that authority, for the reasons stated in this opinion, we are convinced that the exclusive right granted in every patent must be limited to the invention described in the claims of the patent, and that *it is not*

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122 Motion Picture Patents Co. v. Universal Film Mfg. Co. 243 U.S. 502, 512-513, 37 S.Ct. 416, 419 (1917).

123 Id. at 509 ("The 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 with it we are not here concerned. Keeler v. Standard Folding Bed Co. 157 U. S. 659, 39 L. ed. 848, 15 Sup. Ct. Rep. 738.").

124 Id. at 515-517.

> *competent for the owner of a patent, by notice attached to its machine, to, in effect, extend the scope of its patent monopoly by restricting the use of it to materials necessary in its operation, but which are no part of the patented invention, or to send its machines forth into the channels of trade of the country subject to conditions as to use or royalty to be paid, to be imposed thereafter at the discretion of such patent owner.* The patent law furnishes no warrant for such a practice, and the cost, inconvenience, and annoyance to the public which the opposite conclusion would occasion forbid it. (emphasis added)

The *Quanta* Court concluded *Motion Picture Patents* "reiterated the rule 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 upon it.' Id., at 516, 37 S.Ct. 416."[125] By quoting one part of one sentence, the Court asserted that *Motion Picture Patents* decided that a single unconditional sale of a patent product frees the purchaser from all further restrictions on resale and also all further restrictions on use. In other words, *Motion Picture Patents* means that all post-sale restrictions are unenforceable.

This is plainly not what the *Motion Picture Patents* Court meant. The Court in that sentence was talking only about resale price restrictions declared ineffective in *Bauer & Cie.* The Court said only that *Bauer & Cie* established that a patent owner could not sell a patent product and by notice control resale prices by infringement actions against those selling at low prices, because the patent owner's sale exercised the patent owner's exclusive right to sell, and further sales by other were not infringement.

After making the statement that the *Quanta* Court cited, the *Motion Picture Patents* Court discussed the exclusive right to use. The Court did not say that a sale rendered a machine free of all restrictions on use. The Court said only that restrictions on use of the machine had to be limited to the patented invention and could not extend the scope of the patent by restricting the materials used with the machine. *Motion Picture Patents* did not condemn all "post-sale restrictions" on use, as the *Quanta* Court concluded.

If *Motion Picture Patents* was based a condemnation of all "post-sale restrictions" on use, the opinion would have been much shorter. The Court would have said the patent owner by the notice was attempting to restrict a purchaser's use of a patent machine and all such restrictions are unenforceable. That is not what the Court did. The Court tried to explain why a restriction on the use of a patented machine to use only with certain unpatented materials was not a restriction on use of the machine (that patent law protected) and was only a restriction on use of materials (that patent law did not protect). If sale of a patented machine precludes all restrictions on use, the Court would not have had to create this verbal distinction. The Court would have said the restriction on use of a machine only with certain materials was a restriction of use of the machine after it had been sold and was unenforceable for the reason. If all post-sale restrictions

[125] Quanta Computer, Inc. v. LG Electronics, Inc., 128 S.Ct. 2109, 2116 (2008).

are unenforceable, there would have been no reason for the Court to pose its two questions about the two particular restrictions. If all post-sale restrictions are unenforceable, there would have been not reason for the Court to discuss the perceived harmful effects of the tying arrangements on film supplies or unspecified future obligations.

The Court in *Motion Picture Patents* did not discuss the conclusions reached in *Henry v. A.B. Dick* about the different effects of a restricted and an unrestricted sale on the scope of the purchaser's rights. The majority in *Motion Picture Patents* did broadly say that "the decision" in *Henry v. A.B. Dick* "must be regarded as overruled." However, the context of that statement makes clear that *A.B. Dick* was overruled only with respect to the legality of one particular kind of restriction, to use a machine only with supplies purchased from the patent owner. *A.B. Dick* was not overruled to the extent it held that the scope of a purchaser's rights to use a patent machine depended on whether the sale was unconditional or unrestricted.

4. Post-Sale Restrictions Are Valid; Patent Owners May Sell Patented Products and Limit the Rights a Purchaser Receives – *General Talking Pictures*

The Court in *Quanta* said the exhaustion doctrine precludes all post-sale restrictions on use of a patented article.[126] The Court believed that *Motion Picture Patents*, *Univis Lens*, and *Ethyl Gasoline* meant that a patent owner has no infringement claim against any activity conducted with a product purchased in a sale giving rise to exhaustion and that a patent owner is unable to reserve any of its patent rights against any of those activities by a license with a buyer made at the time of the sale granting certain rights and reserving others. The Court did not mention *General Talking Pictures* in reaching those conclusions.

The Court said a patent owner may enter a contract with a purchaser in which the purchaser agrees to limit its use of a product in some way. However, the Court seemed to indicate that such a contract could not be used to reserve to the patent owner any of its patent rights with respect to that customer's use of the product. The Court said the patent owner's remedy if it made such a contract was an action for breach and not a claim for infringement.

Shortly before *Univis Lens* and *Ethyl Corp.*, the Court in *General Talking Pictures* confirmed that not all sales of patented products exhausted all patent rights.[127] The Court also confirmed that a patent owner could sell a patented product and limit the rights a purchaser received.

