Patent Nation Seminar

Structuring Deals and Licenses Post-Quanta

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Post-*Quanta* Considerations in Electronics

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Background Facts

- Intel and LGE license agreement:
  - Covered making, using, selling, *etc*.
  - Included patents to components (chips) and patents to combinations (systems).
  - No license was granted for combinations of Intel and non-Intel components by third parties.
  - Agreement expressly did not restrict exhaustion rights.
  - Intel must send letter to third parties informing them of no license rights for combinations having non-Intel components.

Background Facts

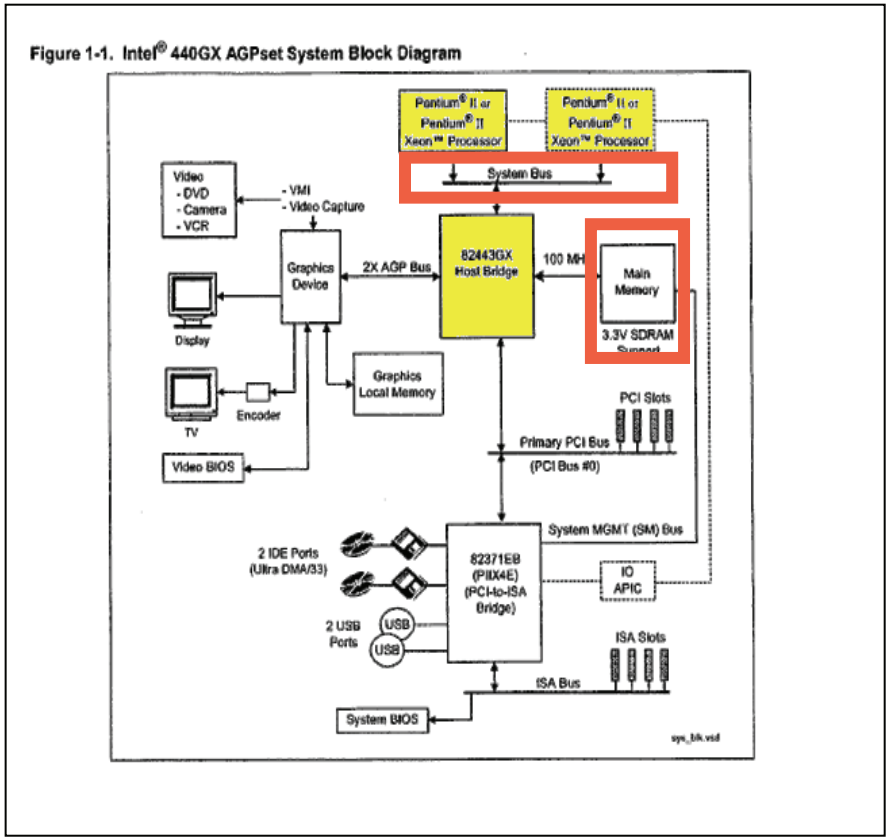
1. A data processing system including one or more central processing units, main memory means, and bus means, for each central processing unit the invention comprising:

cache memory means coupled between the central processing unit and said bus means;

bus monitor means associated with said cache memory means and coupled to said bus means for detecting on said bus means an address associated with a data unit transferred from said main memory means to a bus connection requesting the data unit;

means coupled to said cache memory means and to said bus means for determining if data having the same address as said transferred data unit is present in said cache memory means and, if present, for asserting a hold signal on said bus means, the assertion of the hold signal indicating at least to the bus connection requesting the data unit that another data unit may be transmitted over said bus means; and

means for detecting whether data corresponding to the address of said transferred data unit and determined to be stored in said cache memory means may be different in content from said transferred data unit and, if so, transmitting said data from said cache memory means to said bus means for reception by the bus connection requesting the data unit.



U.S. Supreme Court Decision

- Method Claims.
  - The “exhaustion doctrine” applies to method claims.
- 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 sale of a device that practices patent A will exhaust patent B if the device practices patent A “while substantially embodying” Patent B.

U.S. Supreme Court Decision

- Notice to customers of Intel may have prevented the customers from claiming an “implied license,” but did not eliminate rights under the “exhaustion doctrine,” which concern only Intel’s own license to sell products practicing the LGE Patents.
- The License to Intel required that Intel give notice to its customers. Intel gave such notice and was not in breach of its license agreement. Therefore the sale by Intel was authorized.

