No. 06-937

In The
Supreme Court of the United States

QUANTA COMPUTER, INC., et al.,

Petitioners,

v.

LG ELECTRONICS, INC.,

Respondent.

On Writ Of Certiorari To The United States Court Of Appeals For The Federal Circuit

BRIEF FOR AMICUS CURIAE AMERICAN ANTITRUST INSTITUTE IN SUPPORT OF PETITIONERS

SHUBHA GHOSH
Professor of Law
SMU DEDMAN SCHOOL OF LAW
3315 Daniel Ave.
Dallas, Texas 75205
(214) 768-2598

ALBERT A. FOER
Counsel of Record
RICHARD M. BRUNELL
AMERICAN ANTITRUST INSTITUTE
2919 Ellicott St., N.W.
Washington, D.C. 20008
(202) 276-6002

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INTEREST OF AMICUS CURIAE

The American Antitrust Institute ("AAI") is an independent non-profit education, research, and advocacy organization. Its mission is to advance the role of competition in the economy, protect consumers, and sustain the vitality of the antitrust laws. The Advisory Board of AAI, which serves in a consultative capacity, consists of prominent antitrust lawyers, law professors, economists, and business leaders. *See* http://www.antitrustinstitute.org. AAI's Board of Directors has approved the filing of this brief because AAI believes that the first sale doctrine serves important procompetitive interests that are undermined by the Federal Circuit's narrow interpretation of the doctrine.[1]

SUMMARY OF ARGUMENT

For over a century and a half, the first sale doctrine (also known as the exhaustion doctrine) has provided certainty for users, manufacturers and other business entities in the distribution of goods and services protected by intellectual property law. Patent

[1] The written consents of all parties to the filing of this brief have been lodged with the Clerk. No counsel for a party has authored this brief in whole or in part, and no person or entity other than AAI or its counsel has made a monetary contribution to the preparation or submission of this brief. The individual views of members of the Advisory Board or Board of Directors may differ from the positions taken by AAI.

and copyright law grants to inventors and authors limited rights to control the distribution of the products of their creativity. However, the first sale doctrine creates a bright-line rule that ensures that purchasers of these works can further transfer these items to third parties without the interference of the original intellectual property owners. In this way, the first sale doctrine promotes an active and vibrant marketplace for works created through the benefit of patent and copyright and therefore is integral to the goals of innovation and competition that are at the foundation of the system of intellectual property rights. The doctrine of conditional sale, as articulated and applied by the United States Court of Appeals for the Federal Circuit, allows patent owners to circumvent the first sale doctrine and undermine its beneficial policies, and is inconsistent with this Court's precedent.

Given the intangibility and nonrivalrous characteristic of intellectual property rights, formal legal titling systems cannot readily be created to ensure that such works can be transferred without being at the sufferance of the original patent or copyright owner. The first sale doctrine serves the function of a formal legal titling system for intellectual property. Under the first sale doctrine, a patent or copyright owner exhausts her distribution right upon the first sale of the protected work thereby allowing subsequent purchasers to further transfer the work. The doctrine requires that the intellectual property owner obtain its consideration in the first sale (or license to sell), before allowing the distribution of a product embodying its intellectual property into the stream of commerce. In this way, it allows for active and vibrant markets for works of art, for novels, for movies, for innovative gadgets containing patented inventions, and for technology itself. The doctrine provides the legal foundation for primary markets, for secondary markets for rentals of these types of works, and for credit markets in which copyright and patents can serve as security interests. Absent the first sale doctrine, business people engaged in the buying and selling of works that are either directly protected by intellectual property or contain components protected by intellectual property may be required to compensate the original intellectual property owner whenever a transfer of interest in the work occurs. And purchasers of such works would always take title subject to the claims of the original intellectual property owner, perhaps unaware of such claims. Such actual or potential interference from the original creator would only serve to raise transaction costs and to create impediments to free and open markets.