General Talking Pictures involved several patents on amplifiers. The amplifiers used vacuum tubes and other circuit elements to change a low voltage signal that would provide little or no sound if connected to a speaker into a corresponding high voltage signal able to produce sound from a speaker without distortion. The patented amplifiers were useful in telephones,

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[126] Quanta Computer, Inc. v. LG Electronics, Inc., __ U.S. __, 128 S.Ct. 2109, 2115-2116 (2008).

[127] General Talking Pictures Corp. v. Western Electric Co., 304 U.S. 175 (1937), *rehearing granted* 304 U.S. 587, *aff'd on rehearing* 305 U.S. 124 (1938).

radios, public address systems, talking picture equipment, and other type of equipment that received a weak signal and converted it into a strong signal to produce sound people could hear.[128] The patent owner, American Telephone & Telegraph Company, had various subsidiary corporations, including the Radio Corporation and Western Electric. AT&T granted exclusive licenses to its subsidiaries under the patents to make and sell equipment in different fields. The licensees had the power to grant additional licenses in their fields.

The Radio Corporation had the license for radios. The Radio Corporation granted the American Transformer Company a nonexclusive license to make and sell amplifiers for use in radio broadcast reception, radio amateur reception, and radio experimental reception radios.[129] This was called the private field presumable because private individuals used radio receivers. The license required that Transformer Company affixed to amplifiers sold by it under the license a notice stating in substance that the apparatus was licensed only for radio amateur, experimental and broadcast reception under the patents.[130] The license was in form virtually identical to the license involved in *Motion Picture Patents*. The only difference was the nature of the restriction. The license called for the Transformer Company to pay royalties.

Western Electric apparently had the exclusive license to make and sell commercial equipment for recording and reproducing sound. Under that license, Western Electric made and sold talking picture equipment including the patented amplifiers for use in theaters. The amplifiers were presumably in the speakers and perhaps also the projector.

The American Transformer Company made amplifiers and sold them to the General Talking Pictures Corporation. Those amplifiers could be used in radios, in talking picture equipment or in other types of products. It is not clear whether the amplifiers were sold with vacuum tubes. American Transformer paid royalties on those sales to Radio Corporation. American Transformer knew that General Talking Pictures intended to include the amplifiers in talking picture equipment for use in theaters.[131] General Talking Pictures knew that American Transformer's license did not authorize the sale of amplifiers for use in talking picture equipment. General Talking Pictures Corporation used the amplifiers to make taking picture equipment and leased that equipment to theater owners and operators. General Talking Pictures apparently also purchased vacuum tubes from other Radio Corporation licensees. When Radio Corporation learned about General Talking Pictures' leases, Radio Corporation returned the royalties to American Transformer. Western Electric sued General Talking Pictures for patent infringement based on its leasing of equipment containing the amplifiers it had purchased from the licensee, American Transformer.

The Second Circuit Court of Appeals affirmed the District Court's judgment that General Talking Pictures infringed the patents. The defendant argued that there could be no infringement

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[128] Id. at 176.

[129] Id. at 179-180.

[130] Id. at 180.

[131] Id.

because it was using amplifiers purchased from a licensee and that the sale of the amplifiers placed them outside the patent monopoly and outside the patent owner's ability to restrict their use under *Motion Picture Patents, Bauer &Cie,* and *Bloomer*. The Second Circuit rejected that argument. The Second Circuit said a patent owner may grant a license restricting the use of a patented product. The Second Circuit said the restriction is enforceable against a purchaser if it is a lawful restriction. The Second Circuit said *Motion Picture Patents* does not render all restrictions unenforceable against a purchaser of the product. The Second Circuit said *Motion Picture Patents* renders tying restriction unenforceable as unlawful. The Second Circuit said *Bauer &Cie* renders resale price restrictions unenforceable and unlawful, The Second Circuit said *Bloomer* involved a sale without any restriction.[132] The Second Circuit said that a patent owner "may extend his monopoly beyond a sale by a licensee" citing two of its implied license decisions.[133]

The Court, in a five-to-one decision, affirmed and held that the purchaser were guilty of infringement and would be enjoined. The Court said there were two issues. One was the effect of the sale of a patented product by a licensee with a license to make and sell for a limited or restricted use on a purchaser's infringement liability for selling a product including the patented product for a different use. The other was the effect of a notice on a patented product saying the product was licensed only for a limited or restricted use. The Court characterized the issues this way:[134]

> Under the caption 'Questions Presented' the petition for writ of certiorari submits the following:
>
> '1. Can the owner of a patent, by means thereof, restrict the use made of a device manufactured under the patent, after the device has passed into the hands of a purchaser in the ordinary channels of trade, and full consideration paid therefor?
>
> '2. Can a patent owner, merely by a 'license notice' attached to a device made under the patent, and sold in the ordinary channels of trade, place an enforceable restriction on the purchaser thereof as to the use to which the purchaser may put the device?

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132 Western Electric Co. v. General Talking Pictures Corporation, 91 F.2d 922, 928 -929 (2d Cir. 1937).

133 Western Electric Co. v. General Talking Pictures Corporation, 91 F.2d 922, 928 -929 (2d Cir. 1937)("This circuit recognized that the patentee may extend his monopoly beyond a sale by a licensee. General Electric Co. v. Continental Lamp Works (C.C.A.) 280 F. 846; Radio Corp. v. Andrea, 90 F.(2d) 612, decided June 7, 1937 (C.C.A. 2). It was beyond the scope of the American Transformer Company's license to sell the amplifiers for the use for which it sold them to defendants. The sale was therefore an infringement and not a licensee's lawful sale.").

