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Patent owners have had great flexibility in licensing to determine how and from whom to extract value from their patents. The Supreme Court's unanimous decision in *Quanta v. LGE*, however, limits this flexibility.

LGE licensed certain of its patents to Intel. The License Agreement authorized Intel to make, use, and sell microprocessors and chipsets practicing the LGE Patents ("Intel Products"), but it: (1) granted no license to third parties to combine Intel Products with non-Intel or non-LGE components; and (2) placed no limit on the patent exhaustion doctrine. A separate Master Agreement required Intel to notify its customers that their purchase of Intel Products did not permit them under the LGE Patents to combine the Intel Products with other non-Intel products. But a breach of the Master Agreement would not affect the License Agreement or provide grounds for termination. Under the Master Agreement, Intel gave notice to its customer Quanta. Contrary to the notice, Quanta installed the components into computers with non-Intel parts. LGE sued Quanta for infringement.

Quanta argued Intel's authorized sale of the components to Quanta exhausted LGE's method and system patents under the doctrine of patent exhaustion. This 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 district court agreed with Quanta that Intel's sales exhausted the system claims, but not the method claims. The Federal Circuit reversed-in-part, holding the exhaustion doctrine did not apply to the system claims because the notice provided by Intel to Quanta created a conditional sale. The appellate court also affirmed that sales of patented devices do not exhaust a patentee's method claims. The Supreme Court granted certiorari.

The Court first dispensed with LGE's argument that method claims could not be exhausted. Contrary to the Federal Circuit's holding, the Supreme Court held method patents can be exhausted by the sale of an item embodying the method. The Court reasoned that eliminating method patents from the exhaustion doctrine would seriously undermine the doctrine.

The Court then held that to trigger patent exhaustion, a product must substantially embody the patented invention. The Court concluded Intel's microprocessors and chipset components substantially embodied the LGE Patents because: (1) they had no reasonable noninfringing use; (2) they included all the inventive aspects of the patented methods; and (3) the only step necessary to practice the patent was the application of common processes or the addition of standard parts, such as memories or buses. The Court further considered whether exhaustion of one patent can exhaust other patents. It concluded that exhaustion does not apply across commonly owned patents unless practicing one patent substantially embodies practicing other patents.

Having concluded the Intel Products embodied the patents, the Court next considered whether their sale to Quanta was authorized. Here, the Court found Intel's license permitted Intel to make, use, or sell products free of LGE's Patents. Nothing in the License Agreement restricted Intel's right to sell its products to purchasers who intended to combine them with non-Intel parts. Thus, Intel's sales were authorized.

The Court was clear, exhaustion turned only on Intel's own license to sell products practicing the LGE Patents. The Court also left open the idea that patent owners, by limiting the license grant, could determine whether or not a sale was authorized, appearing to preserve some flexibility for patent owners.