Starting with its decision in *Mallinckrodt, Inc. v. Medipart, Inc.*, 976 F.2d 700 (Fed. Cir. 1992), the Federal Circuit has misconstrued this Court's precedent to permit a patent owner that "conditions" the sale of a patented invention to sue subsequent purchasers who violate the condition for patent infringement. The Federal Circuit's justification for the conditional sale doctrine rests on a misunderstanding of the relationship between the transfer of works protected by intellectual property rights and conditions attendant in contracts that accompany such a transfer. While purporting to rely on contract principles, the Federal Circuit has converted restrictions ancillary to the transfer of a patented invention from contractual rights, subject to the scrutiny under relevant contract, antitrust, and patent law, to intellectual property rights enforceable through a claim for patent infringement, with its attendant panoply of remedies and potential immunity from antitrust scrutiny. Because the Federal Circuit's conditional sale doctrine allows a patent owner to expand the reach of its patent grant and disrupt free and open markets, it should be reversed.

ARGUMENT

I. THE FIRST SALE DOCTRINE IS A LONG-ESTABLISHED PRINCIPLE OF INTELLECTUAL PROPERTY CONSISTENT WITH THE GOALS OF PROMOTING INNOVATION AND COMPETITION.

The grant of a patent to a useful, novel, and nonobvious invention is one step in the development of a free and competitive marketplace. The exclusive rights to make, use, sell, and offer to sell provided by 35 U.S.C. §154(a)(1) and enforced through 35 U.S.C. §271(a) allow the patent owner to distribute its patented invention and enter into transactions that permit dissemination of the protected product through a chain of manufacture and into the hands of many users. In this way, the existence of a patent is no different from the existence of any other legal rule that facilitates the working of a vibrant market. Like the rules of property, contract, tort, and sundry federal and state statutory schemes that protect consumers, investors, and manufacturers, patent law (and its cousin copyright law) sets ground rules for competition.

The first sale doctrine is one of the key elements of these ground rules. Under the first sale doctrine, once the invention is distributed through a lawful transaction, the invention passes into the hands of the purchaser, no longer subject to the exclusive rights of the patent owner. Like any other commodity, a patented invention enters into commerce and can be further distributed without the original seller encumbering and raising the costs of subsequent transactions. Put simply, the principle underlying the first sale doctrine is that the patent owner obtains one bite at the apple, so to speak, by permitting the owner to extract the commercial returns in the first sale of a patented invention and by preventing him from erecting a tollgate at each subsequent transaction.

A. The First Sale Doctrine Is Established By A Long Line Of This Court's Precedents.

The Court has recognized that the first sale doctrine is important for a functioning market shaped by patent law. The Court first articulated the broad contours of the doctrine in *Bloomer v. McQuewan*:

> The inventor might lawfully sell it to him, whether he had a patent or not, if no other patentee stood in his way. And when the machine passes to the hands of the purchaser, it is no longer within the limits of the monopoly. It passes outside of it, and is no longer under the protection of the act of Congress.

55 U.S. 539, 549 (1852).

In *Adams v. Burke*, 84 U.S. 453 (1873), the Court recognized the first sale doctrine as essential to the nature of transactions transferring patented inventions. In *Burke*, the Court was faced with a territorial use restriction on the manufacturer-assignee, who was not permitted to distribute patented coffin lids outside a ten-mile radius of the City of Boston. When a subsequent assignee of the patent owner sued an undertaker who had purchased the lids and removed them from the territory, the Court found that the first sale doctrine barred the claim. This out-of-territory purchaser, the Court reasoned, had "acquired the right to use that coffin for the purpose for which all coffins are used." *Id.* at 456. "[I]n the essential nature of things," the Court wrote, "when the patentee, or the person having his rights, sells a machine or instrument whose sole value is in its use, he receives the consideration for its use and he parts with the right to restrict that use." *Id.* The protected work passes "without the limit of the monopoly." *Id.*

What makes the doctrine "essential" is the way in which the patent owner collects his reward for producing and disseminating the invention. As the Court explained in *Burke*, "the patentee or his assignee having in the act of sale received all the royalty or consideration which he claims for the use of his invention in that particular machine or instrument, it is open to the use of the purchaser without further restriction on account of the monopoly of the patentees." *Id.* The first sale doctrine forces the patent owner to negotiate his consideration once and allows the purchaser to make the permitted use of the invention, including further dispositions, without further compensation owed to the patentee. Allowing the patentee to impose post-sale restrictions on use, the Court said, "would be to engraft a limitation upon the right of use not contemplated by the statute nor within the reason of the contract to say that it could only be used within the ten-miles circle." *Id.* In other words, the patentee cannot negotiate terms in the first sale transaction that would expand its rights under the Patent Act and that would be unreasonable under contract law.