134 General Talking Pictures Corporation v. Western Electric Co., 304 U.S. 175, 177, 58 S.Ct. 849, 850 - 851 (1938).

The Court said the first question misstated the issue in the case, because the amplifiers sold to the purchaser were sold for a limited use and the seller and purchaser knew at the time that the purchaser was going to sell them for a different use. Therefore, the Court said the amplifier sales were outside the scope of the license and therefore were not sales under the patents in the ordinary channels of trade. The Court said:[135]

> Petitioner puts its first question in affirmative form: 'The owner of a patent cannot, by means of the patent, restrict the use made of a device manufactured under the patent after the device has passed into the hands of a purchaser in the ordinary channels of trade and full consideration paid therefor.' But that proposition ignores controlling facts. The patent owner did not sell to petitioner the amplifiers in question or authorize the Transformer Company to sell them any amplifiers for use in theaters or any other commercial use. The sales made by the Transformer Company to petitioner were outside the scope of its license and not under the patent. Both parties knew that fact at the time of the transactions. There is no ground for the assumption that petitioner was 'a purchaser in the ordinary channels of trade.'

The real issue was whether the restriction or limitation in the license was to be given effect even though it restricted a purchaser's resale and use of the product to a limited field of use. If the restriction was enforceable, the purchaser infringed when it resold the product for use outside the field. The Court said the restriction was enforceable.[136] The Court said it was unquestionable that a patent owner may grant licenses extending to all uses or limited to use in a defined field. The Court said a patent owner could grant licenses to manufacture, use, or sell on conditions not inconsistent with the scope of the monopoly.

In other words, a patent owner could license someone to sell on condition that a purchaser uses a product in a limited way. The exhaustion decisions did not preclude that condition even though it reserved some of the patent owner's rights with respect to a purchaser. The Court said the license restriction to make and sell for use by a purchaser in a limited field did not extend the scope of the monopoly beyond that contemplated by the patent statute. In other words, the post-sale restriction on use was lawful and enforceable, unlike the restriction requiring use with unpatented products in *Motion Picture Patents.* The Court said that, because the post-sale restriction in the license was enforceable, the sales of amplifiers to General Taking Pictures were not made under the patents or with the authority of their owner.

The Court then said that, because General Transformer did not have the right to sell amplifiers for post-sale use by the purchaser in theater equipment, General Transformer infringed when it sold amplifiers to General Taking Pictures knowing that company intended to

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[135] Id. at 180-181.

[136] Id. at 181.

use them after the sale in talking picture equipment.[137] General Taking Pictures infringed because that company knew General Transformer did not have the right to sell amplifiers for post-sale use in theater equipment and nonetheless purchased and resold amplifiers in talking picture equipment.

Both of those conclusions depend on the enforceability of restrictions that survive a sale. The sale by General Transformer infringed because the post-sale use by a purchaser was outside the radio reception field. The resale by General Taking Pictures infringed because it knew General Transformer had no right to sell for post-sale use in talking picture equipment. If all post-sale restrictions are unenforceable, both of those conclusions are impossible. If all post-sale restrictions are unenforceable, General Taking Pictures had the right to do anything. Again, *Motion Picture Patents* did not render the post-sale restriction in the license unlawful.

The Court said it was unnecessary to consider the effect of the notice on the amplifiers. General Taking Pictures knew of the restriction in General Transformer's license on post-sale use of the amplifiers and that was enough. There was no need to consider the proper result if General Taking Pictures had not known of the restrictions on post-sale use and resale in that license and had seen them on the amplifiers it bought. A purchaser that knows of a lawful restriction in its supplier's license is bound by that restriction.

Justice Black dissented saying a patent owner could not control how and where a patented device can be used by a purchaser who bought it in the open market.[138] Justice Black said the license granting General Transformer the right to sell for a limited use could not enlarge the scope of the patent rights to limit use by a purchaser. Justice Black believed that a buyer could not infringe patent rights after a sale, even if the buyer knew its supplier agreed with the patent owner not to sell for the use made by the buyer. If Justice Black was right about what *General Talking Pictures* means, the *Quanta* Court was wrong.

The Court granted rehearing on the issues on which it had granted certiorari. The Court said it was not deciding the issues posed, because the case did not involve those issues.[139] The Court then essentially repeated the analysis from its earlier decision. The Court said the question was whether the restriction in the license that the licensee had the right to make and sell for use by a purchaser in a limited field was to be given effect, and the answer was that it was effective.[140] The Court said the purchaser was an infringer because it used the amplifiers without a license to do so. The purchaser had no right to use amplifiers in theaters through its purchase from a licensee, because the licensee had no right to sell for that use.

Justices Black joined by Justice Reed dissented again on the basis that the sale of a patented article by a licensee eliminates the patent rights and the patent owner may not restrict its

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137 Id. at 181-182.

