



***Quanta Computer v. LG Electronics:***  
**A Return to Traditional Principles of Patent Exhaustion**

**I. Introduction.**

The Supreme Court recently issued a unanimous opinion on the scope of the patent exhaustion doctrine in *Quanta Computer, Inc. v. LG Electronics, Inc.* The case has broad implications on licenses in a number of different fields. Under *Quanta*, a patentee cannot impose downstream use or sale restrictions on a third party that are not also imposed on its licensee who sells to the third party.

*Quanta* holds that “[t]he 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 post-sale use of the article.”<sup>1</sup> The case overturns the Federal Circuit’s patent exhaustion jurisprudence, under which patent rights were exhausted only by unconditional sales, in which conditions could be unilaterally imposed and enforced under the patent laws.

Because all patents that embody the invention are exhausted by a sale, the value of multiple forms of claiming, such as separate component, system, and method patents, is diminished. This case makes clear that the sale of a single article can exhaust multiple patent claims, even if those claims appear in different patents. *Quanta* leaves open the possibility of enforcing additional restrictions by contract, but the case does not address the permissible scope of such restrictions.

**II. The Federal Circuit Applied Its “Conditional Sale” Rule to Hold that LGE’s Patents Were Not Exhausted.**

LG Electronics, Inc. (“LGE”) owned a portfolio of computer technology patents. The portfolio contained patents that claimed individual components such as microprocessors, combinations of microprocessors, buses, and other components, as well as methods of managing bus access and cache memory. It licensed the entire portfolio to Intel Corp. A separate agreement (the Master Agreement) required Intel to





notify its customers by letter that they were not licensed to combine “an Intel product with any non-Intel product.”<sup>2</sup> Intel provided that notice to its customers.

Quanta Computer, Inc. (“Quanta”), a computer manufacturer, purchased microprocessors from Intel and combined them with non-Intel components. LGE sued Quanta, and asserted three patents containing system and method claims that could be infringed only by the computers built by Quanta and not by Intel’s components alone.<sup>3</sup>

The district court granted summary judgment in favor of Quanta on all but the method claims, holding that the system claims were exhausted by Intel’s authorized sale of its microprocessors to Quanta.<sup>4</sup> The Federal Circuit affirmed the district court’s holding that the method claims were not exhausted, but reversed the district court’s ruling that the system claims were exhausted. The Federal Circuit applied its rule that patent exhaustion requires an unconditional sale.<sup>5</sup> The Federal Circuit held that Intel’s notice to Quanta that Quanta was not licensed to combine Intel and non-Intel components was sufficient to render the sales conditional, thereby resolving the patent exhaustion issue in LGE’s favor.<sup>6</sup>

### **III. The Supreme Court Reverses, Returning to Traditional Exhaustion Principles.**

The Supreme Court reversed the Federal Circuit’s ruling, holding that Intel’s authorized sale of microprocessors and chipsets exhausted LGE’s patent rights to both the system and method claims asserted against Quanta. The Court received extensive briefing from the parties and various *amici* on exhaustion of method claims, the first sale doctrine, implied licenses, and the economic effects of allowing (or prohibiting) downstream restrictions on sale and use of patented goods.<sup>7</sup> The Solicitor General, on behalf of the United States, argued in support of Quanta that “the first-sale doctrine has evolved in the Federal Circuit in a manner that is at odds with the [Supreme] Court’s precedents.”<sup>8</sup> In support of LGE, the American Intellectual Property Law Association argued that permitting “a patentee, with adequate notice” to “require separate licenses at various stages . . . create[s] market efficiencies [that] allow for the appropriate and

proper exploitation of intellectual property rights.”<sup>9</sup> The Supreme Court sided with the Solicitor General’s position, as it has frequently done in its recent spate of patent decisions.