Nine years ago, the Court affirmed the broad principle of the first sale doctrine in the copyright context by holding that the doctrine applied to the importation right granted to the copyright owner by the Copyright Act of 1976. The Court's decision in *Quality King Distributors, Inc. v. L'anza Research Inter. Inc.*, 523 U.S. 135 (1998), relied on a 1908 precedent to recognize the right of a legitimate, overseas purchaser of copyrighted materials to import copyrighted materials into the United States. According to the Court, this right was consistent with the statutory first sale doctrine codifying the Court's holding in *Bobbs-Merrill Co. v. Straus*, 210 U.S. 339 (1908).[2] As the Court held in *Bobbs-Merrill*, "It is not denied that one who has sold a copyrighted article, without restriction, has parted with all right to control the sale of it. The purchaser of a book, once sold by authority of the owner of the copyright, may sell it again, although he could not publish a new edition of it." *Id.* at 350 (quoted in *Quality King Distributors*, 523 U.S. at 141). Just as the copyright owner could not prevent the resale of lawfully purchased books, so the copyright owner could not prevent the importation of merchandise lawfully made under United States copyright law and purchased in the United States.

The first sale doctrine, in patent as well as copyright law, rests on a carefully constructed balance between property and contract rights. The

[2] This Court's holding in *Bobbs-Merrill*, which originated the first sale doctrine in copyright, is codified under the Copyright Act at 17 U.S.C. §109(a), and continues to be a keystone in copyright law. *See*, *e.g.*, *Vincent v. City Colleges of Chicago*, 485 F.3d 919 (7th Cir. 2007).

doctrine recognizes that transactions between patent or copyright owners and purchasers will be subject to a myriad of negotiated terms. In *Bobbs-Merrill,* for example, the Court applied the first sale doctrine to sales "without restriction." This qualifying language recognizes that the copyright or patent owner can impose *contractual* restrictions on the initial purchaser, including, presumably, clear limitations on the right of the initial purchaser to resell the intellectual property. In this way, for example, the owner can create a rental market for intellectual property analogous to rental markets for real or personal property. But as the Federal Circuit itself has acknowledged, "patented articles when sold 'become the private individual property of the purchasers, and are no longer specifically protected by the patent laws.' The fact that an article is patented gives the purchaser neither more nor less rights of use and disposition." *Jazz Photo Corp. v. International Trade Comm'n*, 264 F.3d 1094, 1102 (Fed. Cir. 2001) (quoting *Mitchell v. Hawley*, 83 U.S. 544, 548 (1873)). In other words, limitations imposed in the sale of a patented invention are a matter of contract law, not patent law. The first sale doctrine lets a purchaser of a patent-protected work and all subsequent parties in the chain of distribution know that the work has been transferred free of any *patent* claims of the original owner on the use or disposition of the work, although not necessarily of *contract* claims.

The early case of *Bloomer v. McQuewan* established this important balance between property and contract in the first sale doctrine. There, the Court said that upon the sale of a patented invention, "if [the patentee's] right to the implement or machine is infringed, he must seek redress in the courts of the State, according to the laws of the State, and not in the courts of the United States, nor under the law of Congress granting the patent. . . . Contracts in relation to it are regulated by the laws of the State, and are subject to State jurisdiction." 55 U.S. at 549-50.

B. The First Sale Doctrine Promotes The Stability Of Contracts And Development Of Markets, And Complements Antitrust Law.

The first sale doctrine should not be understood as a limitation on rights, but as an essential legal doctrine for the construction of competitive markets driven by intellectual property. There are many ways in which the first sale doctrine promotes competition. By permitting unencumbered resale, the first sale doctrine permits competition through the creation of rental markets and markets for second-hand products. Manufacturers at various stages of a production chain can negotiate without fear of interference from patent owners who have obtained their reward through the first negotiation. Creditors can assess the business assets and contracts of business entities and determine appropriate valuation for the purposes of secured or unsecured lending.