U.S. Supreme Court Decision

[7] We note that the authorized nature of the sale to Quanta does not necessarily limit LGE's other contract rights. LGE's complaint does not include a breach-of-contract claim, and we express no opinion on whether contract damages might be available even though exhaustion operates to eliminate patent damages. See *Keeler* v. *Standard Folding* himself and his assignees by special contracts brought home to the purchasers is not a question before us, and upon which we express no opinion. It is, however, obvious that such a question would arise as a question of contract, and not as one under the inherent meaning and effect of the patent laws").

Possible Strategies to Avoid the Effect of *Quanta* -- Summary

1. Create Clearer Contractual Obligations Against Licensee, or Limit License Scope Itself
2. Target Licensee Customers and End Users for Licenses
3. Patents Held by Different Entities
4. Claim Drafting Alternatives
5. Can a Covenant-Not-to-Sue be Used Instead of a License?

Possible Strategies to Avoid the Effect of *Quanta*

1. Create Clearer Contractual Obligations Against Licensee – Option #1
   - If LGE had licensed Intel to sell only to end users who purchased only Intel components
     - Sales to end users who used non-Intel components would be unauthorized sales and exhaustion would not apply
       - However, Intel would also be an infringer since the sales to end users who used non-Intel components would not be authorized.
       - Effect on Intel could be reduced by contractual provisions – for example, additional requirements of proof with an arbitration clause, low damages where Intel has a reasonable belief of no infringement, option to later license, stipulated damages (the latter two may affect reasonable royalty), etc.

Possible Strategies to Avoid the Effect of *Quanta*

1. Create Clearer Contractual Obligations Against Licensee – Option #2
   - If LGE had licensed Intel to sell only to <u>end user's who contractually agreed</u> to purchase only Intel components.
     - Sales would be authorized for end users who entered into such an agreement, and exhaustion would apply.
       - LGE would have a breach of contract case against Intel
       - Intel would have a contract action against the end users who violated the agreement.

Possible Strategies to Avoid the Effect of *Quanta*

1. Create Clearer Contractual Obligations Against Licensee – Option #3
   - If LGE had licensed Intel to sell only to end users who already had a license from LGE to the system patents.
     - Exhaustion might apply since component sales would be authorized.
     - Would end users be contractually bound to pay royalties based on a prior license to the system patents even if exhaustion applies to the purchased components?
       - Patent misuse?
     - LGE would have a breach of contract action against Intel

Possible Strategies to Avoid the Effect of *Quanta*

- Limiting License: Language #1: Make it a "field of use" license.
  - "LGE grants a nonexclusive . . . license to Intel solely in the Field of Use"; "The Field of Use shall be limited to microprocessors incorporated with Intel components (e.g. memories, buses, etc.) and shall not include microprocessors incorporated with any non-Intel components"
- Language #2: Include "for the sole purpose" language.
  - "LGE grants a nonexclusive . . . license to Intel . . . for the sole purpose of making, using selling, etc., microprocessors which incorporate only Intel memories, buses, etc."
- Language #3: Include "carve out" language
  - "This License Agreement shall not allow Intel to make, use, sell, etc. . . . Microprocessors to third parties for incorporation with non-Intel components."

Possible Strategies to Avoid the Effect of *Quanta*

2. Create Clearer Contractual Obligations Against End Users
   - Could LGE have concentrated on the customers of Intel (i.e., the end users) as the only licensees and avoided the exhaustion problem?
     - If LGE licensed the customers on the component patents, would LGE have faced the same exhaustion problem?
       - Possibly not, since the customers would not have purchased components, but only taken a license to make, use or sell components; thus there would be no authorized sale and no exhaustion.
     - Could LGE extract 2 license fees from the customers – one for the component patents and one for the system patents?
       - Possibly, but as a practical matter, it would be easier to collect two royalties from different licensees.

Possible Strategies to Avoid the Effect of *Quanta*

3. Other Arrangements: E.g., Component patents owned by one entity and system patents owned by a different entity?
   - E.g., LGE forms two subsidiaries: LGE Components, Inc. (LGEC); and LGE Systems, Inc. (LGES).
     - LGEC licenses the components to Intel.
     - LGES licenses the systems to the end users.
   - Can a sale of components by LGEC exhaust the system patents owned by LGES?