138 Id. at 184-185.

139 General Talking Pictures Corporation v. Western Electric Co., 305 U.S. 124, 125 (1938).

140 Id. at 126-127.

use by a buyer in any way through actions for infringement.[141] Justice Black said a sale eliminates all post-sale restrictions, relying in part on *Motion Picture Patents*. Justice Black said *A.B. Dick* permitted products to be sold and thereafter be subject to conditions as to use imposed by patent owners, and *Motion Picture Patents* reasserted the rule that a product once sold is free of all patent rights.[142] Justice Black said the Court's return to the *A.B. Dick* rule resulted in General Talking Pictures being enjoined from making full use of tubes and amplifiers which it owned.[143]

According to Justice Black, General Talking Pictures purchased vacuum tubes from various retailers authorized by the Radio Corporation to sell in the open market and purchased amplifiers from a manufacturer who had the complete right to make them and had "contracted to sell only for limited uses." Justice Black said the Court departed from *Motion Picture Patents* by permitting the patent owner by its contract with the manufacturer to restrict the uses to which this purchaser and owner may put the tubes and amplifiers.[144] Justice Black reasoned that, if a notice to the purchaser could not under patent law limit or restrict the use of the amplifiers after they were sold, the knowledge by both vendor and purchaser that the articles were purchased for use outside the field for which the vendor had been given the right to sell could not limit their use, because the transaction between them was still a sale.[145] Again if Justice Black was right about *General Talking Pictures*, the *Quanta* Court was wrong.

How does the Court's analysis in *General Taking Pictures* square with the analysis in *Motion Picture Patents*? Motion Picture Patents granted a license to the Precision Machine Company to make and sell projecting machines "with the further restriction that each machine put out by the licensee shall be used (1) solely for exhibiting or projecting motion pictures containing the invention of reissued letters patent No. 12,192, leased by a licensee of the licensor while it owns said patent ...."[146] The license also required a notice on the projectors to the same

[141] Id. at 128-129.

[142] Id. at 128-129.

[143] Id. at 129-133.

[144] Id.

[145] Id.

[146] Motion Picture Patents Co. v. Universal Film Mfg. Co., 235 F. 398, 399 (2d Cir. 1916)("This cause comes here on an appeal from a decree dismissing the complainant's bill. The complainant is the owner of the patent in suit (No. 707,934) for motion picture projecting machines, and on June 12, 1912, granted to the Precision Machine Company a license to manufacture and sell these machines for not less than $150 per machine, and at a royalty of $5 to the licensor each, with the further restriction that each machine put out by the licensee shall be used (1) solely for exhibiting or projecting motion pictures containing the invention of reissued letters patent No. 12,192, leased by a licensee of the licensor while it owns said patent; and (2) upon other terms to be fixed by the licensor and complied with by the user while the said machine is in use and while the licensor owns said patents (which said other terms shall only be the payment of a royalty or rental to the licensor while in use).").

effect. The Court focused its opinion on saying the notice was ineffective. Suppose the patent owner had proved that its licensee Precision Machine Company had sold a projector to the 72nd Street Amusement Company knowing that 72nd Street would use it with films from others or would lease its theater to companies such as Prague which would use films of others and that 72nd Street knew of Precision's limited license at the time 72nd Street purchased and Prague knew at the time of its lease. Would the Court have said the sale was outside the scope of the license and the licensee Precision and the purchaser 72nd Street were patent infringers when the restriction was violated? No. The Court would have said the restriction in the license was unenforceable for the same reason the notice was unenforceable – the restriction attempted to expand the scope of the monopoly to include unpatented films. The Court would not have said the restriction in the license was unenforceable because it attempted to restrict post-sale use of the projector. We know the Court would not have said that because *General Talking Pictures* shows that the Court did not view all license restrictions on post-sale use of a patented product as unenforceable.

General Taking Pictures means the restriction that is important is the post-sale restriction on use in the license. If such a restriction may be enforced in a license granted to a seller, the same restriction should be enforceable when included in a license granted to a purchaser.

Suppose that General Transformer's license was to make and sell amplifiers only to customers having a license from the Radio Corporation to use the amplifiers in radio broadcast reception, radio amateur reception, and radio experimental reception radios. Radio Corporation was attempting to do the same thing by expressly licensing amplifier users to use in limited fields. Suppose that General Transformer sold to General Taking Pictures knowing General Taking Pictures had no license and General Taking Pictures bought knowing that General Transformer had no license to sell to it. It is almost inconceivable that the Court would have said General Transformer and General Taking Pictures did not infringe. If a restriction on use by a purchaser is enforceable when it is found in a seller's license, the same restriction should be enforceable when found in a purchaser's license. The effect is the same in both cases.

Suppose instead that Radio Corporation or General Transformer granted General Taking Pictures an express license to use amplifiers in radio broadcast reception, radio amateur reception, and radio experimental reception. Suppose General Transformer then sold to General Taking Pictures knowing General Taking Pictures did not intend to use the amplifiers in that field. Suppose General Taking Pictures bought knowing that it would use the amplifiers in theater equipment, not in radio equipment. Again, it is hard to imagine that the Court would have said General Transformer and General Taking Pictures did not infringe.

5. Post-Sale Restrictions Are Valid; Patent Owners May Sell Patented Products and Limit the Rights a Purchaser Receives – *Mallinckrodt v. Medipart*

The Court unwisely ignored the decisions of the Court of Appeals for the Federal Circuit. This section describes only one of them. In 1992 in *Mallinckrodt v. Medipart*, the Court of

Appeals confirmed that, under *General Talking Pictures,* a purchaser of a patented product infringes the patent, when it uses the product in violation of a lawful restriction or condition on use specified by the seller at the time of the sale.[147] The Court of Appeals found that the purchaser infringed even though the seller was the patent owner.