Academic commentary supports the role of the first sale doctrine in maintaining the health and dynamism of competitive markets. *See*, *e.g.*, Mark R. Patterson, *Contractual Expansion of the Scope of Patent Infringement Through Field-of-Use Licensing*, 49 Wm. & Mary L. Rev. 157, 209-11 (2007) (criticizing application of conditional sale doctrine to field-of-use restrictions enforced against downstream purchasers); R. Anthony Reese, *The First Sale Doctrine in the Era of Digital Networks*, 44 B.C. L. Rev. 577 (2003) (identifying the role of the first sale doctrine in promoting dissemination of works in the marketplace); Richard H. Stern, *The Unobserved Demise of the Exhaustion Doctrine in US Patent Law*, 15 Eur. Intell. Prop. L. Rev. 460, 465 (1993) (criticizing Federal Circuit's *Mallinckrodt* decision "as a remarkable change in the law, which may have remarkable consequences"). The scholarly commentary dovetails with the interests of industry in having predictable and stable business relationships that promote competitive markets.

The fact that the first sale doctrine has been held not to apply to restrictions imposed on a manufacturing licensee, *see United States v. Gen. Elec. Co.*, 272 U.S. 476 (1926) (resale price restriction); *General Talking Pictures Corp. v. Western Elec. Co.*, 305 U.S. 124 (1938) (field of use restriction), does not undercut the significance of the doctrine. Such an exception has been explained by the fact that a manufacturing licensee is equivalent to the patentee who can, of course, impose resale restrictions on itself. *See* Patterson, *supra*, at 165 ("manufacturing licensees in effect stand in the shoes of the patentee, and imposing restrictions on them can reasonably be treated as economically equivalent to individual decisions by the patentee itself"). Purchasers who buy from the manufacturing licensee in knowing violation of the restriction *on the licensee* (i.e., who make unauthorized purchases) may be held liable for patent infringement, but, as Professor Patterson points out, "the Supreme Court has never upheld the use of a patent infringement action to enforce license restrictions on the ultimate purchasers of patented products." *Id.* Allowing infringement suits against knowing unauthorized purchasers of a manufacturing licensee is a relatively narrow and explicable exception to the first sale doctrine and hardly justifies abrogating its much broader application to commerce in general. Nor is the doctrine undercut by the fact that it only applies to sales, and not to licenses without the incidents of a sale (although the distinction may be difficult to make in some cases) because without the incidents of a sale the issue of free transferability of property embodying patented inventions does not arise.

This Court's decision in *United States v. Univis Lens Co.*, 316 U.S. 241 (1942) illustrates how the first sale doctrine complements the antitrust treatment of use restrictions. At issue in *Univis Lens* was an alleged antitrust violation arising from resale restrictions imposed by a manufacturer patentee. The manufacturer argued under the rule of *General Electric* it was engaged in a licensing transaction that allowed it to impose the resale restrictions. The Court found that the transactions was a sale, and not a license, and therefore was outside the scope of the patent monopoly. The Court reasoned:

> [W]here one has sold an uncompleted article which, because it embodies essential features of his patented invention, is within the protection of his patent, and has destined the article to be finished by the purchaser in conformity to the patent, he has sold his invention so far as it is or may be embodied in that particular article. The reward he has demanded and received is for the article and the invention which it embodies and which his vendee is to practice upon it. He has thus parted with his right to assert the patent monopoly with respect to it and is no longer free to control the price at which it may be sold either in its unfinished or finished form.

Id. at 250-51.

In short, the first sale doctrine made the legal issue a pure question of how the contractual restriction would be treated under antitrust law. After *Leegin Creative Products, Inc. v. PSKS, Inc.*, 127 S. Ct. 2705 (2007), a restriction like the one at issue in *Univis* would be subject to the rule of reason and, as in *Univis*, patent law would be irrelevant to the antitrust analysis because the patent rights would have been exhausted.

