

IS THE SUPREME COURT EXHAUSTED WITH PATENTS?

By: Paul Veravanich and John Kappos

The Supreme Court's interest in patent law has recently been piqued. Or, is the patent rights exhausted with a perceived overreaching of the patent rights?

The United States Supreme Court historically has been reticent when it comes to taking on patent law matters. In the twenty years prior to 2006, the Court rarely decided a patent case. Recently, however, the Supreme Court's focus has sharpened dramatically. Since 2006, the Court addressed substantive issues of patent law five times. Unfortunately—or fortunately, depending on your side of the fence—the Court generally limited the reach of patent rights. In the process, the Court made it more difficult to enforce patents, particularly when compared to the landscape prior to the Court's recent flurry of activity.

During just the last two years the Supreme Court ruled against the interests of patent holders in numerous cases, including the following:

- In *eBay v. MercExchange*, 126 S. Ct. 1837 (2006), the Court made the grant of a permanent injunction less likely, and certainly not automatic, for a “non-manufacturing patentee” who successfully enforces a patent. By not making an injunction a perfunctory result of a successful patent infringement action, particularly by non-manufacturing patentees, the Supreme Court limited the potential recovery available to those prevailing parties. As a practical matter, the *eBay* decision will reduce the negotiating power of patent holders whose exclusive revenue stream is an aggressive licensing program.
- In *MedImmune v. Genentech*, 127 S. Ct. 764 (2007), the Court determined that a licensee has standing to challenge the licensed patent while maintaining rights under the license by continuing to pay royalties. In so ruling, the Supreme Court relaxed the case-or-controversy requirement for licensees who seek declaratory relief of non-infringement or invalidity. This decision may lead to an increased number of actions by licensees for non-infringement or invalidity because they no longer risk the loss of rights under the license.
- In *Microsoft v. AT&T*, 127 S. Ct. 1746 (2007), the Court limited the extraterritorial reach of U.S. patents. Here, the Court held that copies of software were not supplied from the United States, even though those copies were themselves made from a master disc supplied from the United States.
- And perhaps most notably, in *KSR v. Teleflex*, 127 S. Ct. 1727 (2007), the Supreme Court addressed obviousness in a manner that many analysts and courts interpreted as relaxing the standard for patent invalidity. The result of the *KSR* decision has been an unmistakable increase in the willingness of federal courts to invalidate patents as obvious. Post-*KSR*, a patent owner can no longer discount the possibility of a successful invalidity counterclaim based on an obviousness defense when deciding to file an action for infringement.

These opinions share a common thread: the Supreme Court continues to chip away at the rights of patent owners.

This past June, the Supreme Court took another swing at a patent case. In *Quanta Computer v. LG Electronics*, 128 S. Ct. 2109 (2008), the Court addressed the “patent exhaustion” doctrine in a manner that may ultimately curtail attempts to exert patent rights beyond the first sale of a patented item. A patent holder has, of course, the right to exclude others from making, using, offering to sell, or selling a patented invention in the United States. Furthermore, and even before the Supreme Court's recent decision, it is established that patent exhaustion arises by selling a patented device or granting a license unconditionally. An unconditional sale or license exhausts the patent holder's right to control the purchaser's use of the device. Thus, the patent exhaustion doctrine prevents a double royalty on the sale of a single patented item.

The question becomes whether, and how, a patent holder may retain any of these exclusive rights beyond the first sale of a patented device. The courts traditionally allowed patent holders to circumvent the exhaustion doctrine by expressly conditioning a sale or license. In those situations, the courts presumed that the negotiated price reflected the conditional—rather than an unconditional—use of the patent. For instance, patent owners commonly place use restrictions on licenses. One example is a field-of-use license pursuant to which the licensee will agree to use the invention only in a certain field. A purchaser of a patented diagnostic kit might, for example, agree to limit its use of the kit to research purposes, rather than using it as part of a commercial screening lab.

In *Quanta*, the Court, in its words, confronted the question of “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.” The Supreme Court answered in the affirmative. But, perhaps equally important, the Court provided an analysis that may have far-reaching consequences for sales and licensing transactions beyond the narrow issue the Court described.