Mallinckrodt owned several patents on a device for delivering chemicals in aerosol form to the lungs of a patient for diagnosis or treatment of lung disease. Mallinckrodt made devices and sold them to hospitals. The device was a kit having the parts of the device and the chemicals. Certain parts came in contact with the patient during use. Some parts of the device were marked with patent numbers and the inscription "Single Use Only." The package insert accompanying the kit said that each unit was "For Single Patient Use Only" and instructed the user that the entire kit should be disposed of after one use. Some hospitals did not dispose of the device after using it for one patient. Rather, they shipped certain parts of the device to the Medipart company. Medipart sterilized those parts, checked them for damage, assembled them with new parts and shipped the "reconditioned" kit back to the hospital. The kit returned to the hospitals continued to bear the inscription "Single Use Only."

Mallinckrodt asserted that Medipart both infringed the patent by making the reconditioned kit and induced infringement by hospitals by assisting them in making more than a single use of one kit. The District Court dismissed both claims. The District Court said that there could be no claim because the exhaustion doctrine rendered ineffective all restrictions or conditions on use by a purchaser of a patented product from a patent owner. The Court of Appeals for the Federal Circuit reversed.

Judge Newman's opinion summarized the Court of Appeals' conclusions as follows:[148]

> This action for patent infringement and inducement to infringe relates to the use of a patented medical device in violation of a "single use only" notice that accompanied the sale of the device. Mallinckrodt sold its patented device to hospitals, which after initial use of the devices sent them to Medipart for servicing that enabled the hospitals to use the device again. Mallinckrodt claimed that Medipart thus induced infringement by the hospitals and itself infringed the patent.
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> The district court held that violation of the "single use only" notice can not be remedied by suit for patent infringement, and granted summary judgment of noninfringement. [footnote omitted]
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> The district court did not decide whether the form of the "single use only" notice was legally sufficient to constitute a license or condition of sale from Mallinckrodt to the hospitals. ....

147 Mallinckrodt, Inc. v. Medipart, Inc., 976 F.2d 700, 701 (Fed Cir. 1992).

148 Id.

> Instead, the district court held that no restriction whatsoever could be imposed under the patent law, whether or not the restriction was enforceable under some other law, and whether or not this was a first sale to a purchaser with notice. This ruling is incorrect, for if Mallinckrodt's restriction was a valid condition of the sale, then in accordance with *General Talking Pictures Corp. v. Western Electric Co.,* 304 U.S. 175, 58 S.Ct. 849, 82 L.Ed. 1273, 37 USPQ 375, *aff'd on reh'g,* 305 U.S. 124, 59 S.Ct. 116, 83 L.Ed. 81, 39 USPQ 329 (1938), it was not excluded from enforcement under the patent law.
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> On review of these issues in the posture in which the case reaches us:
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> 1. The movant Medipart did not dispute actual notice of the restriction. Thus we do not decide whether the form of the restriction met the legal requirements of notice or sufficed as a "label license", as Mallinckrodt calls it, for those questions were not presented on this motion for summary judgment.
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> ***
>
> 3. We also conclude that the district court misapplied precedent in holding that there can be no restriction on use imposed as a matter of law, even on the first purchaser. The restriction here at issue does not *per se* violate the doctrine of patent misuse or the antitrust law. Use in violation of a valid restriction may be remedied under the patent law, provided that no other law prevents enforcement of the patent.

The Court of Appeals focused primarily on the second part of the *General Talking Pictures* analysis, namely whether the restriction on the purchaser was lawful. However, the Court of Appeals rejected the notion that the *General Talking Pictures* rule is limited to sales by licensees and therefore a patent owner that sells may not restrict the use by purchasers. The Court of Appeals noted correctly that to limit General *Talking Pictures* in that way would be to make a "formalistic distinction of no economic consequence."[149]

The Court of Appeals considered and rejected the District Court's view that the restriction was unenforceable. The Court of Appeals accurately described the history of the development of the exhaustion doctrine and, importantly, recognized that decisions such as *Mitchell v. Hawley, Adams v. Burke* and *Keeler v. Standard Folding Bed,* affirm the principle that an "unconditional sale of a patented device exhausts the patentee's rights to control the

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149 *Id.* at 705.

purchaser's use of the device," and also establish that "the sale of patented goods, like other goods, can be conditioned." The Court of Appeals said:[150]

> Viewing the entire group of these early cases, it appears that the Court simply applied, to a variety of factual situations, the rule of contract law that sale may be conditioned.[FN7] *Adams v. Burke* and its kindred cases do not stand for the proposition that no restriction or condition may be placed upon the sale of a patented article. It was error for the district court to derive that proposition from the precedent. Unless the condition violates some other law or policy (in the patent field, notably the misuse or antitrust law, *e.g., United States v. Univis Lens Co.,* 316 U.S. 241, 62 S.Ct. 1088, 86 L.Ed. 1408 (1942)), private parties retain the freedom to contract concerning conditions of sale. As we have discussed, the district court cited the price-fixing and tying cases as reflecting what the court deemed to be the correct policy, *viz.,* that no condition can be placed on the sale of patented goods, for any reason. However, this is not a price-fixing or tying case, and the *per se* antitrust and misuse violations found in the *Bauer* trilogy and *Motion Picture Patents* are not here present. [footnote omitted] The appropriate criterion is whether Mallinckrodt's restriction is reasonably within the patent grant, or whether the patentee has ventured beyond the patent grant and into behavior having an anticompetitive effect not justifiable under the rule of reason.
>
> FN7. In accordance with the Uniform Commercial Code a license notice may become a term of sale, even if not part of the original transaction, if not objected to within a reasonable time. U.C.C. § 2-207(2)(c).

