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TESTING THE LIMITS OF PATENT EXHAUSTION'S "AUTHORIZED SALE" REQUIREMENT USING CURRENT HIGH-TECH LICENSING PRACTICES

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I. INTRODUCTION

The current trend in United States Supreme Court patent decisions is to restrict the boundaries of patent rights.¹ In *Quanta Computer, Inc. v. LG Electronics, Inc.*,² the Supreme Court’s latest decision regarding patent exhaustion,³ the Court held that “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 the post-sale use of the article.”⁴ Two legal issues regarding the limits of patent exhaustion’s “authorized sale” requirement, which affect

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³. Though it will be defined in greater detail in the subsequent section, the patent exhaustion doctrine exhausts patent rights with respect to an article if there is an authorized sale of the article that substantially embodies a patent. See infra Part II.A.

⁴. Id. at 2122.
current high-tech licensing practices, were not specifically addressed in *Quanta*. The first is whether patent exhaustion's authorized sale requirement can be satisfied when a patent agreement does not grant use rights. The second is under what circumstances does a covenant not to sue satisfy the authorized sale requirement.

For high-tech companies, unpredictability regarding these limits can distort the contours of a patent bargain because both patentees and licensees may not know the exact implications of their bargain and whether patent exhaustion will apply. The patent exhaustion doctrine should allow patent holders to receive the fair value for their inventive contributions by providing flexibility and predictability in contracting their patent rights. However, this flexibility must be balanced against preventing patent holders from obtaining more than the fair value by licensing the same inventive contribution to multiple parties.

This comment analyzes two current high-tech licensing practices, and proposes solutions to the two open questions regarding the limits of the authorized sale requirement. Both solutions attempt to strike the proper balance between providing flexibility in contracting patent rights and preventing patent holders from unfairly receiving multiple royalties for the same inventive contribution. This comment first proposes that a patent license grant with the right to sell, but not the right to use, should satisfy the authorized sale requirement, because otherwise, a patentee could easily bypass patent exhaustion by acquiring sufficient value for a subset of the bundle of rights while purposely leaving out an insignificant right. Secondly, a covenant not to sue should satisfy the authorized sale requirement if a patent holder extracts a sufficient reward for its patents.

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5. *See infra* Part III.
6. *See infra* Part IV.B.
7. *See infra* Part IV.C.
8. *See infra* Part IV.A.
10. *See id.*
11. *See infra* Parts IV–V.
12. *See infra* Part V.A.
13. *See infra* Part V.B.
proposes an objective test, which takes the circumstances surrounding a patent transaction into account, for determining whether the authorized sale requirement is satisfied. The test will look to objective factors such as whether the patentee and covenantee are market competitors, whether the patentee is attempting to extract royalties from multiple points in a product value chain, and whether the patentee is a non-practicing entity.

This comment provides an overview of the patent exhaustion doctrine and discusses two current high-tech licensing practices. Part III identifies the legal issues regarding patent exhaustion's authorized sale requirement. Next, Part IV analyzes the limits of the authorized sale requirement. Lastly, Part V presents solutions for determining when, in light of today's policy considerations, the authorized sale requirement is satisfied.

II. BACKGROUND

A. The Patent Exhaustion Doctrine

The patent exhaustion doctrine, also known as the first-sale doctrine, "provides that the initial authorized sale of a patented item terminates all patent rights to that item." The non-statutory doctrine traces its roots to Supreme Court precedents from the mid-1800s. The modern doctrine, fully explicated in United States v. Univis Lens Co., gained appeal in the 1990s, "when it came to be viewed as a viable affirmative defense in situations where there was an authorized sale of a component of a patented combination." An authorized sale is a sale by the patentee or a licensee acting within the scope of its license. Today, patent

14. See infra Part V.B.
15. See infra Part V.B.
16. See infra Part II.A.
17. See infra Part II.B.
21. Osborne, supra note 19, at 647.
exhaustion is a key consideration when licensing patents in industries, such as the high-tech industry, that utilize complex product value chains.\textsuperscript{23}

1. Patent Exhaustion Is an Implied Authority Defense to Patent Infringement

The Constitution allows Congress to promote "the Progress of Science and useful Arts."\textsuperscript{24} To encourage innovation, patent laws attempt to balance the grant of temporary exclusive rights—the incentive for inventors to publicly disclose their inventions—with the avoidance of stifling market competition.\textsuperscript{25}

The exclusive rights granted to patent holders are "the right to exclude others from making, using, offering for sale, or selling the invention throughout the United States or importing the invention into the United States," and includes the right to exclude others from products made by an inventive process.\textsuperscript{26} Congress has prescribed that, "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 lifetime of the patent grant infringes the patent.\textsuperscript{27} Therefore, activities can lead to infringement only if they are carried out "without authority" of the patent holder.\textsuperscript{28}

An express license, which may be granted by either oral or written agreement,\textsuperscript{29} is the clearest grant of authority from a patent holder.\textsuperscript{30} However, authorization may also arise by implication.\textsuperscript{31} Implied authorization can limit a patent

\textsuperscript{23} See, e.g., Brief for Amici Curiae Nokia, \textit{supra} note 9, at 5; Brief of Qualcomm Inc. as Amicus Curiae in Support of Respondent, Quanta Computer, Inc. \textit{v.} LG Elecs., Inc., 128 S. Ct. 2109 (2008) (No. 06-937); Brief of Amicus Curiae Motorola, Inc. in Support of Petitioners, \textit{Quanta}, 128 S. Ct. 2109 (No. 06-937).

\textsuperscript{24} U.S. CONST. art. I, § 8, cl. 8.