Possible Strategies to Avoid the Effect of *Quanta*

4. Claim Drafting Alternatives – Option #1.
   - Draft combination claims and component claims such that there is a clear non-infringing use for the component.
     - Showing non-infringing uses would help against a finding of exhaustion.
   - E.g., drafting a dependent claim for the '731 patent that includes . . .
   - Not entirely clear from SCt language whether exhaustion requires both no NIU and no point of novelty, or just one of those two.

Claim Drafting Alternatives

1. A data processing system including one or more central processing units, main memory means, and bus means, for each central processing unit the invention comprising:
   - cache memory means coupled between the central processing unit and said bus means;
   - bus monitor means associated with said cache memory means and coupled to said bus means for detecting on said bus means an address associated with a data unit transferred from said main memory means to a bus connection requesting the data unit;
   - means coupled to said cache memory means and to said bus means for determining if data having the same address as said transferred data unit is present in said cache memory means and, if present, for asserting a hold signal on said bus means, the assertion of the hold signal indicating at least to the bus connection requesting the data unit that another data unit may be transmitted over said bus means; and
   - means for detecting whether data corresponding to the address of said transferred data unit and determined to be stored in said cache memory means may be different in content from said transferred data unit and, if so, transmitting said data from said cache memory means to said bus means for reception by the bus connection requesting the data unit; and
   - a mouse.

Possible Strategies to Avoid the Effect of *Quanta*

- Argument – the Intel chips can be used in a system that does not include a mouse; therefore there is no exhaustion as there are non-infringing uses.
- Supreme Court did not clarify the extent to which the sale of a component exhausts the combination.
- The test is whether the component sold "substantially embodies" the combination.
  - Non-infringing use test?
  - Point of novelty test?

Possible Strategies to Avoid the Effect of *Quanta*

- Issues:
  - Amendment to limit infringing uses reduces claim scope
  - Industry knowledge important
  - May not suffice if addition not “point of novelty”
  - May not suffice if other claim in same patent exhausted.

Possible Strategies to Avoid the Effect of *Quanta*

4. Claim Drafting Alternatives – Option #1.
   - Could be good to have many dependent claims with many non-essential features to avoid the component "substantially embodying" the combination.
     - But if the non-essential features are all routine, then there could be a problem.
     - Not clear that there is a claim-by-claim analysis, ie possible that exhaustion of a single claim exhausts "patent".
   - Also, the S. Ct. was against "clever drafting" of claims.

Possible Strategies to Avoid the Effect of *Quanta*

4. Claim Drafting Alternatives – Option #2.
   - Could break-up the essential feature of the patent into two parts (A & B) and the parts would need to be combined (A with a B).
     - A is licensed but B is not. LGE then licenses B to customers and end users.
     - The S. Ct. was against "clever drafting" of claims.

Possible Strategies to Avoid the Effect of *Quanta*

4. Claim Drafting Alternatives – Option #3.
   - Draft claims / specification to provoke a restriction of system claims.
     - Patent Office may opine on patentable distinction.
     - S. Ct. clear that exhaustion analyzed separately for separate patents.
     - Use of continuations / multiple applications risky because of potential double patenting rejection.

Possible Strategies to Avoid the Effect of *Quanta*

5. License v. Covenant-not-to-sue.
   - Is there a difference between a license and a covenant-not-to-sue under *Quanta*?
   - Can a covenant-not-to-sue create an authorized sale?
     - Component suppliers sometimes file DJ actions or intervene based on DJ jurisdiction in cases brought against customers.
     - Patentees sometimes covenant-not-to-sue a component supplier in order to remove DJ jurisdiction.

Post-*Quanta* Litigation Considerations

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Quanta Litigation

Patentee's arguments against claims of patent exhaustion:

- Licensed technology has some reasonable use that does not practice the patent.
- Licensed technology is not a material part of the patented system and therefore does not substantially embody the patent.
- The manufacture, sale or use was unauthorized or outside of the scope of or in violation of the license grant.

Quanta Litigation

Reasonable Use That Does Not Practice the Patent

- Practicing the patent vs. Infringement
  - Foreign sales
  - Replacement parts
- Patentee must be careful not to undermine any contributory infringement claims.