The Court of Appeals then found that, because the restriction related to subject matter within the scope of the patent claims, there was no violation of antirust law and no patent misuse.[151] The Court of Appeals concluded the post-sale restriction on reuse was enforceable:[152]

> We conclude that the district court erred in holding that the restriction on reuse was, as a matter of law, unenforceable under the patent law. If the sale of the UltraVent was validly conditioned under the applicable law such as the law governing sales and licenses, and if the restriction on reuse was within the scope of the patent grant or otherwise justified, then violation of the restriction may be remedied by action for patent infringement.

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150 *Id.* at 708.

151 *Id.* at 708-09.

152 *Id.* at 709.

After *Quanta*, it is unclear whether this patent owner could sell and license in this way. If it may not, consumers will be worse off. Mallinckrodt faced the age-old problem of many sellers – having the value of new products reduced by sales of used products. Assume that Mallinckrodt would sell a new kit for $2, if the kit will be used only once and not resold. This is the value of one use. However, if the law prevents Mallinckrodt from limiting a buyer to one use and used kits are used again, Mallinckrodt will no longer sell for $2. If Mallinckrodt expects each kit will be reused three times, Mallinckrodt will sell for $6. Hospitals and doctors who want to use a new kit for every patient must no pay three times as much for a kit. In addition, if the law prevents Mallinckrodt from limiting a buyer to one use and allows buyers to sell used kits, the buyers' sales of used kits is likely to reduce the price Mallinckrodt may charge for new kits. Mallinckrodt may not be able to charge $6 for new kits due to the sale of used kits at lower prices that are profitable for a resell who may be able to obtain used kits at nominal cost from hospitals and doctors who want every patient treated with a new kit.

E. A Patent Owner May Sell with Conditions and Have Contract Claims for Breach

The *Quanta* Court said it was not deciding whether LG might have a claim against Intel for breach of contract.[153]

> The License Agreement authorized Intel to sell products that practiced the LGE Patents. No conditions limited Intel's authority to sell products substantially embodying the patents. Because Intel was authorized to sell its products to Quanta, the doctrine of patent exhaustion prevents LGE from further asserting its patent rights with respect to the patents substantially embodied by those products.[FN7]
>
> FN7. We note that the authorized nature of the sale to Quanta does not necessarily limit LGE's other contract rights. LGE's complaint does not include a breach-of-contract claim, and we express no opinion on whether contract damages might be available even though exhaustion operates to eliminate patent damages. See *Keeler v. Standard Folding Bed Co.,* 157 U.S. 659, 666, 15 S.Ct. 738, 39 L.Ed. 848 (1895) ("Whether 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. It 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").

The Court did not suggest what provision of the license Intel may have breached by its sales or other actions. The Court's comments seem to be explained only by its citation to *Keeler*, and its quotation from that decision saying the Court was not deciding whether a patent owner might have protected himself and his assignees by special contracts brought home to purchasers.

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[153] Quanta Computer, Inc. v. LG Electronics, Inc., __ U.S. __, 128 S.Ct. 2109, 2122 (2008).

1. A Patent Owner May Sell, License with Conditions, and Prevent Violations of the Conditions by a Claim for Patent Infringement – *Keeler and Mitchell*

Here again, the Court casts an unfortunate shadow on the meaning of *Keeler,* and the ability of a patent owner to prevent exhaustion by expressly conditioning a purchase transaction so that it limits the scope of the rights a purchaser acquires. The Court in *Quanta* seemed to accept the rule that exhaustion applies only to unconditional sales by a patent owner or authorized and unconditional sales by a licensee. However, the Court seemed to suggest that if a patent owner made a sale that was conditional on the purchaser agreeing that it had only a limited license under some patent, the violation of that condition by the purchaser would give rise only to an action for breach of contract, and not a claim for patent infringement.

Keeler is not so limited. *Keeler* simply echoed *Mitchell,* the decision on which the Court of Appeals for the Federal Circuit relied.

In 1895, in *Keeler v. Standard Folding Bed Co.,*[154] the Supreme Court declared that, when an assignee of a limited territory sold in its territory, the purchaser could resell the product outside the territory. The owner of a patent on folding beds had assigned the rights in Massachusetts to the plaintiff, Standard Folding Bed Co., and the rights in Michigan to the Welsh Folding Bed Company. The defendant, Cornelius Keeler, bought a carload of beds from the Welsh company in Grand Rapids, Michigan, shipped them to Massachusetts, and sold them in the plaintiff's territory. Six Justices said the issue was controlled by the earlier decisions.[155]

> Upon the doctrine of these cases, we think it follows 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. Whether 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. It 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.
>
> The conclusion reached does not deprive a patentee of his just rights, because no article can be unfettered from the claim of his monopoly without paying its tribute. The inconvenience and annoyance to the public that an opposite conclusion would occasion are too obvious to require illustration.

The Court said one who buys patented articles from one authorized to sell them becomes possessed of an absolute property in such articles, unrestricted in time or place. The patent owner is not deprived of its rights, because no article can be unfettered from the claim of the

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[154] Keeler v. Standard Folding Bed Co., 157 U.S. 659, 15 S.Ct. 738 (1895).