C. The Transaction At Issue In This Case Is Subject To The First Sale Doctrine.

In the case at bar, respondent's licensee, to quote the language from *Univis Lens*, has sold an article that "embodies essential features" of the patented invention and "has destined the article to be finished by the purchaser in conformity to the patent." Respondent acquired a large patent portfolio of technologies used in the manufacture of computer chips. After a dispute with Intel, the chip manufacturer, respondent entered into a complex licensing agreement with Intel that allowed Intel to use the technology in the construction and sale of chips. These chips in turn were sold to petitioners and incorporated as components in computer hardware systems. Now, respondent seeks to enforce its patent rights against the petitioners based on their alleged violation of "conditions" placed on the original agreement with Intel.[3]

[3] The LG-Intel license agreement contained a proviso that no license was granted to any third party to combine the chips with non-Intel products, and that Intel was required to and did provide notice of this limitation to petitioners. *See LG Electronics, Inc. v. Bizcom Electronics, Inc.,* 453 F.3d 1364, 1368 (Fed. Cir. 2006). But the license agreement also stipulated that it would not "limit or alter the effect of patent exhaustion that otherwise would apply when" the chips were sold, the notice received by petitioners was apparently sent after many of the sales had already occurred, and the chips had no other reasonable use. *See* Brief for Petitioners 2, 8-9.

The first sale doctrine was designed to prohibit precisely this type of reach-through by the patent owner to enforce its patent rights. Under this Court's precedents, once the petitioners purchased products embodying essential features of the patented invention in an authorized sale, respondent's patent rights were exhausted. If the conditions placed in the license with Intel are consistent with contract law, antitrust law, and the patent misuse doctrine, then any violations can be enforced against Intel as contract claims (or possibly against the petitioners as third party contract claims), rather than patent infringement claims with the attendant remedies of injunctive relief, treble damages, and attorneys' fees. Such a result is consistent with the need for certainty and competitiveness of not only this market transaction, but also the wide ranges of market transactions that rest on intellectual property.[4]

[4] In *eBay Inc. v. Mercexchange, L.L.C.*, 126 S. Ct. 1837 (2006), a plurality of the Court was concerned about the development of an industry "in which firms use patents not as a basis for producing and selling goods but, instead, primarily for obtaining licensing fees", and the potentially harmful effects of injunctive relief "[w]hen the patented invention is but a small component of the product the companies seek to produce . . . . " *Id.* at 1842 (Kennedy, J., concurring). The first sale doctrine plays a role in preventing similar market disruption, as here, when a non-manufacturing patentee seeks to control the manufacture of end products in which the patented item is but a small component.

II. THE CONDITIONAL SALE DOCTRINE IS INCONSISTENT WITH THIS COURT'S PRECEDENT AND THE POLICIES OF THE FIRST SALE DOCTRINE.

The Federal Circuit's ruling in favor of respondent rests on an application of the "conditional sale doctrine," a rule created by the Federal Circuit that all but eliminates the first sale doctrine. The conditional sale doctrine, however, is based on a faulty reading of this Court's precedent. Although this Court has stated an unconditional sale is sufficient for the invocation of the first sale doctrine in a patent infringement suit, the Federal Circuit has inferred that a conditional sale is sufficient to eliminate the first sale doctrine as a defense. This inference does not logically follow from the case law and, more critically, contradicts the role of the first sale doctrine in ensuring the certainty of transactions and the competitiveness of markets.

A. The Federal Circuit's Conditional Sale Doctrine Eviscerates The First Sale Doctrine.

The conditional sale doctrine was first articulated by the Federal Circuit in *Mallinckrodt v. Medipart*, 976 F.2d 700 (Fed. Cir. 1992). That case dealt with a limitation imposed by the patent owner on reuse of a patented medical device sold to hospitals. The hospitals distributed the used devices to the defendant who refurbished them and sold them back to the hospitals for reuse. Mallinckrodt, the patent owner, sued the refurbisher for inducing patent infringement by allowing the hospital to violate the restriction on reuse. The district court dismissed the claim, holding that the restriction on reuse constituted patent misuse and that the refurbishment constituted a non-infringing repair. The Federal Circuit reversed, holding that the restriction was not patent misuse and reversed the grant of summary judgment in favor of the refurbisher.[5]