Quanta Litigation

Substantial Embodiment

- The Supreme Court discussed two conditions that demonstrate "substantial embodiment"
  - No reasonable non-infringing use
  - Including all inventive aspects of the patent

Quanta Litigation

Substantial Embodiment

- Is this a strict two-pronged test? Not clear whether exhaustion requires both conditions.
- Validity considerations – arguing that the inventive aspects (point of novelty) are not practiced by the licensee, but rather the downstream user requires close analysis of the prior art.

Quanta Litigation

Claim-by-Claim Analysis

- The *Quanta* case did not provide a claim by claim analysis. Does exhaustion of a single claim exhaust the entire patent?
  - The S.Ct. was clear that exhaustion analyzed separately for separate patents.
- Patent holder may want to carefully consider which claims to assert in litigation to avoid patent exhaustion.

Quanta Litigation

Unauthorized Manufacture, Use or Sale

- Requires contract interpretation.
- Careful drafting of licenses to create clear contractual obligations and limitations of the license grant may circumvent patent exhaustion defense.

Quanta Litigation

License vs. Covenant Not to Sue

- Is there a difference between a license and a covenant not to sue under *Quanta*?
- Can a covenant not to sue create an authorized sale?
  - Component suppliers sometimes file DJ actions or intervene based upon DJ jurisdiction in cases brought against customers.
  - Patentees sometimes covenant not to sue a component supplier in order to remove DJ jurisdiction.

Quanta Litigation

License vs. Covenant Not to Sue

- *Quanta* is written in terms of an authorized sale, not a licensed sale. Under the rationale of *Quanta*, a recipient of a covenant not to sue is probably authorized to sell products and such a sale is probably an authorized sale that would lead to exhaustion.

Quanta Litigation

Contract Provision for Conditional Sales

- Do conditional sales avoid patent exhaustion?
- *Mallinckrodt v. Medipart*, 976 F.2d 700 (Fed. Cir. 1992) -The Federal Circuit held that patent owners can avoid patent exhaustion by imposing express conditions in the license.
  - Patent misuse concerns
  - Antitrust concerns

Quanta Litigation

Invitation for Breach of Contract Claims

- "[T]he authorized nature of the sale to Quanta does not necessarily limit [the patentee]'s other contract rights. [The patentee]'s complaint does not include a breach-of-contract claim, and we express no opinion on whether contract damages might be available even though exhaustion operates to eliminate patent damages."

Quanta, 128 S.Ct. at 2122 n.7.

Quanta Litigation

Shift from Patent to Contract Litigation

- Contract law requires agreement and privity
  - Usually a lack of privity for downstream users
  - Licensee is unlikely to agree to be liable for improper downstream uses.
- Patent holders with lesser market power will have more difficulty controlling downstream uses.

Quanta Litigation

Contract Litigation

- Contract provisions could lessen damages available.
  - Stipulated damages provisions (may have an affect on reasonable royalty)
  - Arbitration provisions (including additional requirements for proof)
  - Choice of law provision
- Patent litigation typically results in stronger relief than contract litigation.

Quanta Litigation

Licensee's Potential Liability

- If a license agreement does not authorize downstream uses, potential liability for those uses needs to be considered by the licensee.
- Potential liability will likely drive contract negotiations regarding indemnities.

Post-*Quanta* Bio/Pharma Patent Exhaustion

- Part A: Patent "Exhaustion" Issues
  David v. Monsanto Supreme Court Test case
- Part B: Contractual and other Non-Patent Restrictions
- Part C: International Exhaustion

Harold C. Wegner

Quanta Bio/Pharma Exhaustion

Resources Cited:

Baluch:

Andrew Baluch, *Seed Exhaustion: Quanta's Effect on Biotech Patents,* IP Law 360 (July 7, 2008).

Maebius:

Stephen B. Maebius, *Biotech Transfers: From Bailing Mice To Selling Hybridomas*, 76 J. Pat. & Trademark Off. Soc'y 601, 613 (1994) (discussing bailment theory introduced by Walter N. Kirn, Jr., *The Use Of Common Law Bailments in Connection with the Licensing of Living Organisms*, 9 LIC.L. & BUS.REP. 97-108 (1986)).

Part A:

Patent “Exhaustion” Issues

Quanta Bio/Pharma Exhaustion

Self-Replication: Seeds and Bio Cultures

- When a self-replicating living invention is sold, does the purchaser have a right to reproduce that invention to make one – or thousands or more – copies?