\textsuperscript{25} \textit{See} Brief for Amici Curiae Nokia, \textit{supra} note 9, at 5.

\textsuperscript{26} 35 U.S.C. § 154(a) (2006). The patent grant does not give the right to make, use, sell, offer for sale, or import, but rather it provides the right to exclude others. \textit{Id}.

\textsuperscript{27} \textit{Id.} § 271(a).

\textsuperscript{28} \textit{See id.} § 271(a), (f) & (g).

\textsuperscript{29} JOHN W. SCHLICHER, PATENT LAW, LEGAL AND ECONOMIC PRINCIPLES § 1:67 (2d ed. 2007).


\textsuperscript{31} SCHLICHER, \textit{supra} note 29, § 1:68.
holder's rights when challenging activities involving products sold by either the patent holder or its licensee under one of three doctrines.\textsuperscript{32} The repair right doctrine may apply when a court interprets a purchaser's activities as merely repairing the patented product, as opposed to impermissibly making or reconstructing a new product.\textsuperscript{33} The implied license doctrine may apply when a component that is useful in constructing or carrying out an invention is sold.\textsuperscript{34} Finally, the patent exhaustion doctrine may apply when a patent holder or an authorized licensee makes a sale of a patented product.\textsuperscript{35}

Although the implied license and patent exhaustion defenses have been described as confusingly similar, the implied license doctrine, born from principles of equity, will only apply under circumstances where the conduct of the parties plainly indicates that a license should be inferred.\textsuperscript{36} Thus, an implied license may be “expressly disclaimed” by the patent owner.\textsuperscript{37} In contrast, “the parties’ intent with respect to downstream customers is of no moment in a patent exhaustion analysis.”\textsuperscript{38} Both the implied license and patent exhaustion doctrines promote market efficiency.\textsuperscript{39} Absent the two, a buyer would hesitate to purchase a product at full price without assurance from the seller that use or resale of the product would not infringe any of the seller’s patents.\textsuperscript{40}

2. A Brief Legal History of Patent Exhaustion Following the History Outlined in Quanta

For over 150 years, the Court has restricted the patent

\textsuperscript{32} Id. The law generally treats these as separate doctrines. Id.
\textsuperscript{34} See McCoy, 67 F.3d at 920.
\textsuperscript{37} Brief of Qualcomm Inc. as Amicus Curiae, supra note 23, at 19. But cf. Transcore, LP v. Elec. Transaction Consultants Corp., 563 F.3d 1271, 1278 (Fed. Cir. 2009) (finding that a patent, which had not yet issued and was thus not identified in the TransCore-Mark IV settlement agreement, was exhausted by Mark IV’s authorized sale under an implied license to practice that patent by virtue of legal estoppel).
\textsuperscript{38} Transcore, 563 F.3d at 1275.
\textsuperscript{40} See id.
rights that endure past the initial authorized sale of a patented item.\textsuperscript{41} In 1852, the Supreme Court laid the foundation for the patent exhaustion doctrine in \textit{Bloomer v. McQuewan}.\textsuperscript{42} The Court wrote in dicta, "when the machine passes to the hands of the purchaser, it is no longer within the limits of the monopoly."\textsuperscript{43} Thus, a patent holder should have no claim for infringement against a buyer who purchased a product from either the patent holder or a licensee in an authorized, unrestricted, and unconditional sale.\textsuperscript{44}

In the 1872 decision of \textit{Mitchell v. Hawley},\textsuperscript{45} the Court clarified that where "a licensee has made an unauthorized sale outside the scope of its license, the downstream purchaser infringes even if it lacks notice that the licensee is acting in an unauthorized manner."\textsuperscript{46} The Court found that an innocent purchaser of an unauthorized sale may be held liable for patent infringement because "the law imposes the risk upon the purchaser, as against the real owner, whether the title of the seller is such that he can make a valid conveyance."\textsuperscript{47}

Forty years later, the Court decided \textit{Henry v. A.B. Dick Co.},\textsuperscript{48} a case involving mimeograph machines sold without "an attached license stipulating that the machine could only be used only with ink, paper, and other supplies made by the A.B. Dick Company".\textsuperscript{49} Today, the Court interprets this decision as rejecting the notion that "a patent holder 'can only keep the article within the control of the patent by retaining the title,' and held that any 'reasonable stipulation, not inherently violative of some substantive law' was 'valid and enforceable.'"\textsuperscript{50} The Court only required the company to notify the purchaser that, instead of "an unconditional title to the machine," the purchaser was only entitled to a "qualified

\textsuperscript{41} Quanta Computer, Inc. v. LG Elecs., Inc., 128 S. Ct. 2109, 2113 (2008).
\textsuperscript{42} Bloomer v. McQuewan, 55 U.S. (14 How.) 539 (1852).
\textsuperscript{43} Id. at 549.
\textsuperscript{44} SCHLICHER, \textit{supra} note 29, § 8:14.
\textsuperscript{45} Mitchell v. Hawley, 83 U.S. (21 Wall.) 544 (1872).
\textsuperscript{47} \textit{Mitchell}, 83 U.S. (21 Wall.) at 550.
\textsuperscript{48} Henry v. A.B. Dick Co., 224 U.S. 1 (1912).
\textsuperscript{49} \textit{Quanta}, 128 S. Ct. at 2116 n.2.
\textsuperscript{50} Id. (quoting \textit{A.B. Dick}, 224 U.S. at 18) (citation omitted).
right to use. "Although the Court permitted post-sale restrictions on the use of a patented article in A.B. Dick, the decision was short-lived. Several years later, Motion Picture Patents Co. v. Universal Film Manufacturing Co. explicitly overruled A.B. Dick to prevent patent holders from using A.B. Dick-style licenses to limit the use of their products and thereby effectively use their patents to secure market control of related, unpatented items. In Motion Picture Patents, the Court found that limiting the use of a film projector to only films made by the same company amounted to an attempted "monopoly in the manufacture and use of moving picture films." Observing that the primary purpose of the patent laws is "to promote the progress of science and useful arts," the Motion Picture Patents Court held that "the scope of the grant which may be made to an inventor . . . must be limited to the invention described in the claims of his patent" and not be allowed to extend to unpatented components.