In finding for the patent owner in *Mallinckrodt,* the Federal Circuit concluded that "[i]f the sale . . . was validly conditioned under the applicable law such as the law governing sales and licenses, and if the restriction on reuse was within the scope of the patent grant or otherwise justified, then violation of the restriction may be remedied by action for patent infringement." *Id.* at 709. The Federal Circuit considered this Court's precedent on the first sale doctrine but concluded that

[5] The patent holder advanced the kind of justification (product safety and product liability risks) that may have provided a basis for a valid post-sale restraint under contract and antitrust law. Indeed, the Federal Circuit referred to the decisions in *Continental T.V., Inc. v. GTE Sylvania, Inc*., 433 U.S. 36 (1977) and *Tripoli Co. v. Wella Corp.,* 425 F.2d 932 (3rd Cir. 1970) (en banc), to justify its conclusion that the imposition of such a restraint was not patent misuse and should be lawful. *See Mallinckrodt*, 976 F.2d at 706-08. But the court erred in reasoning that because the patentee may not be liable under antitrust law, it therefore was entitled to sue for patent infringement. Moreover, the conditional sale test it adopted undermines proper antitrust analysis, as discussed *infra*.

> *Adams v. Burke* and its kindred cases do not stand for the proposition that no restriction or condition may be placed upon the sale of a patented article. It was error for the district court to derive that proposition from the precedent. Unless the condition violates some other law or policy (in the patent field, notably the misuse or antitrust law, *e.g.*, *United States v. Univis Lens Co.*, 316 U.S. 241 (1942)), private parties retain the freedom to contract concerning conditions of sale.

Id. at 708.

Five years later, the Federal Circuit reviewed use restrictions once again in *B. Braun Medical, Inc. v. Abbott Laboratories*, 124 F.3d 1419 (Fed. Cir. 1997), in which the patent owner was seeking to enforce a use restriction against a purchaser through a patent infringement claim. In its decision for the patent owner, the Federal Circuit explicitly stated that a conditional sale is not subject to the first sale doctrine.

> As a general matter, we explained [in *Mallinckrodt*] that an unconditional sale of a patented device exhausts the patentee's right to control the purchaser's use of the device thereafter. The theory behind this rule is that in such a transaction, the patentee has bargained for, and received, an amount equal to the full value of the goods. This exhaustion doctrine, however, does not apply to an expressly conditional sale or license. In such a transaction, it is more reasonable to infer

> that the parties negotiated a price that reflects only the value of the "use" rights conferred by the patentee. As a result, express conditions accompanying the sale or license of a patented product are generally upheld.

Id. at 1426 (internal citations omitted). The validity of use restrictions are judged, according to the Federal Circuit, under "antitrust, patent, contract, and any other applicable law, as well as equitable considerations such as patent misuse," and violations of valid conditions are remedied by either a claim for patent infringement or for contract breach. *Id.* The Federal Circuit stated in *Braun* that this general framework applied to all use restrictions and reversed the district court for issuing jury instructions that restrictions on resale were *per se* patent misuse.

In this case, the Federal Circuit applied the general framework developed in *Mallinckrodt* and refined in *Braun* to a use restriction enforced as a patent infringement claim against a third party purchaser. *LG Electronics, Inc. v. Bizcom Electronics, Inc.*, 453 F.3d 1364 (Fed. Cir. 2006). While in both *Mallinckrodt* and *Braun* the patent owner was enforcing its patent rights against the direct purchaser (either through an action for inducement, as in *Mallinckrodt*, or a direct claim, as in *Braun*), in this case the patent owner was reaching through to purchasers from Intel, the direct licensee of the patented invention, to enforce a condition that LG requested Intel to impose on petitioners. The Federal Circuit concluded that this condition was enforceable against the purchasers from

Intel because the "exhaustion doctrine . . . does not apply to an expressly conditional sale or license," citing *Braun*. *Id.* at 1369-70. Within the general framework established in *Braun*, if the use restriction was not invalid under applicable law or under equitable principles like misuse, it was enforceable as patent infringement.