#### **A. *Univis Lens* Is the Controlling Precedent.**

The Court held that the *Univis Lens* case controlled and mandated a finding that LGE’s patents were exhausted. In *Univis*, the government challenged a patentee’s licensing and price maintenance scheme on patents to multifocal eyeglasses. Univis Corporation was the assignee of “a number of patents . . . relating to multifocal lenses.”<sup>10</sup> It licensed its parent corporation, Univis Lens Company (“Univis”), to manufacture lens blanks in exchange for a royalty.<sup>11</sup> It also licensed three classes of purchasers who could buy the blanks and finish them into eyeglass lenses, who were each subject to resale price restrictions.<sup>12</sup>

The *Univis* Court stated the first-sale doctrine as follows: “[T]he 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.”<sup>13</sup> The case held that Univis exhausted its patent by the sale of the lens blanks, because they were an article that embodied the invention and could only be used in a finished eyeglass lens.

#### **B. Application to the Quanta – LGE Facts.**

##### **1. Method Claims Are Treated Equally to System Claims.**

The *Quanta* Court first held that “[n]othing in this Court’s approach to patent exhaustion supports LGE’s argument that method patents cannot be exhausted.”<sup>14</sup> It agreed that “a patented method cannot be sold in the same way as an article or device.”<sup>15</sup> The Court went on to conclude that “methods may nonetheless be ‘embodied’ in a product, the sale of which exhausts patent rights.”<sup>16</sup> Clever patent claim drafting, thought the Court, “could shield practically any patented item from exhaustion”<sup>17</sup> unless all types of claims were subject to exhaustion.



## 2. A Product Must Embody a Patent to Trigger Exhaustion.

The Court next “consider[ed] the extent to which a product must embody a patent in order to trigger exhaustion.”<sup>18</sup> It rejected each of LGE’s attempts to distinguish *Univis Lens*, and held that “[w]e agree with Quanta that *Univis* governs this case.”<sup>19</sup> The Court refused to limit *Univis Lens* to products that “contain all the physical aspects needed to practice the patent,” or to situations in which both the article sold and the finished article are covered by only a single patent.<sup>20</sup>

Just as the lens blanks in *Univis Lens* had no utility until they were made into lenses, LGE suggested no reasonable use for the microprocessors other than to incorporate them into computer systems.<sup>21</sup> Both the lens blanks and the microprocessors “constitute a material part of the patented invention and all but completely practice the patent.”<sup>22</sup> “Everything innovative about each patent is embodied in the Intel Products.”<sup>23</sup> “In each case the final step to practice the patent is common and noninventive: grinding a lens to the customer’s prescription, or connecting a microprocessor or chipset to buses or memory.”<sup>24</sup>

The Court also rejected LGE’s argument that exhaustion could not apply because the microprocessor and the combination claims that included the microprocessor were the subject of separate patents. “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 does not prevent exhaustion of patent B.”<sup>25</sup>

## 3. Only Authorized Sales Trigger Exhaustion.

The opinion then found that Intel’s sales to Quanta were authorized by LGE. The Court rejected LGE’s argument that there was no authorized sale because the license agreement “does not permit Intel to sell its products for use in combination with non-Intel products.”<sup>26</sup> Intel’s authority to sell was not conditioned on Quanta’s decision to abide by the purported restrictions on third parties in the license, because “exhaustion turns only on Intel’s license to sell products practicing the LGE patents.”<sup>27</sup>



The Court left open the possibility that “the authorized nature of the sale to Quanta does not necessarily limit LGE’s other contract rights . . . we express no opinion on whether contract damages might be available even though exhaustion operates to eliminate patent damages.”<sup>28</sup>

#### **IV. Implications for Practitioners.**

##### **A. Exhaustion Is Determined by Patentee/Licensee Relationship.**

After *Quanta*, analysis of patent exhaustion focuses on a single transaction - that between the patentee and the licensee. As a result, language within a license attempting to restrict a third party purchaser’s rights that does not also restrict the licensee’s rights will be ineffective. Such was the case in the LGE-Intel license, which purported to deny a license to third parties.