In General Talking Pictures Co. v. Western Electric Co., a company purchased patented amplifiers for use in "talking picture" theaters from a seller who held a license to "make and sell amplifiers for use in radio broadcast reception, radio amateur reception, and radio experimental reception radios." The Court made clear that a patent holder may legally limit a licensee's right to make sales for particular purposes or uses. In general, contractual conditions such as field-of-use, temporal restrictions, and geographical restrictions, will "be enforced through the patent law unless the court determines that they violate some other law or policy, such as antitrust law or the doctrine of patent misuse." Therefore, patent exhaustion may not apply if a

51. Id. (quoting A.B. Dick, 224 U.S. at 26).
52. Id. at 2115–16 (citation and footnote omitted).
54. Quanta, 128 S. Ct. at 2116.
55. Motion Picture Patents, 243 U.S. at 518.
56. Quanta, 128 S. Ct. at 2116 (citing Motion Picture Patents, 243 U.S. at 511) (internal quotation marks omitted).
59. Id.
60. See ROGER E. SCHECHTER & JOHN R. THOMAS, PRINCIPLES OF PATENT
licensee or purchaser performs activities in violation of a lawful restriction or condition (i.e., performs activities outside those legally authorized by the seller).

In United States v. Univis Lens Co., a holder of eyeglass lens patents:

licensed a purchaser to manufacture lens blanks, 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.

The Univis Court noted that the “incident to the purchase of any article, whether patented or unpatented, is the right to use and sell it, and, upon familiar principles, the authorized sale of an article which is capable of use only in practicing the patent is a relinquishment of the patent monopoly with respect to the article sold.” The Court assumed that the patents containing claims for the finished lenses were practiced in part by the wholesalers and the finishing retailers who ground the blanks into lenses, and held that the sale of the lens blanks exhausted the patents on the finished lenses.

The Univis Court explained that the lens blanks “embodie[d] essential features of the patented device and [were] without utility until . . . ground and polished as the finished lens of the patent.” 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.”


61. See SCHLICHER, supra note 29, §§ 8:60–8:63.
62. Id. (citing Univis, 316 U.S. 241).
63. Univis, 316 U.S. at 249.
64. Quanta, 128 S. Ct. at 2116 (citing Univis, 316 U.S. 241) (footnote omitted).
65. Id. (quoting Univis, 316 U.S. at 250–51) (internal quotation marks omitted).
66. Id. at 2117 (citing Univis, 316 U.S. 241).
a. Quanta Computer, Inc. v. LG Electronics, Inc.

The Court recently considered the contours of the patent exhaustion doctrine in Quanta. In this case, LG Electronics (LGE) licensed computer system patents to Intel that contained both method and apparatus claims. "The License Agreement authorize[d] Intel to make, use, sell (directly or indirectly), offer to sell, import, or otherwise dispose of its own products practicing the LGE Patents." In a separate agreement ("Master Agreement") with LGE, Intel agreed to notify its customers in writing that the LGE "license does not extend . . . to any product that [the customers] make by combining an Intel product with any non-Intel product." The separate agreement also stated that "a breach of this Agreement shall have no effect on and shall not be grounds for termination of the Patent License." Quanta purchased microprocessors and chipsets from Intel, and received the notice required by the separate agreement. Nonetheless, Quanta manufactured computers using Intel parts in combination with non-Intel memory and buses in ways that practiced the LGE patents.

The Court noted that nothing in the license agreement restricted Intel's right to sell its microprocessors and chipsets to purchasers who intended to combine them with non-Intel parts, or limited Intel's ability to sell its products practicing LGE patents. Furthermore, a breach of the separate agreement would not constitute a breach of the license agreement, and therefore Intel's authority to sell its products embodying the LGE patents was not conditioned on the notice provision being satisfied or Quanta's decision to abide by LGE's directions in that notice. Thus, the performance of the license agreement was independent of the separate agreement.

67. Id. 2109.
68. Id. at 2114.
69. Id. (internal quotation marks omitted).
71. Id. at 2114 (internal quotation marks omitted).
72. Id. at 2110.
73. Id.
74. Id. at 2121.
75. Id. at 2122.
76. See MARK S. HOLMES, PATENT LICENSING: STRATEGY, NEGOTIATION,
The Court stated that method claims may be exhausted. A contrary decision would undermine the patent exhaustion doctrine because patentees “could simply draft their patent claims to describe a method rather than an apparatus.” The Court noted that apparatus and method claims “may approach each other so nearly that it will be difficult to distinguish the process from the function of the apparatus.” In this regard, Quanta is consistent with Univis.

Further, the Court stated that “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 post-sale use of the article.” An article substantially embodies a patent if there is “no reasonable noninfringing use,” and it includes “all the inventive aspects of the patented methods.” An incomplete article substantially embodies a patent when the steps necessary to practice the patent are “common and noninventive,” such as requiring the application of common processes, or the addition or removal of standard parts.