Quanta Bio/Pharma Exhaustion

Patented seed produces a plant, seeds are harvested:

- Is the patent right exhausted as to the progeny seed ?

Individual microorganism is cultured to make multiple copies:

- Is patent right to the copies exhausted?

Quanta Bio/Pharma Exhaustion

Federal Circuit: No exhaustion

"The fact that a patented technology can replicate itself does not give a purchaser the right to use replicated copies of the technology. Applying the first sale doctrine to subsequent generations of self-replicating technology would eviscerate the rights of the patent holder."

Monsanto Co. v. Scruggs, 459 F.3d 1328, 1336 (Fed. Cir. 2006)(Mayer, J.); see also *Monsanto v. McFarling,* 302 F.3d 1291 (Fed.Cir.2002)(Newman, J.).

Quanta Bio/Pharma Exhaustion

May a farmer freely harvest, sell or replant progeny free from patent law restrictions if the patent covers the seeds, *per se*, or a method of growing the seeds?

"In response [to Justice Kennedy], counsel for patentee [ ] attempted to distinguish the right to *use* a product from the right to *make* a product, such that only the former can be exhausted. But Justice Kennedy quickly pointed out that the Supreme Court's prior *Univis* decision implicated the right to make a product: the sale of uncompleted lens blanks exhausted the patents on finished lenses made by retailers. →

Quanta Bio/Pharma Exhaustion

- Indeed, the *Quanta* opinion itself states that the exhaustion doctrine terminates 'all patent rights' over the product sold. One of those exclusionary patent rights is the right to *make* the product [under 35 USC § 154]." [Baluch]

Quanta Bio/Pharma Exhaustion

"The exhaustion doctrine, [per *amicus* American Seed Trade Association ("ASTA")], does not relinquish a patentee's rights in progeny seeds because progeny seeds are not the articles that were first sold. Quoting *Univis* [316 U.S. at 249], ASTA argued that an initial sale only exhausts rights to 'the article sold'—i.e., the original seed sold to a farmer—not the progeny seed that was later made by the article sold. →

Quanta Bio/Pharma Exhaustion

- In *Quanta*, the Supreme Court adopted similar language, stating that "the initial authorized sale of a patented item terminates all patents rights to *that item*.' [slip op. at 5, emphasis added]. Thus, according to ASTA, no exhaustion would arise over progeny seeds because the price charged for an original seed reflects the value of 'the article sold' (per *Univis*) or 'that item' (per *Quanta*), namely, the first-generation seeds. Exhausting rights in all successive generations of seeds, it is argued, would make the initial sale price prohibitively expensive for a farmer-purchaser." [Baluch]

Quanta Bio/Pharma Exhaustion

Should *Univis* be applied to seed exhaustion?

"[D]o first-generation seeds sold to farmers have 'any reasonable noninfringing use' besides being planted to grow crops in which the production of progeny seeds is inherent? Presumably, rather than being planted using a patented method, the first-generation seeds can used as food or feed. It can be debated, however, whether this a *reasonable* use of such seeds."

[Baluch] quoting *Quanta*, 128 S.Ct. at 2122.

Quanta Bio/Pharma Exhaustion

Quanta considers the "inventive" contributions:

"[Does] the first-generation seeds include 'all the inventive aspects of the patented methods'? In *Univis* and *Quanta*, the answer was 'yes' because the steps performed by the buyer were common and noninventive: grinding a lens to the customer's prescription, or connecting a microprocessor or chipset to buses or memory.-->

Quanta Bio/Pharma Exhaustion

- In the case of a patented method of growing crops, does the farmer perform any additional, inventive steps besides the (presumably standard) steps of watering and fertilizing the first-generation seeds? This again is a fact question that depends on what was sold and what was patented." [Baluch]

Quanta Bio/Pharma Exhaustion

Supreme Court Test Case

David v. Monsanto Co., Supreme Court No. 08A26, *proceedings below, Monsanto Co. v. David,* 516 F.3d 1009 (Fed. Cir. 2008)(Lourie, J.), challenging *Monsanto v. McFarling,* 302 F.3d 1291 (Fed.Cir.2002)(Newman, J.).

Quanta Bio/Pharma Exhaustion

David v. Monsanto:

- *Certiorari* Petition due September 11, 2008.
- *Certiorari* decision Late 2008.
- If *certiorari* is denied in this case, issue will remain open for a future case.