Extending patent exhaustion to method claims reduces a patentee’s options only slightly. It is important to note again that *Quanta* did not address the separate doctrine of implied license, which is another means by which a downstream purchaser can acquire patent rights. Under implied license, rights to apparatus and method claims have remained closely linked. For example, *Met-Coil Systems Corp.* held that “unrestricted sales of a machine useful only in performing [a] claimed process . . . plainly indicate that the grant of a license should be inferred.”<sup>29</sup>

*Quanta* substantially reduces the ability of a patentee to receive royalties from multiple points in a chain of manufacture or value. This will be particularly so when, as in this case, a single component of a combination claim is found to exhibit all of the inventive aspects of the combination. A patentee who holds patents on a component, a combination, and a method will have to establish a single royalty-bearing transaction if the licensed component is found to “substantially embody” the combination and method claims. Conversely, one who is accused of infringing a system or method claim should consider an exhaustion defense if it has made an authorized purchase of a component that is critical to the system or method.



Even after *Quanta*, it appears that a patentee is still free to impose restrictions on its licensee's ability to sell in particular geographic areas or to particular fields of use. The *Quanta* Court distinguished the license in *General Talking Pictures*, which contained such restrictions, from the LGE-Intel license, but did not appear to limit the holding of *General Talking Pictures*.<sup>30</sup> The Solicitor General, although arguing for reversal and a return to the *Univis Lens* standard, did not challenge the propriety of enforcing such field of use restrictions through patent infringement suits.<sup>31</sup>

Thus, there remains the possibility that a patentee could license one entity to enter a high-value field of use, with an appropriately high royalty, while restricting another licensee to a lower-value field of use, and be able to prevent third parties from purchasing from the low-price licensee and then entering the high-value field of use.

#### **B. Not All Components Substantially Embody a Patent.**

*Quanta* limits exhaustion to sales of components that embody a patent. On the facts of the case, the patented microprocessors were held to embody both system and method claims that incorporated them because (1) the microprocessors had "no reasonable use" other than to be incorporated into computer systems that practiced the asserted patents,<sup>32</sup> and (2) "the final step [of adding memory or a bus] to practice the patent is common and noninventive."<sup>33</sup>

It may be possible to avoid exhaustion if one of these factors is absent. For example, if a component has other reasonable uses than to be incorporated into the asserted patents, then its sale may not exhaust patents that include that component in combination. It remains unclear whether the "embodies the patent" standard is met only by components whose unauthorized sale would constitute contributory infringement, or whether the "no reasonable use" factor differs from contributory infringement's requirement that such articles must lack "substantial noninfringing use."<sup>34</sup>

A patentee may also argue that a combination patent is not exhausted by sale of a component because the addition of other elements has an innovative aspect such that they are not simply "common and noninventive." This argument may be available if a



combination claim contains two or more inventive components. It may also be available if the novelty resides in the entire combination, even though no particular element is inventive. *Quanta* appears to recognize that certain types of combinations fall into this category, as its discussion of the *Aro* case shows.<sup>35</sup>

**C. A Patentee May Attempt to Enforce Additional Restrictions by Contract.**

*Quanta* leaves open the possibility of enforcing additional restrictions on downstream use or sale by contract, rather than by patent law. Patentees may try to incorporate many characteristics of patent law into such contracts, such as entitlement to attorneys' fees, availability of enhanced damages, or entitlement to injunctive relief. Given the Supreme Court's trend to apply its older precedents, it is likely to follow its earlier statement that such breach of such contracts does not also give rise to a cause of action for patent infringement.<sup>36</sup>

Enforcement of such contracts may be difficult for a number of reasons, such as state-law hostility to liquidated damages provisions. Further, contractual arrangements, particularly between competitors or where the patentee has a dominant market position, are more likely to receive scrutiny from antitrust scrutiny than patent infringement suits would receive.