In sum, Quanta reaffirmed Univis, and held that the patent exhaustion doctrine applies to method claims. It further held that because the patent license agreement between LGE and Intel authorized Intel to sell components that substantially embody the LGE patents, “the patent exhaustion doctrine prevents LGE from further asserting its patent rights with respect to the patents substantially embodied by those products.” Because the steps taken by Quanta necessary to practice the LGE patents were “common and noninventive,” the Quanta products created by combining Intel parts with non-Intel parts substantially embodied the

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77. Quanta, 128 S. Ct. at 2117.
78. Id.
79. Id. at 2117–18 (quoting United States ex rel Steinmetz v. Allen, 192 U.S. 543, 559 (1904)).
80. Id. at 2117.
81. Id. at 2122.
82. Id.
84. See id. at 2113.
85. Id. at 2122.
LGE patents. 86

b. TransCore LP v. Electronic Transaction Consultants Corp. 87

After the Supreme Court decided Quanta, the United States Court of Appeals for the Federal Circuit held that “an unconditional covenant not to sue authorized sales by the covenantee, for purposes of patent exhaustion.” 88 TransCore, a manufacturer of automated toll collection systems, entered into a settlement agreement with Mark IV, including an unconditional covenant not to sue for future infringement. 89 Several years later, TransCore sued Electronic Transaction Consultants Corp. (ETC) for infringement of three patents related to toll-collection systems ETC purchased from Mark IV. 90

TransCore relied heavily on the Federal Circuit’s earlier opinion in Jacobs v. Nintendo of America, Inc., 91 and contended that sales under a covenant not to sue are not authorized. 92 In Jacobs, the Federal Circuit discussed “the respective roles of a license term and a covenant not to sue in a settlement agreement.” 93 The Jacobs court noted that “if all that Jacobs intended to do through the settlement agreement was to free Analog of its liability for infringement . . . (the covenant not to sue) would have been fully sufficient to serve that purpose”; however, the license provision goes much further, by granting an affirmative right. 94 This language seemed to recognize a key distinction between licenses and covenants not to sue. 95 However, in TransCore, the Federal Circuit clarified that the Jacobs court was only “differentiating between settlement terms for the express purpose of determining the contracting parties’ intent in the

86. See id. at 2120.
88. Id. at 1274.
89. Id. at 1273.
90. Id.
92. Transcore, 563 F.3d at 1274.
93. Id. at 1274–75.
94. Jacobs, 370 F.3d at 1101.
context of an implied license analysis.\textsuperscript{96}

The TransCore court reasoned that the grant of a patent provides the patentee with the right to exclude, not an affirmative right to practice the patent.\textsuperscript{97} Therefore, a patent owner, "by license or otherwise, cannot convey an affirmative right to practice a patented invention," because "one cannot convey what one does not own."\textsuperscript{98} A patentee "can only convey the freedom from suit."\textsuperscript{99} Therefore, the pertinent question is not whether an agreement is structured as a covenant not to sue or a license grant, because that difference is only one of form, not substance.\textsuperscript{100} The pertinent question is whether the agreement authorizes sales\textsuperscript{101}—a sale is authorized if it falls within the scope of a covenant not to sue.\textsuperscript{102} Using this framework to analyze patent exhaustion, the parties need only determine whether a sale was within the scope of the agreement.\textsuperscript{103} The agreement does not need to extend to downstream customers or users to trigger patent exhaustion; it need only authorize the first-sale by the licensee or covenantee.\textsuperscript{104} However, a covenant not to sue may not provide the necessary authorization to sell if it only applies to past conduct or is limited to only the acts of making and using, and not selling.\textsuperscript{105}

\textbf{B. Two Current High-Tech Licensing Practices}

High-tech industries, such as the wireless communication and semiconductor industries, frequently develop products using a multi-step chain of production.\textsuperscript{106} As a result, various high-tech companies own large portfolios of patents that cover all or portions of an entire product value chain.\textsuperscript{107} Accordingly, many high-tech companies have licensing agreements with a diverse array of companies, each with

\begin{itemize}
  \item \textsuperscript{96} TransCore, 563 F.3d at 1275.
  \item \textsuperscript{97} Id.
  \item \textsuperscript{98} Id.
  \item \textsuperscript{99} Id.
  \item \textsuperscript{100} Id. at 1276.
  \item \textsuperscript{101} Id.
  \item \textsuperscript{102} See TransCore, LP v. Elec. Transaction Consultants Corp., 563 F.3d 1271, 1276 (Fed. Cir. 2009).
  \item \textsuperscript{103} See id.
  \item \textsuperscript{104} See id. at 1277.
  \item \textsuperscript{105} See id. at 1276.
  \item \textsuperscript{106} Brief of Qualcomm Inc. as Amicus Curiae, supra note 23, at 10.
  \item \textsuperscript{107} Id.
\end{itemize}
different licensing needs depending on where they operate along the multi-step chain of production. Two current high-tech licensing practices for potentially avoiding patent exhaustion include (1) restricting the grant of “use” rights and (2) using a covenant not to sue instead of a typical license grant.

1. Restricting the Grant of “Use” Rights

Patents confer on their owners the statutorily created, exclusive right to “make, use, offer to sell, sell, or import into the United States” the claimed invention. Like holders of any property, patent owners may license distinct rights to third parties without losing the remainder. For example, a patent owner may restrict “use” rights by limiting the licensee’s authority to only making and selling certain components.