Part B:

Contractual and other Non-Patent Restrictions

Quanta Bio/Pharma Exhaustion

Quanta holding did *not* resort to contractual issues:

"The License … authorized Intel to sell products that practiced the [patents]. No conditions limited Intel's authority to sell products substantially embodying the patents. Because Intel was authorized to sell its products to Quanta, the doctrine of patent exhaustion prevents [the patentee] from further asserting its patent rights with respect to the patents substantially embodied by those products."

Quanta, 128 S.Ct. at 2122 (footnote omitted)

Quanta Bio/Pharma Exhaustion

An Open Door to Contract Issues

"[T]he authorized nature of the sale to Quanta does not necessarily limit [the patentee]'s other contract rights. [The patentee]'s complaint does not include a breach-of-contract claim, and we express no opinion on whether contract damages might be available even though exhaustion operates to eliminate patent damages."

Quanta, 128 S.Ct. at 2122 n.7.

Quanta Bio/Pharma Exhaustion

"Whether a patentee may protect himself … by special contracts brought home to the purchasers is not a question before us…. It is, however, obvious that such a question would arise as a question of contract, and not as one under the inherent meaning and effect of the patent laws."

Keeler v. Standard Folding Bed Co., 157 U.S. 659, 666 (1895), *quoted,* Quanta,128 S.Ct. at 2122 n.7.

Quanta Bio/Pharma Exhaustion

When do Contractual Proscriptions Trump Exhaustion?

- Is *Mallinckrodt v. Medipart* Good Law?
- *Mallinckrodt v. Medipart* was not Defended by the Patentee:

JUSTICE STEVENS: "Am I correct in understanding that you do not defend the *Mallinckrodt* decision?"

MR. PHILLIPS [FOR THE PATENTEE]: "I do not defend the *Mallinckrodt* decision, Justice Stevens…..

Bailment:
An Alternative to Licensing?

Quanta Bio/Pharma Exhaustion

"Bailment is and will continue to be a useful legal tool for transferring biological material. However, its application is limited by the doctrine of accession, which forces the putative bailor to prohibit commingling of bailed biological materials with other biological materials." [Maebius]

Quanta Bio/Pharma Exhaustion

"[B]ailment is best suited for biological materials which are fully developed products capable of commercial use in their existing form or for biological materials which will be transformed in a predictable way. On the other hand, joint ownership, sales, and conditional sales are useful alternatives for parties who intend to combine their biological materials and create new products." [Maebius]

Quanta Bio/Pharma Exhaustion

Biotechnology Beyond Seeds

"The debate, of course, is not limited only to seeds, but implicates any product that can make copies of itself: self-replicating cell lines, genetic material, and even software. It now remains for the next seed patent infringement case to reach the Federal Circuit and, possibly, the Supreme Court." [Baluch]

Part C:

International Exhaustion

Quanta Bio/Pharma Exhaustion

International Exhaustion Question:

Whether the patentee's sale of a patented product in Country "A" constitutes an exhaustion of patent rights whereby the patentee's purchaser may freely import and use that product in Country "B" even though the same patentee has a parallel patent in Country "B"?

Quanta Bio/Pharma Exhaustion

Federal Circuit: No Exhaustion

- *Jazz Photo Corp. v. International Trade Com'n,* 264 F.3d 1094,1105 (Fed. Cir. 2001)(Newman, J.)

Supreme Court: First Impression

- *Boesch v. Graff,* 133 U.S. 697, 701-03 (1890)(dictum)

Quanta Bio/Pharma Exhaustion

"To invoke the [patent exhaustion] protection of the first sale doctrine, the authorized first sale must have occurred under the United States patent."

Federal Circuit – *Jazz Photo*

Quanta Bio/Pharma Exhaustion

Holding of *Boesch v. Graff* has nothing to do with patent exhaustion:

- There was no German parallel patent right to be exhausted as the German manufacturer operated without a license and was not an infringer.

Quanta Bio/Pharma Exhaustion

- *Boesch* dealt with the right of a party to import and sell in the United States a U.S. patent-protected stove from Germany where there were parallel patents.

- German stove manufacturer was ***exempt*** from German patent infringement due to prior user right statute.

Thank you for your attention!

Questions?

"The List"

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