**D. Both Patentee and Purchasers Should Remain Alert to the Possibility of Implied Licenses.**

Implied license is an equitable doctrine that requires examining the bilateral relationship between the patentee and its purchasers. It can arise "by acquiescence, by conduct, by equitable estoppel (estoppel in pais), or by legal estoppel."<sup>37</sup> The most significant distinction from patent exhaustion is that a patentee can effectively disclaim an implied license at the time of the transaction. Patentees may continue to include such disclaimers in their express licenses and sales, while purchasers and licensees who are presented with such disclaimers may wish to clarify their scope before entering into a transaction.



**E. Questions Remain Concerning a Patentee's Ability to Authorize Sales of Components that Would Contributorily Infringe.**

There is an arguable tension in *Quanta* and the law of contributory infringement. *Quanta* holds that sale of a component that embodies an invention can exhaust the entire patent. However, Section 271(d) provides that "no patent owner otherwise entitled to relief for infringement or contributory infringement of a patent shall be denied relief" for engaging in a number of activities. Pertinent here are the following: (1) "derived revenue from acts which if performed by another without his consent would constitute contributory infringement," and (2) "licensed [] another to perform acts which if performed without his consent would constitute contributory infringement."<sup>38</sup> If components that embody an invention are also components whose unauthorized sale would be contributory infringement, *Quanta's* exhaustion rule would seem to entirely vitiate the patentee's safe harbors to license component sales under this section.

**F. *Quanta* Does Not Address Its Application to Biotechnology.**

*Quanta* confined its discussion to precedent and its application to the facts of the LGE license. It did not address, even in *dicta*, the application of its patent exhaustion rule to biotechnology. In its amicus brief, the Biotechnology Industry Organization pointed out that the rights to make and use an invention are granted separately by the patent laws, and that acquisition of the right to use does not ordinarily confer a right to make a patented invention as well.<sup>39</sup> The brief goes on to state that "[p]reserving the rule that patent exhaustion law does not extend to the making of patented products is of critical importance to the biotechnology industry."<sup>40</sup> Because many biotechnology inventions are self-replicating, "[t]he line between using and making can be a fine one."<sup>41</sup>

In addressing the distinction between using and making a patented article, *Quanta* tersely rejected LGE's arguments that patent exhaustion "does not apply to post-sale restrictions on 'making' an article."<sup>42</sup> It states that "this is simply a rephrasing" of LGE's other arguments.<sup>43</sup> The Court saw little difference between using and making



in this case: “making a product that substantially embodies a patent is, for exhaustion purposes, no different than making the patented article itself.”<sup>44</sup>

Such a sweeping pronouncement is troubling if applied without modification to biotechnology inventions. Although some litigants will likely try to apply *Quanta* to self-replicating inventions, the better view is that *Quanta*'s elision of the distinction between making and using is limited to “the addition of standard parts” to form a claimed combination, and not making copies of a patented invention, whether self-replicating or not.

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<sup>1</sup> *Quanta Computer, Inc. v. LG Elecs., Inc.*, 553 U.S. \_\_\_\_, (2008) (slip op. at 19).

<sup>2</sup> *Id.* (slip op. at 4).

<sup>3</sup> *Id.* (slip op. at 5) (stating that “[t]he [district] court found that [] the Intel Products do not fully practice any of the patents at issue”).

<sup>4</sup> *LG Elecs., Inc. v. Asustek Computer, Inc.*, 65 USPQ2d 1589, 1598 (N.D. Cal. 2002).

<sup>5</sup> *Id.*

<sup>6</sup> *Id.*

<sup>7</sup> Beyond the parties' briefing, the Court received twenty-eight amicus briefs. Ten of those briefs, including those of the Solicitor General and the American Antitrust Institute, were in support of *Quanta* and the other petitioners. Fourteen briefs, including those from the Intellectual Property Owners Association, the American Intellectual Property Law Association, and various law professors, supported LGE's position. Four briefs were in support of neither party.