B. The Federal Circuit's Reasoning Is Faulty.

The development of the conditional sale doctrine from *Mallinckrodt* to *LG Electronics* illustrates the expanding reach of the patent owner to enjoin the activities of companies in the downstream manufacturing chain as patent infringement. Once it is recognized that a patent owner can condition a transfer of patented technology and that this condition prevents the exhaustion of the patent owner's rights, then the patent owner logically has the ability to bring patent infringement claims against anyone who takes from the first purchaser and violates the contractual condition. However, under this Court's precedents, the patent owner cannot "engraft" rights onto the scope of its patent grant through reasonable contract terms. While some of the Court's precedents do speak in terms of unconditional sales, there is no suggestion that a conditional sale would abrogate the first sale doctrine.[6] The Court's precedents recognize the rights of the patent owner and purchasers to engage in contractual bargaining and to include terms on the use of the patented invention as part of the bargain. But the Federal Circuit reads from this freedom of contracting, a right of the patent owner to expand the scope of its *patent rights* to limit the activities of downstream purchasers and users. It is this conclusion, and its potential disruptive effects on commerce, that this Court should correct.[7]

[6] Indeed, some of early precedents involved sales that were subject to conditions in the sense that the Federal Circuit uses the term. *See* Patterson, *supra*, at 168 & n.54. *Mitchell v. Hawley*, 83 U.S. 544 (1873), does not support the conditional sale doctrine. The Court in *Hawley* affirmed the principle articulated later in the same year by *Burke* that "when [patentees] have made one or more of the things patented, and have vended the same to others to be used, they have parted to that extent with their exclusive right, as they are never entitled to but one royalty for a patented machine . . . ." *Hawley,* 83 U.S. at 546. At issue was the right of a purchaser/licensee of a patented machine to continue using the machine when the original patent term was extended. The conclusion that the purchaser had to renegotiate the right to continue using the patented machine followed from the narrow contractual rights that had passed to the manufacturer. The Court in *Hawley* was not abrogating or limiting the first sale doctrine in any way but rather was acknowledging the power of the patent owner and the manufacturer to define what constitutes an authorized sale.

[7] The Federal Circuit also affirmed the district court's holding that the exhaustion doctrine does not apply to method claims, relying on *Bandag, Inc. v. Al Bolser's Tire Stores, Inc*. 750 F.2d 903 (Fed. Cir. 1984) and *Glass Equip. Dev., Inc. v. Besten, Inc.,* 174 F.3d 1337 (Fed. Cir. 1999). This ruling is

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C. The Conditional Sale Doctrine Conflicts With The Procompetitive Policies Of The First Sale Doctrine.

While the Federal Circuit's own precedents acknowledge the first sale doctrine,[8] the conditional sale doctrine creates a loophole that allows a patent owner to prevent its patent rights from becoming exhausted. Under the terms of the conditional sale doctrine, a patent owner can avoid the implications of the first sale doctrine by imposing a condition in the transfer of a patented invention for consideration, such as "Do not use on Sunday." As the patented invention is further transferred through the stream of commerce, any subsequent purchaser will take subject to the condition. If a subsequent purchaser does use the invention on a Sunday, the original patent owner has a suit for patent infringement against the purchaser, with the possible remedies of a permanent injunction, treble damages, and attorneys' fees. And this threat of potential liability for patent infringement would provide the basis for the patent owner to

erroneous. These two cases are best read as dealing with the issue of implied license, rather than the doctrine of exhaustion.

[8] *See, e.g., Jazz Photo Corp. v. International Trade Comm'n*, 264 F.3d 1105 (Fed. Cir. 2001) ("[T]he unrestricted sale of a patented article, by or with the authority of the patentee, 'exhausts' the patentee's right to control further sale and use of that article by enforcing the patent under which it was first sold."); *Intel Corp. v. ULSI Sys. Tech., Inc.*, 995 F.2d 1566, 1568 (Fed. Cir. 1993) ("The law is well settled that an authorized sale of a patented product places that product beyond the reach of the patent.").

renegotiate the restriction with each subsequent purchaser for additional consideration. Under the application of the first sale doctrine, however, the patent owner would have at best a contract claim for violation of the condition by the first purchaser, with a remedy generally limited to actual damages, and no claims against subsequent purchasers with whom there was no privity of contract or a third-party contractual relationship, and the restriction could be challenged as an antitrust violation like any vertical restraint engaged in by the seller of a nonpatented product.