The restriction of use rights can be seen in a company’s license agreements. Qualcomm is a wireless communications research and development company that has many license agreements, called ASIC Patent License Agreements (APLAs), with chipmakers that provide chipmakers with “nontransferable, worldwide, nonexclusive, restricted licenses to its portfolio of technically necessary patents.” Qualcomm’s APLA license has a limited scope and requires the licensee to act within those limitations. A licensee can make its own application-specific integrated circuits (ASICs) under an APLA. Furthermore, the agreement “provides the chipmaker-licensee with a restricted license to sell ASICs, but only to handset makers that the APLA defines to be an ‘Authorized Purchaser’ for incorporation into fully assembled handsets.” Authorized Purchasers are handset makers with licenses through Qualcomm’s “Subscriber Unit License Agreement (“SULA”) to make, use and sell fully assembled

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108. Id.
109. See infra Parts III–IV.
110. See HOLMES, supra note 77, § 2:1 (internal quotation marks omitted).
111. Brief of Qualcomm Inc. as Amicus Curiae, supra note 23, at 19 n.7; HOLMES, supra note 77, § 2:1.
112. Brief of Qualcomm Inc. as Amicus Curiae, supra note 23, at 17–18.
113. Id. at 9.
114. Id. at 8.
115. Id.
116. Id. (emphasis omitted).
handsets that, in the absence of a SULA, would infringe Qualcomm’s patents.”

Qualcomm’s APLA does not explicitly grant a license to the chipmaker-licensee to use the ASICs. Instead, it states that “the rights to use the ASICs to make, operate or sell handsets are only conferred by licensing agreements between Qualcomm and Authorized Purchasers (i.e., by SULAs).”

2. Use of Covenants Not to Sue

Many large high-tech companies “own issued patents in many jurisdictions such as the United States, Europe or Japan.” These companies with extensive patent portfolios “occasionally enter mutual, portfolio-wide agreements with other companies not to assert current or future patent rights against each other.” This result is achieved by using covenants not to sue, or non-assertion covenants.

As Nokia details in its amicus brief in Quanta, the decision to enter into one of these agreements may reflect several business concerns. A covenant not to sue may simply use patents as a metric for “some other aspect of the company’s operations such as its research investments” or “be related to another business relationship between the parties.” For example, there may be a desire to enter into patent peace agreements to avoid “patent thickets,” an industry term describing “the fact that modern electronics devices often implicate hundreds of different patent rights that can be difficult to separate and identify.”

The Supreme Court’s patent exhaustion precedents have all involved license agreements, not covenants not to sue. High-tech companies such as Nokia, Qualcomm, and Motorola

117. Id.
118. Brief of Qualcomm Inc. as Amicus Curiae, supra note 23, at 8.
119. Id.
120. Brief for Amici Curiae Nokia, supra note 9, at 19.
121. Id.
122. Cf. Brief of Qualcomm Inc. as Amicus Curiae, supra note 23, at 17 n.6 (“Qualcomm agrees with the point made by Nokia in its amicus brief . . . that mere cross-covenants not to sue for infringement do not amount to authority and are incapable of exhausting the patents that are the subject of such cross-covenants.”).
123. Brief for Amici Curiae Nokia, supra note 9, at 19.
124. Id.
125. Id.
have argued that the Court should limit its holding to only
the patent exhaustion effect under a license, and not
encompass other types of agreements that may, or may not,
grant or convey patent rights such as covenants not to sue.¹²⁷
Though covenants not to sue and patent licenses are closely
related, there may be significant differences between them.¹²⁸
For example, a covenant not to sue is personal in nature and
is not inherently transferable.¹²⁹

III. IDENTIFICATION OF THE LEGAL ISSUES

This comment addresses two legal issues regarding the
limits of patent exhaustion's authorized sale requirement
that affect current high-tech licensing practices. The first is
whether patent exhaustion's authorized sale requirement can
be satisfied when a patent agreement does not grant use
rights. The second is under what circumstances does a
covenant not to sue satisfy the authorized sale requirement.
The resolution of these issues, which will clarify when patent
exhaustion is triggered, is important to high-tech companies
with patents covering aspects of both components and
systems over various points in a product value chain.
Further, the resolution of these issues will provide guidance
to high-tech companies who are navigating through patent
thickets.

IV. ANALYSIS

A. Policy Considerations

The policy reasons for the patent exhaustion doctrine
conflict.¹³⁰ The traditional rationale is that patent exhaustion

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¹²⁷. See id. at 3; Brief for Amici Curiae Nokia, supra note 9, at 19 ("The
court's decision here should give companies the flexibility to prove that the
substance of the rights granted and used under a given contract do not
implicate the patent exhaustion doctrine. . . . A vigorous application of the
document, however, should not result in bright-line, inflexible rules with
unintended consequences. Parties enter contracts for myriad reasons, and
contracts concerning patents—for instance non-assert provisions—should not
necessarily result in patent exhaustion."); Brief of Qualcomm Inc. as Amicus
Curiae, supra note 23, at 16.
¹²⁹. See, e.g., Hilgraeve Corp. v. Symantec Corp., 265 F.3d 1336, 1346 (Fed.
Cir. 2001) (finding a covenant not to sue nontransferable).
¹³⁰. SCHLICHER, supra note 29, § 1.69.
attempts to prevent patentees from "double dipping"—receiving multiple royalties for the same invention.\textsuperscript{131} However, in light of today's high-tech environment, other policy reasons, such as providing flexibility in dealing with patent thickets, must also be considered. Six of these policy considerations are identified below.

