Keywords: **restricted license; patent exhaustion; method claims**

General: **The Supreme Court reverses the Federal Circuit's holding that the doctrine of patent exhaustion does not apply to method claims.**

Quanta Computer Inc. v. LG Electronics Inc.
128 S. Ct. 2109, 86 U.S.P.Q.2d 1673 (2008)
Decided June 9, 2008

I. Facts

LG Electronics (LGE) owns a patent portfolio that includes patents relating to microprocessors and associated chipsets, and the manner in which the microprocessors and chipsets interact with other components of a computer system, such a main memory and busses. LG licensed its portfolio to Intel as part of a cross-licensing agreement. The license agreement permits Intel to manufacture and sell microprocessors and chipsets that use the LGE patents. Specifically, the license agreement authorizes Intel to "make, use, sell (directly or indirectly), offer to sell, import, or otherwise dispose of" its own products that practice the LGE patents. The license agreement further states that no license is granted by either party to any third party for the combination by the third party of licensed products with items from sources from other than a party to the agreement. Finally, the license agreement states that the parties agree that nothing in the license agreement will alter the effect of patent exhaustion that would otherwise apply when a party sells any of its licensed products.

In a separate agreement, called the Master Agreement, Intel agreed to give written notice to its customers informing them that it had obtained a broad license from LGE but that the license "did not extend, expressly or by implication, to any product that you make by combining an Intel product with any non-Intel product." The Master Agreement states that a breach of the agreement shall have no effect on the license agreement. Subsequently, Quanta purchased microprocessors and chipsets from Intel and received the notice required by the Master Agreement. Nevertheless, Quanta manufactured computers using Intel parts in combination with non-Intel memory and busses in ways that practiced the LGE patents. Quanta did not modify the Intel components, and Quanta followed Intel's specifications in order to incorporate the non-Intel parts into its own systems.

LGE filed a complaint against Quanta, asserting that the combination of the Intel products with the non-Intel memory and busses infringed the LGE patents. At the district court level, Quanta obtained a summary judgment that it was a legitimate purchaser of the Intel products and the doctrine of patent exhaustion applied to those purchases. More specifically, the district court found that, although the Intel products did not fully practice any of the patents at issue, they had no reasonable non-infringing use and, therefore, their authorized sale exhausted patent rights in the completed components under the *Univis* case. In a later order, however, the district court limited its summary judgment ruling by holding that patent exhaustion applies only to apparatus claims and not to method claims. Because the LGE patents included method claims, patent exhaustion did not apply. On appeal, the Federal Circuit agreed that the doctrine of patent exhaustion does not apply to method claims and, alternatively, concluded that exhaustion did not apply because LGE did not license Intel to sell the Intel products to Quanta for use in combination with non-Intel products. The Supreme Court granted *certiorari* to decide 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.

II. Issues

1. Does the doctrine of patent exhaustion apply to method claims?

2. To what extent must a product embody a patent in order to trigger the doctrine of patent exhaustion?

3. Was Intel's sale to Quanta an "authorized" sale sufficient to trigger the doctrine of patent exhaustion?

III. Discussion

1. Yes, the doctrine of patent exhaustion applies to method claims. LGE argued that because method patents are linked to a process rather than a tangible article, they can never be exhausted through a sale. Quanta, on the other hand, argued that there is no reason to preclude the application of the doctrine to method claims and pointed out that both the Supreme Court and the Federal Circuit have applied exhaustion to method claims previously. The Court agreed with Quanta. The Court noted that, while it is true a patented method cannot be sold in the same way as an article, methods may be "embodied" in a product, the sale of which exhausts the patent rights. After noting previous Supreme Court precedent for applying the doctrine of patent exhaustion to method claims, including the *Ethyl Gasoline Corp.* and the *Univis* cases, the Court held that eliminating exhaustion for method patents would seriously undermine the exhaustion doctrine because patentees seeking to avoid patent exhaustion could simply draft method claims rather than apparatus claims. Hence, the Court held that the doctrine of patent exhaustion applies to method claims.

2. Quanta argued that, although sales of an incomplete article do not necessarily exhaust the patent in that article, the sale of the microprocessors and chipsets exhausted LGE's patents because the Intel products could not practice the LGE patents, or function at all, until they are combined with the memory and busses of a computer system. In other words, Quanta argued that the Intel products embodied the essential features of the patented invention and had no other reasonable use other than in the patented combination. LGE countered that the doctrine of patent exhaustion should be limited to the products that contained all that is needed to practice the claimed invention. The Court agreed with Quanta and relied heavily upon the *Univis* case. In *Univis*, the court held that the authorized sale of an article that is capable of use only in practicing the patent is a relinquishment with respect to that article if sold. In *Univis*, the patents related to lens blanks that could be fused together to create bifocal and trifocal lenses after the lens blanks were ground and polished by downstream wholesalers or retailers. The lens blanks in *Univis* met this standard because they were without utility until ground and polished into finished lenses, and the grinding and polishing were nothing more than common processes used to finish all eyeglass lenses. Similarly, the Court found that the microprocessors and chipsets that made up the Intel products substantially practiced the patent claims because everything inventive in each patent is embodied in the Intel products, and the Intel products are incapable of use without the addition of standard parts, such as standard memories and busses. Therefore, the Court held that the relevant consideration is whether a sold article embodies the essential features of the patent. If so, then its sale exhausts that patented invention.

3. Yes, Intel's sale to Quanta exhausted LGE's patent rights. LGE argued that there was no authorized sale because the license agreement did not permit its products for use in combination with non-Intel products to practice the LGE patents. However, the court noted that LGE overlooked an important aspect of the license agreement and the Master Agreement.

Specifically, the court noted that nothing in the license agreement restricts Intel's right to sell its microprocessors and chipsets to purchasers with intent to combine them with non-Intel parts. Indeed, the license grant authorizes Intel to "make, use, sell, … or otherwise dispose of" its own products under LGE's patents. In the Master Agreement, LGE did require Intel to give appropriate notice to its customers, but Intel did not breach that agreement because Intel provided Quanta with the required notice. Furthermore, even if Intel had breached the Master Agreement, the Master Agreement specifically states that its breach does not constitute a breach of the license agreement. Hence, the Court found that Intel's authority to sell its products embodying the LGE patents was not conditioned on the notice or on Quanta's decision to abide by LGE's directions in that notice. Because no conditions limited Intel's authority to sell products substantially embodying the patents, the sale constituted an authorized sale, and the doctrine of patent exhaustion applies.