The dispute underlying the *Quanta* case arose out of a license between LG Electronics and Intel, and Intel's subsequent sale of components to Quanta Computer. LGE granted Intel a license for various patents relating to chips and chipsets. In an attempt to prevent the

combination of licensed products with non-Intel components, LGE included language in the LGE-Intel license specifying that no license “is granted ... to any third party for the combination ... of licensed products ... with ... components ... from sources other than” LGE or Intel. LGE did not, however, include that restriction in the actual license grant clause, which simply authorized Intel to “make, use, sell (directly or indirectly), offer to sell, import or otherwise dispose of” licensed products. Instead, LGE included the restriction in a separate provision of the license. LGE's intent was to require a separate license for any Intel customer who desired to combine licensed products, which were Intel chips and chipsets, with non-Intel parts. License in hand, Intel began selling licensed products to its customers, including Quanta Computer. Quanta Computer ultimately built computers by combining the licensed Intel parts with non-Intel parts and busses. LGE subsequently filed a patent infringement action against Quanta Computer, alleging that Quanta's use of the Intel components was not authorized under the LGE-Intel license.



John Kappos



Paul Veravanich

LGE took the position that its license to Intel did not authorize Intel to sell components to Quanta without restrictions on Quanta's use of those parts. The Supreme Court ultimately ruled against LGE. The Court emphasized that patent exhaustion is triggered by a patent holder's authorized sale of a patented device, and LGE had in fact authorized the sale by Intel to Quanta. The Court, perhaps elevating form over substance, noted that the LGE-Intel license grant clause itself did not restrict Intel's right to sell licensed components to purchasers who intended to combine them with non-Intel parts. Although LGE actually did include language in the agreement evidencing its intent that Intel customers such as Quanta would not be licensed, those magic words were not included in the actual grant clause language. According to the Supreme Court:

Nothing in the License Agreement restricts Intel's right to sell its microprocessors and chipsets to purchasers who intend to combine them with non-Intel parts. It broadly permits Intel to “make, use, [or] sell” products free of LGE's patent claims. *Quanta*, 128 S. Ct. at 2122.

Based on the *Quanta* decision, a drafting holder must now take even greater care when granting license and sales agreements, with a keen eye focused on the details of the language sufficient. To reserve certain rights in the patent, it is no longer sufficient to include a general grant clause while relying on restrictive language elsewhere in the agreement to reserve those rights. For example, the Court may have ruled in LGE's favor if LGE had simply combined the use restriction language with the grant clause itself. One possibility for LGE would have been to expressly permit Intel to only “make, use, sell (directly or indirectly) to purchasers who do not intend to combine licensed products with non-Intel parts, offer to sell to purchasers who do not intend to combine licensed products with non-Intel parts, import or otherwise dispose of” licensed products.

One type of license that deserves revisiting because of *Quanta* is the single-use license commonly used by medical device companies. As a cost savings measure, hospitals began re-sterilizing and reusing medical devices that were labeled, because of FDA restrictions, as single-use only products. In an effort to prevent multiple uses without further royalty payments, medical device companies began to sell their products under single-use licenses that expressly called out re-sterilization and reuse as unauthorized. A typical single-use license includes the following language: “This product is licensed to the customer for single use only. Any re-sterilization or subsequent reuse is an unlicensed use and therefore constitutes patent infringement.” Although purportedly a restriction on use, this language does not typically appear as part of a formal license grant.

Based on the Court's rationale in *Quanta*, medical device companies should consider reevaluating the language in their single-use licenses. Medical device companies may now negotiate a specific license agreement with hospitals, and include a single-use restriction in the license grant clause. For example, the grant language could read: “The Seller grants to the Buyer a license to use the Product on a single occasion, and does not authorize any re-sterilization or subsequent reuse. This product is licensed to the customer for single use only. Any re-sterilization or subsequent reuse is an unlicensed use and therefore constitutes patent infringement.” Although this grant clause admittedly introduces a degree of redundancy, this type of drafting may now be required as a result of the Court's elevation of form over function.

Recent Supreme Court decisions signal its belief that our patent laws need reform. And the Court may not be done. In *In re Bilski*, the Federal Circuit is considering a case that promises to impact the patentability of business methods. As a general matter, we expect the non-prevailing parties in Federal Circuit decisions to seek Supreme Court review with ever-increasing frequency. The losing side in the *Bilski* case will no doubt follow suit. Stay tuned.

John Kappos, a partner in the Newport Beach office, and counsel Paul Veravanich are members of O'Melveny & Myers LLP's Intellectual Property & Technology practice.



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