1. Prevent "Double Dipping" by Patent Holders

The most widely stated rationale for patent exhaustion is to prevent "double dipping."\textsuperscript{132} Under this theory, where a patent holder either sells or authorizes a sale, the patent holder is deemed to have "bargained for, and received, an amount equal to the full value for the goods sold."\textsuperscript{133} In Univis, the Court articulated this policy as "when the patentee has received his reward for the use of his invention by the sale of the article[,] . . . the patent law affords no basis for restraining the use and enjoyment of the thing sold."\textsuperscript{134}

2. Place the Burden on Patentees Because They Are in the Best Position to Notify Purchasers of Product Limitations

Aside from the "double dipping" prevention rationale, patent exhaustion forces the patent holder to notify the purchaser when a product's "subsequent use or resale is subject to limitations or patent infringement claims."\textsuperscript{135} Arguably, it is less costly for the patent holder or licensee to notify the purchasers than requiring the purchasers to find this information.\textsuperscript{136} In sum, the burden is placed on patent holders because they are in the best position to minimize the problem of informing purchasers about product limitations at the lowest cost.\textsuperscript{137}

\textsuperscript{131} See, e.g., Brief for Amici Curiae Nokia, supra note 9, at 3.
\textsuperscript{132} See, e.g., Brief of Qualcomm Inc. as Amicus Curiae, supra note 23, at 13. (citing B. Braun Med., Inc. v. Abbott Labs., 124 F.3d 1419, 1426 (Fed. Cir. 1997)).
\textsuperscript{133} See, e.g., id. (quoting B. Braun Med., Inc., 124 F.3d at 1426) (internal quotation marks omitted).
\textsuperscript{134} United States v. Univis Lens Co., 316 U.S. 241, 251 (1942).
\textsuperscript{135} SCHLICHER, supra note 29, § 1:69.
\textsuperscript{136} Id.
\textsuperscript{137} See id.
3. Prevent Patent Exhaustion Design-Arounds Due to Trivial Differences

The patent exhaustion doctrine is triggered by the authorized sale of a component that substantially, even if not completely, embodies essential features of a patented invention.\(^{138}\) Without the “substantially embodies” requirement, “patent holders could authorize the sale of [articles] that are complete with the exception of one minor step . . . and extend their rights through each downstream purchaser all the way to the end user.”\(^{139}\)

When considering whether an article substantially embodies a patent, the relevant characteristic is not whether material has been added or removed, but whether the final steps in producing the infringing article were common and noninventive.\(^{140}\) This prevents patent exhaustion design-arounds based on trivial differences in a product or a patent’s scope.\(^{141}\) Therefore, patentees who wish to acquire compensation for authorized sales from more than one point in a product’s value chain may do so only for substantially different embodiments.\(^{142}\)

4. Make the Termination of Patent Rights a Predictable Event

Patent exhaustion legally terminates a patent holder’s exclusionary rights.\(^{143}\) The circumstances under which patent exhaustion occurs should be clear to both patentees and licensees in order to minimize the zone of uncertainty when contracting patent rights.\(^{144}\) Greater predictability in determining when a patentee’s legal rights are terminated will improve the bargaining of economic interests during licensing negotiations.\(^{145}\)

\(^{139}\) Id. at 2118.
\(^{140}\) See id. at 2118–20.
\(^{141}\) Cf. id. (discussing the extent to which a product must embody a patent in order to trigger patent exhaustion).
\(^{142}\) Cf. id. (discussing the extent to which a product must embody a patent in order to trigger patent exhaustion).
\(^{143}\) Brief of Amicus Curiae International Business Machines Corp., supra note 46, at 25.
\(^{144}\) Id.
\(^{145}\) See id.
5. Allow Flexibility in Contracting Patent Rights to Promote Economic Efficiency

While preventing patent holders from extracting multiple royalties for the same invention, the patent exhaustion doctrine should also allow patentees flexibility in contracting. This flexibility should include allowing "patent holders . . . to license their patent rights under various restrictions," subject to the antitrust laws. For example, a patent owner may license another party to practice the invention in "only a particular geographic area or for only a particular purpose".

A patent holder should have the flexibility to "pick a point along a chain of production from which to extract royalties." However, "once that point is chosen and the patent holder receives value for its invention, the patent holder should be stuck with that choice." By allowing the financial obligations of patent licensing to be spread across the product value chain, greater economic efficiency results because the parties benefiting most from the licensed technology can carry a greater share of the financial burden.

6. Allow Flexibility in Dealing with Patent Thickets

The term "patent thickets" describes the fact that "modern electronics devices often implicate hundreds of different patent rights that can be difficult to separate and identify." Unlike traditional industries, in which there is a closer correspondence between a patented invention and a product, many high-tech industry products incorporate numerous technologies that may be the subject of hundreds of patents. "With this myriad of often-overlapping patents, no technology business can review every potentially relevant patent before designing and commercializing a new

146. Brief for Amici Curiae Nokia, supra note 9, at 2.
147. Id. at 3.
148. Id.
149. Id.
150. Id.
151. See Brief of Qualcomm Inc. as Amicus Curiae, supra note 23, at 22.
152. Brief for Amici Curiae Nokia, supra note 9, at 19.
product." As a result, substantial time and resources may be invested in a new product before a company becomes aware that an arguably patented technology is embedded within the new product. Because redesigning a product after significant investments have been made may not be economically viable, a patent owner asserting infringement may be able to demand a royalty that reflects more than just the ordinary market value for the patented technology.

To overcome the existence of patent thickets and promote design freedom, high-tech companies should have flexibility in negotiating for patent peace without fear of triggering patent exhaustion. Patent peace agreements allow high-tech companies to focus their engineers on inventing future products, rather than providing litigation support.

B. Can Patent Exhaustion Be Triggered, Even Though “Use” Rights Are Not Granted?

Some argue that when a patent license agreement grants authority to exercise only certain make/use/sell rights, or only grants authority that is restricted to a particular field, the patent owner has not bargained for or received adequate compensation for the patent. Therefore, when “use” rights are not granted, some believe that the patent owner has not received adequate compensation for the rights that have not been licensed.