[155] Id. at 666-667 (1895).

"monopoly" without paying its tribute. They added that any other rule would cause inconvenience and annoyance to the public in ways too obvious to require illustration. Justice Brown, with the Chief Justice and Justice Field, disagreed.

The result in *Keeler* may have been entirely sensible. In *Keeler* as in *Adams*, the patent owner and its territorial assignees or licensees did not inform the purchaser at the time of the transaction that the purchaser's rights to use or resell were limited. If restrictions of that kind are likely to apply only to a very small percentage of total sales transactions (because only a small percentage of sales involve patented products), the costs of engaging in those transactions are likely to be much lower if the law places the burden on the seller to inform the buyer of limitations, rather than requiring buyers to inquire in each instance about their existence. It is more efficient to require information of that kind to be exchanged only in those cases where the product is patented and the seller wishes to impose or is obligated to impose limitations.

In these cases, the terms of the sales imposed no limits. The buyers were not granted express limited patent licenses. The law places the burden on patent owners and their licensees to inform buyers that their rights regarding patents are limited. It was entirely sensible for the Court to declare, as it did in *Adams v. Burke*, that it would not "imply" any such limitation either as a matter of patent law or as a matter of contract law. The Supreme Court's opinions seemed consistent with the view that patent owners could prevent undesired transactions between territories. The Court said the owner could do so by express limitations or restrictions against the territorial assignee's right to sell in the territory for use or resale outside the territory or by express limitations or conditions on the purchaser's right to use or resell elsewhere.

In *Keeler*, the Court made clear that it was merely defining the rights of a patent owner under the patent law when a purchaser bought from a licensee in an authorized and unconditional sale. The Court in *Keeler* found that a customer acquired the right to sell the product in any territory it wished and declined to interpret the patent law to mean that, because the licensee seller had only rights to make, use and sell in a limited territory, the customer necessarily had the same limited rights. The Court in *Keeler* said that if the patent owner wished to alter that state of affairs by contract, it needed to do so at the time of sale, something that had not happened in *Keeler* or the other decisions applying the same rule. The Supreme Court in *Keeler* did not say that a patent owner could not reserve its patent infringement rights against the purchaser in any situations. The Supreme Court in *Mitchell* found that they could.

F. Exhaustion Applies Only to Authorized Sales by a License

The Court affirmed that only authorized sales by a licensee created exhaustion. The Court concluded that LG's license to Intel authorized Intel to sell microprocessors to Quanta and others for the use they had made of them, namely to make and sell computers. The Court concluded that LG had done so because the license included all LG patents, the grant did not limit Intel's right to sell to purchasers who intend to combine the Intel products with others to make computers, and nothing limited Intel's right to sell its products for any use under any LG patent.[156]

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[156] Quanta Computer, Inc. v. LG Electronics, Inc. 128 S.Ct. 2109, 2121-2122 (2008).

> Having concluded that the Intel Products embodied the patents, we next consider whether their sale to Quanta exhausted LGE's patent rights. Exhaustion is triggered only by a sale authorized by the patent holder. *Univis,* 316 U.S., at 249, 62 S.Ct. 1088.
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> LGE argues that there was no authorized sale here because the License Agreement does not permit Intel to sell its products for use in combination with non-Intel products to practice the LGE Patents. It cites *General Talking Pictures Corp. v. Western Elec. Co.,* 304 U.S. 175, 58 S.Ct. 849, 82 L.Ed. 1273 (1938), and *General Talking Pictures Corp. v. Western Elec. Co.,* 305 U.S. 124, 59 S.Ct. 116, 83 L.Ed. 81 (1938), in which the manufacturer sold patented amplifiers for commercial use, thereby breaching a license that limited the buyer to selling the amplifiers for private and home use. The Court held that exhaustion did not apply because the manufacturer had no authority to sell the amplifiers for commercial use, and the manufacturer "could not convey to petitioner what both knew it was not authorized to sell." *General Talking Pictures, supra,* at 181, 58 S.Ct. 849. LGE argues that the same principle applies here: Intel could not convey to Quanta what both knew it was not authorized to sell, *i.e.,* the right to practice the patents with non-Intel parts.

The Court was correct that *General Talking Pictures* required that exhaustion applied only to a sale by a licensee that its license authorized the licensee to make. However, the *Quanta* Court's description of the facts in *General Talking Pictures* is difficult to understand. The *Quanta* Court said in *General Talking Pictures* the manufacturer sold patented amplifiers breaching a license that limited the "buyer" to selling the amplifiers for private and home use. In *General Talking Pictures*, the owner of the patent on amplifiers licensed another company to make and sell amplifiers. The licensee made the amplifiers; it did not buy them from the patent owner. The seller was not a "buyer." The manufacturer was licensed to sell for radio reception, the private and home use the *Quanta* Court referred to. The manufacturer sold amplifiers to a company that it knew planned to use them in motion picture equipment and that company then made and sold motion picture equipment to a theater. The Supreme Court found that the sale was not authorized by the license. Therefore, the Court said the licensee and its amplifier customer were patent infringers.

The Supreme Court in *General Talking Pictures* did not say that the licensee breached the license, the *Quanta* Court said. The Court in *General Talking Pictures* said that the licensee made a sale outside the scope of its license and therefore was a patent infringer. The Court did not say that selling outside the scope of a license was breach of a license. The Court said a sale not authorized by the license was patent infringement, because such a sale had the same legal consequences as if the license did not exist.

