

NORTH AMERICA



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US Supreme Court to Clarify Patent Exhaustion Doctrine

One of the most significant and closely watched business cases to be decided by the United States Supreme Court this year involves the more than one-hundred-year-old doctrine of “patent exhaustion” or “first sale.” The case, *Quanta Computer, Inc. vs LG Electronics, Inc.*, pits a Taiwan-based computer manufacturer against a Korean electronics giant. As an indication of the commercial significance of the issues to be decided by the Supreme Court, over twenty amicus (friend of the court) briefs have been filed by major technology companies, industry associations and the United States Patent Office. A decision on the case is expected to be rendered by June 2008.

The patent exhaustion or first sale doctrine generally prevents a patent owner from enforcing a patent against the use or subsequent sale of a patented product following its first unrestricted and authorized sale. The first sale is said to exhaust the patent rights in the product so that it thereafter is treated like any other chattel, free from the scope of the patent laws. The precise contours of the patent exhaustion doctrine are of critical importance in commercial transactions involving patented products, or products which include patented components, and hence are critical to virtually all modern

commerce. The patent exhaustion doctrine allows downstream customers to be secure in their ability to use and sell the products they buy, without the need to engage in what could be a hugely complex investigation of what patents may be involved in those products and negotiate licenses with what could be a myriad of patent holders. Thus, in the words of the Supreme Court over one hundred years ago: “[t]he inconvenience and annoyance to the public that an opposite [rule] would occasion are too obvious to require illustration” – *Keeler vs Standard Folding Bed Co.* [157 U.S. 659, 667 (1895)].

While the broad principles of the exhaustion doctrine are well accepted under US law, significant disputes exist as to its specific application and patent owners have struggled to find ways to structure their businesses in a way to avoid exhaustion and hence permit control under the patent laws of the downstream use or disposition of products sold with their authority.

The Quanta case before the Supreme Court concerns product and method patents which relate to integrated circuit processors used in combination with computer memory. The processors were sold under license from the patent owner, but the license purported to reserve rights against customers when the customers combined the licensed processors with memory to form a working product. By agreement with the patent owner, the licensee was also required to send a notice of the license restrictions to its customers. The issues raised by the case include:

- Does the patent exhaustion doctrine apply to a product which performs a patented method so that the method patent, in addition to any product patent, is exhausted by the sale?
- To what extent does the patent exhaustion doctrine apply to the sale of components which are used to assemble or manufacture a patented product?
- Under what circumstances may the application of the patent exhaustion doctrine be limited by the terms of a patent license agreement?
- Under what circumstances may the application of the patent exhaustion doctrine be limited by notice provided to customers?

The outcome in Quanta promises to have major implications not only in commercial sales activities, but also in shaping technology transfer agreements and licenses. Substantial business interests are lined up on both sides of these issues and depending on what the Supreme Court has to say, established norms and expectations may be uprooted.

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