<sup>8</sup> Brief for the United States as *Amicus Curie* Supporting Petitioners, *Quanta Computer, Inc. v. LG Elecs., Inc.*, 553 U.S. \_\_\_\_ (2008) at 6.

<sup>9</sup> Brief of the American Intellectual Property Law Association as *Amicus Curie* In Support of Respondent, *Quanta Computer, Inc., et al., v. LG Electronics, Inc.*, 553 U.S. \_\_\_\_, (2008) at 2.

<sup>10</sup> *Univis Lens*, 316 U.S. at 242.

<sup>11</sup> *Id.*

<sup>12</sup> *Id.* at 244-45 (describing licenses to wholesalers, finishing retailers, and prescription retailers).

<sup>13</sup> *Id.*

<sup>14</sup> *Quanta*, 553 U.S. at \_\_\_\_ (slip op. at 9).

<sup>15</sup> *Id.*

<sup>16</sup> *Id.*

<sup>17</sup> *Id.*

<sup>18</sup> *Id.* (slip op. at 11).

<sup>19</sup> *Id.* (slip op. at 12).

<sup>20</sup> *Id.* (slip op. at 11-12).

<sup>21</sup> *Id.* (slip op. at 12-13).



<sup>22</sup> *Id.* (slip op. at 14).

<sup>23</sup> *Id.*

<sup>24</sup> *Id.* (slip op. at 15).

<sup>25</sup> *Id.*

<sup>26</sup> *Id.* (slip op. at 17).

<sup>27</sup> *Id.*

<sup>28</sup> *Id.* (slip op. at 18, n.7).

<sup>29</sup> *Met-Coil Sys. Corp. v. Korner Unlimited, Inc.*, 803 F.2d 684, 687 (Fed. Cir. 1986).

<sup>30</sup> *Quanta*, 553 U.S. at \_\_\_\_ (slip op. at 9) (discussing *General Talking Pictures Corp. v. Western Elec. Co.*, 304 U.S. 175 (1938)).

<sup>31</sup> See Brief for the United States as *Amicus Curie* Supporting Petitioners, *Quanta Computer, Inc., et al., v. LG Elecs., Inc.*, 553 U.S. \_\_\_\_ (2008) at 16-17 (identifying “restrictions on a licensee’s ability to make an authorized sale” and a sale “in violation of the field-of-use terms of [a] license” as “license restrictions that, when breached, will give rise to a valid patent-infringement suit”).

<sup>32</sup> *Quanta*, 553 U.S. at \_\_\_\_ (slip op. at 12-13).

<sup>33</sup> *Id.* (slip op. at 15).

<sup>34</sup> See 35 U.S.C. § 271(c).

<sup>35</sup> *Quanta*, 553 U.S. at \_\_\_\_ (slip op. at 16) (discussing *Aro Mfg. Co. v. Convertible Top Replacement Co.*, 365 U.S. 336, 344 (1961)).

<sup>36</sup> See *Keeler v. Std. Folding Bed. Co.*, 157 U.S. 659, 666 (1895) (stating that “special contracts brought home to purchasers . . . would arise as a question of contract and not as one under the inherent meaning and effect of the patent laws”).

<sup>37</sup> *Wang Labs. v. Mitsubishi Elecs. Am. Inc.*, 41 USPQ2d 1263, 1271 (Fed. Cir. 1997).

<sup>38</sup> 35 U.S.C. § 271(d).

<sup>39</sup> Brief of the Biotechnology Industry Organization as *Amicus Curie* In Support of Neither Party, *Quanta Computer, Inc., et al., v. LG Elecs., Inc.*, 553 U.S. \_\_\_\_ (2008) at 12-13.

<sup>40</sup> *Id.* at 13.

<sup>41</sup> *Id.* at 15.

<sup>42</sup> *Quanta*, 553 U.S. \_\_\_\_ (slip op. at 18).

<sup>43</sup> *Id.*

<sup>44</sup> *Id.*