An entity cannot sell rights that it does not possess. Therefore, a component manufacturer “that has been granted authority only to make and sell—but not use—such components cannot confer upon its customers the unrestricted authority to use the components by combining them with other components to create a finished product.” Similarly, an entity with a restricted authority to sell only a particular

154. Id. at 15.
155. Id.
156. Id. at 16.
157. See id. at 14–15.
158. See id.
159. Brief of Qualcomm Inc. as Amicus Curiae, supra note 23, at 17.
160. Id. at 17–18 (emphasis omitted). A patentee’s intent to withhold use rights may be relevant in an implied license analysis, but is of no consequence in a patent exhaustion analysis.
161. Brief of Qualcomm Inc. as Amicus Curiae, supra note 23, at 18.
162. Id. (emphasis omitted).
component "cannot confer upon the buyer broader authority with respect to other components or products in violation of that restriction."\textsuperscript{163}

It is good policy to permit patent holders and licensees with different needs to make licensing agreements with restricted or conditional authority because it permits licensees to pay only for the authority that is needed.\textsuperscript{164} Further, the ability to restrict license scope by dividing and separately licensing make/use/sell rights, or granting authority in connection with only one particular field of use, helps high-tech companies manage patent thickets.\textsuperscript{165}

However, it is not clear that patentees should have to receive value for all rights before triggering patent exhaustion.\textsuperscript{166} A patent holder's receipt of sufficient value for a subset of rights may provide a sufficient "reward," as stated in \textit{Univis}.\textsuperscript{167}

If a patentee is able to sell all but an insignificant right without triggering patent exhaustion, then the patentee would be able to bypass patent exhaustion and receive multiple royalties for the same invention. Of course, if a licensee has been granted the right to use and make, and not the right to sell, then there can be no authorized sale.\textsuperscript{168} In contrast to making and using, it is through a sale that an article is transferred to a downstream third party, which in turn brings into consideration the policies necessary to protect that third party.\textsuperscript{169}

Because Qualcomm's APLAs restrict chipmaker-licensee ASIC sales to only SULA handset makers, the only authorized sales that the chipmaker-licensees can make are to already-licensed handset makers.\textsuperscript{170} However, if Qualcomm's APLAs granted the right to make and sell ASICs, but did not restrict the chipmaker-licensees to sell only to SULA handset makers, then the chipmaker-licensees should be authorized to sell ASICs to any handset maker, thereby triggering patent exhaustion. If patent exhaustion is

\textsuperscript{163} \textit{Id.} at 19.
\textsuperscript{164} \textit{Id.} at 20.
\textsuperscript{165} \textit{See id.}
\textsuperscript{166} \textit{But see id.}
\textsuperscript{167} \textit{See United States v. Univis Lens Co.,} 316 U.S. 241, 251 (1942).
\textsuperscript{168} \textit{See Holmes, supra note 77, § 17:4.9[D].}
\textsuperscript{169} \textit{See supra Part IV.A.}
\textsuperscript{170} \textit{See Brief of Qualcomm Inc. as Amicus Curiae, supra note 23, at 8.}
not triggered, then Qualcomm could potentially receive royalties from both chipmakers and handset makers for the same invention. In either case, Qualcomm will not be able to extract royalties from both chipmakers and handset makers who have purchased ASICs through an authorized sale, if the handset products substantially embody the patents licensed by the chipmakers.

C. When Does a Covenant Not to Sue Satisfy the Authorized Sale Requirement?

High-tech companies use patent license agreements and covenants not to sue for various reasons and to achieve different effects. For example, patent license agreements are often used when resolving assertions of patent infringement while covenants not to sue are often used “when businesses units, product lines, or divisions are sold, acquired, or spun off into separate stand-alone entities.” Covenants not to sue may also be used when parties wish to simply clear potentially blocking patent positions or conduct their businesses without fear of patent litigation.

Both patent licenses and covenants are intellectual property contracts that are interpreted and construed under the law of contracts. Some argue that “the word ‘license’ has become so uncertain of meaning and so encumbered by inconsistent case law respecting the implied rights and obligations of the parties that [license-drafters] cannot be altogether certain what [they have] done when [they] grant a ‘license.’” This uncertainty caused some license-drafters to utilize covenants not to sue for infringement, rather than license grants, in order to avoid potential problems due to implied assumptions under licenses. TransCore, however,

171. See supra Part IV.A.
172. See generally Quanta Computer, Inc. v. LG Elecs., Inc., 128 S. Ct. 2109 (2008) (stating that the authorized sale of an article that substantially embodies a patent exhausts a patent holder's rights).
174. Id.
175. Id.
176. See Brief of Amicus Curiae Papst Licensing GMBH & Co. in Support of Respondent at 15–16, Quanta, 128 S. Ct. 2109 (No. 06-937).
177. 1 HAROLD EINHORN AND THOMAS J. PARKER, PATENT LICENSING TRANSACTIONS § 1.01[2][a] (2008).
178. Id. § 1.04[2].
179. Id.
makes clear that covenants not to sue may satisfy the authorized sale requirement.\textsuperscript{179}

The \textit{TransCore} decision provides a more predictable rule for when the authorized sale requirement is satisfied—a sale is authorized if it falls within the scope of a covenant not to sue.\textsuperscript{180} However, this more predictable rule may be too inflexible, because it does not seem to leave room for negotiating patent peace agreements or other strictly business relationships without fear of triggering patent exhaustion.