VI. Conclusion

Quanta is understandable. However, it is also unfortunate. In this situation, an oddly written agreement may have resulted in fundamental and sensible doctrines of patent law being swept away for no good reasons.

Quanta is also out of step with current law. *Quanta* is based on the Court's decisions in the 1940s in *Univis Lens* and *Ethyl Gasoline* where the Court found that patent owners violated antitrust law by controlling what the Court believed were effectively resale prices. In 1997, the Court said an agreement by which a company set maximum prices for resale of its products could have beneficial effects for consumers and was not *per se* unlawful under antitrust law.[157] In 2007, the Court said the same was true of an agreement by which a company set minimum prices for resale.[158] The Court said the rule against general restraints on alienation was irrelevant to determining the economic effects of restrictions a seller places on its distributors or retailers.[159]

Quanta seems to ignore that the Court would have decided *Univis Lens* and *Ethyl Gasoline* by a very different method than the Court used in the 1940s and would have based those decisions on economic effects and consumer benefits, and not on legal formulas about exhaustion of legal rights. In my view, *Univis Lens* and *Ethyl Gasoline* would likely be decided differently today. The Univis Corporation and the Ethyl Gasoline Corporation where trying to license in ways that would increase their profits from commercial use of their inventions. Those

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[157] State Oil Co. v. Khan, 522 U.S. 3, 7, 18-19, 118 S.Ct. 275, 278 (1997).

[158] Leegin Creative Leather Products, Inc. v. PSKS, Inc., __U.S. __, 127 S.Ct. 2705, 2710 (2007).

[159] Leegin Creative Leather Products, Inc. v. PSKS, Inc. 127 S.Ct. 2705, 2713 - 2714 (2007)("The reasoning of the Court's more recent jurisprudence has rejected the rationales on which *Dr. Miles* was based. By relying on the common-law rule against restraints on alienation, *id.,* at 404-405, 31 S.Ct. 376, the Court justified its decision based on "formalistic" legal doctrine rather than "demonstrable economic effect," *GTE Sylvania, supra,* at 58-59, 97 S.Ct. 2549. The Court in *Dr. Miles* relied on a treatise published in 1628, but failed to discuss in detail the business reasons that would motivate a manufacturer situated in 1911 to make use of vertical price restraints. Yet the Sherman Act's use of "restraint of trade" "invokes the common law itself, ... not merely the static content that the common law had assigned to the term in 1890." *Business Electronics, supra,* at 732, 108 S.Ct. 1515. The general restraint on alienation, especially in the age when then-Justice Hughes used the term, tended to evoke policy concerns extraneous to the question that controls here. Usually associated with land, not chattels, the rule arose from restrictions removing real property from the stream of commerce for generations. The Court should be cautious about putting dispositive weight on doctrines from antiquity but of slight relevance. We reaffirm that "the state of the common law 400 or even 100 years ago is irrelevant to the issue before us: the effect of the antitrust laws upon vertical distributional restraints in the American economy today." *GTE Sylvania,* 433 U.S., at 53, n. 21, 97 S.Ct. 2549 (internal quotation marks omitted).").

companies where not fixing prices merely to increase the profits earned by retail sellers of the finished eyeglasses or retail gasoline sellers.

Quanta is also based on the Court's decision in the 1940s in *Motion Picture Patents* where the Court found that patent owners could not employ tying arrangements in any circumstances and for any reasons. In 1952, Congress amended the Patent Act to overturn some the Court's decisions in the 1940s on the ability of patent owner's to employ tying arrangements, as the Court explained in 1980.[160] In 1988, Congress again amended the Patent Act to limit the way the patent misuse doctrine limited a patent owner's ability to employ tying arrangements.[161] This amendment overruled *Motion Picture Patents.* Again, the Court seemed unaware that the law had moved on and rejected the Court's views in the 1940s of the proper limits on the ways patent owners could exploit their rights.

In the 1930s and 1940s, the Court said over and over that owners of system or method patents were improperly extending the scope of their patents by selling unpatented products useful in making the systems and practicing the methods.[162] The Court believed the prices of the products did not reflect the value of the inventions and patent owner should not be permitted to exploit their inventions by selling those products. In 2008, the Court says the owners of system or method patents are capturing the value of those inventions by selling unpatented products useful in making the systems and practicing the methods. Today, the Court apparently believes the prices of the products necessarily reflect the full value of the inventions and patent owners always exhaustion their patent rights by selling those products. The only constant appears to be that patent owners lose.

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160 35 U.S.C. § 271(d); Dawson Chemical Co. v. Rohm & Haas Co., 448 U.S. 176 (1980).

161 35 U.S.C. § 271(d)(4)-(5).

162 Mercoid Corp. v. Mid-Continent Co., 302 U.S. 661, 664-65, 667 (1944); Mercoid Corp. v. Minneapolis-Honeywell Reg. Co., 320 U.S. 680, 682-684 (1944); B.B. Chemical Corp. v. Ellis, 314 U.S. 495, 496-7 (1942); Leitch Mfg. Co. v. Barber Co., 30 U.S.458, 460-63 (1938); Carbice Corp. v. American Patents Devel. Corp., 283 U.S. 27, 30-35 (1931).