V. PROPOSAL

A. A License Grant with the Right to Sell, but Not the Right to Use, Should Satisfy the Authorized Sale Requirement

A patent license grant, with the right to sell, but not the right to use, should satisfy the authorized sale requirement and trigger patent exhaustion. Consistent with legal precedent where the right to sell is granted, courts should find that a patent holder can receive a sufficient reward for its patented invention, even though only a subset of the bundle of patent rights is bargained for. If patent exhaustion is not triggered, then a patentee could acquire sufficient value for a subset of rights, and purposely leave out an insignificant stick (e.g., make or use rights depending on the circumstances). The patentee would then be able to bypass patent exhaustion, and potentially receive multiple royalties for the same invention. Further, in contrast to the granting of make and use rights, the granting of the right to sell allows an article to be transferred to a downstream third party, which brings into consideration the policies necessary to protect that third party.\textsuperscript{181}

B. A Covenant Not to Sue Should Satisfy the Authorized Sale Requirement if a Patentee Extracts Sufficient Reward for Its Patents

The courts should find that the use of a covenant not to

\textsuperscript{179} See supra Part II.A.2.b.
\textsuperscript{180} See \textit{TransCore}, LP v. Elec. Transaction Consultants Corp., 563 F.3d 1271, 1276 (Fed. Cir. 2009).
\textsuperscript{181} See supra Part IV.A.
sue satisfies the authorized sale requirement if the patentee extracts a sufficient reward for its patents. Otherwise, a patentee could extract a sufficient reward for providing a covenantee with the ability to sell the patented invention and bypass patent exhaustion. However, the rule should be flexible enough to allow market competitors to enter into patent peace agreements, or other strictly business relationships that do not sufficiently exploit patent rights, without triggering patent exhaustion. Providing the ability to navigate around “patent thickets” is especially important today since patent litigation is unusually expensive.182

If the effect of a transaction is that a patent holder sufficiently exploits the value of its patented invention, then patent exhaustion should apply.183 “In such a case, the patent holder has received [sufficient] value for giving up its right to exclude and should not be allowed to extract additional royalties from downstream use” for the same patented invention.184 If a covenant not to sue does not provide for an authorized sale, and therefore, does not trigger patent exhaustion, then third party purchasers may want to protect themselves by demanding indemnification from component suppliers with respect to purchased items.185

Depending on the objective circumstances surrounding a patent transaction and the activities of the covenantee, a covenant not to sue “may or may not implicate the type of ‘consent for value’ exchange that justifies the patent exhaustion doctrine.”186 For example, a contract that includes a covenant not to sue “may be part of a larger business transaction” and may not extract royalties from a particular point in the product value chain or reflect authorization to practice a particular invention.187 A covenant not to sue that does not involve royalties for a particular patented invention should not result in patent exhaustion because the patentee

182. Brief of Dell, Inc., supra note 154, at 20–21. For example, the cost of litigating a case with more than twenty-five million dollars at risk is approximately three million dollars through discovery and five million dollars through trial and appeal. Id.
183. Brief for Amici Curiae Nokia, supra note 9, at 20.
184. Id.
185. See HOLMES, supra note 77, § 17:4.9[S].
186. Brief for Amici Curiae Nokia, supra note 9, at 19.
187. Id.
The proposed test for determining whether the authorized sale requirement is satisfied is: "would a reasonable person believe that a patentee had already sufficiently exploited their patent and is trying to double dip?" This test is objective and should include analysis of the specific contract in question, the circumstances surrounding the formation of the contract, and whether or not the patent holder has received a sufficient reward for its patents. Objective factors that bear on the analysis should include whether the patentee and covenantee are market competitors, whether the patentee is attempting to extract royalties from multiple points in the product value chain, and whether the patentee is a non-practicing entity. While not providing the same degree of predictability as a bright-line rule, the objective "reasonable person" standard prevents patent exhaustion design-arounds while providing the necessary flexibility to allow high-tech companies to enter into patent peace agreements and other strictly business relationships without fear of triggering patent exhaustion.

VI. CONCLUSION

High-tech companies rely on patent laws to provide incentive for capital investment in research and development, and contract laws to allow parties to sell, license, and structure their capital investments efficiently. The patent exhaustion doctrine provides an important check on a patent holder's ability to exploit its patents. Because patent exhaustion's authorized sale requirement determines when a patent holder's patent rights are potentially terminated, it is important to provide a predictable guideline to both patent holders and licensees. However, a more predictable guideline should not come at the expense of being so inflexible as to not allow for patent peace agreements or other strictly business relationships without the fear of triggering patent

188. See id. at 20–21; United States v. Univis Lens Co., 316 U.S. 241, 251 (1942).
189. See Brief for Amici Curiae Nokia, supra note 9, at 19–20.
190. See id.
191. See id. at 2.
192. Id. at 3.
193. See supra Part IV.A.
exhaustion.

This comment proposes solutions to two legal issues regarding the limits of patent exhaustion's "authorized sale" requirement, which affect current high-tech licensing practices. The proposed solution to the first legal issue is that the authorized sale requirement may be satisfied by a patent license grant, even though it does not grant "use" rights, because otherwise, it would allow a patentee to easily bypass patent exhaustion by acquiring sufficient value for a subset of rights while purposely leaving out an insignificant right. Further, in contrast to making and using, it is through a sale that an article is transferred to a downstream third party, which brings into consideration the policies necessary to protect that third party. The proposed solution to the second legal issue is that the use of a covenant not to sue may satisfy the authorized sale requirement, if a patent holder extracts a sufficient reward for its patents. An objective test that takes into account the circumstances surrounding a patent transaction is proposed for determining whether the authorized sale requirement is satisfied. The test considers objective factors including whether the patentee and covenantee are market competitors, whether the patentee is attempting to extract royalties from multiple points in a product value chain, and whether the patentee is a non-practicing entity.

194. See supra Parts III and V.
195. See supra Part V.A.
196. See supra Part IV.A.
197. See supra Part V.B.
198. See supra Part V.B.
199. See supra Part V.B.