The conditional sale doctrine plainly creates uncertainty for downstream purchasers and users, which the first sale doctrine is designed to avoid. The Federal Circuit relies on commercial law principles to allow sales to be conditioned, but its application of those principles seemingly would allow sales to be conditioned *after* the original purchase. *See* Patterson, *supra*, at 148 (citing cases). For example, in this case, the Federal Circuit relies upon U.C.C. §2-202, which the Court reads to allow contracts "to be supplemented by consistent additional terms unless the writing is intended to be complete and exclusive," to explain how the patent owner can condition the first sale. *LG Electronics*, 453 F.3d at 1370. This implies that the patent owner has the power to add conditions anytime after the first sale simply by providing notice. Admittedly, the Federal Circuit does find some limitation on the power to condition if the purchaser objects to the conditions within a reasonable time. *See Mallinckrodt*, 976 F.2d at 708 n.7 ("a license notice may become a term of sale, even if not part of the original transaction, if not objected to within a reasonable time") (citing U.C.C. §2-207(2)(c)). But even with such a limitation, this power to amend the terms of sales adds considerable uncertainty to transactions among downstream purchasers. *See* Patterson, *supra* at 185-90 (criticizing courts' contract analysis). Moreover, as petitioners and others have pointed out, infringement actions may be brought against downstream purchasers even without notice of the conditions, as property theory allows. *See* Brief for Petitioners 48; Patterson, *supra*, at 209 ("U.S. courts take the view, derived from the Federal Circuit, that when a use restriction is violated, no valid license of the patent right exists. Consequently, the infringement suit against the downstream purchaser is equivalent to one against the purchaser of an illegally manufactured product, and knowledge of infringement is not central to patent law.").

The effect of the conditional sales doctrine on competitive markets is even more troubling in light of the Federal Circuit's unduly solicitous treatment of patent rights under antitrust law, and the prospect that the conditional sale doctrine may effectively immunize restraints from antitrust scrutiny. To be sure, the Federal Circuit has suggested that conditions in sale transactions are subject to review under antitrust (and other applicable law). In reviewing these conditions, the Federal Circuit stated, "The appropriate criterion is whether [the] restriction is reasonably within the patent grant, or whether the patentee has ventured beyond the patent grant and into behavior having an anticompetitive effect not justifiable under the rule of reason." *Mallinckrodt,* 976 F.2d at 708. However, asking whether a condition is "reasonably within the patent grant" is not the same question as asking whether a restraint outside the patent grant (because of exhaustion) violates the antitrust laws. *See id.* (whether restriction is reasonably within the patent grant depends on whether "it relates to subject matter within the scope of the patent claims"); Patterson, *supra*, at 170 (test under *Mallinkrodt* has come to "mean that the defendant's activity in some way involves the patented invention" which "effectively removes any limitations on field-of-use licensing"). In general, the Federal Circuit has taken an expansive view of what conduct is within the patent grant even when it has potential anticompetitive effects. *See*, *e.g.*, *In re Independent Service Organizations Antitrust Litigation*, 203 F.3d 1322, 1327-28 (Fed. Cir. 2000) (holding that "even though his refusal to sell or license his patented invention may have an anticompetitive effect," it is within the patent grant and immune from antitrust liability "[i]n the absence of any indication of illegal tying, fraud in the Patent and Trademark Office, or sham litigation"). Moreover, the Federal Circuit has taken the position that patent rights have special protection under antitrust law. Thus, for example, the Federal Circuit has stated, "Determination of whether the patentee meets the Sherman Act elements of monopolization or attempt to monopolize is governed by the rules of application of the antitrust laws to market participants, with due consideration to the exclusivity that inheres in the patent grant." *Abbott Laboratories v. Brennan*, 952 F.2d 1346, 1354-55 (Fed. Cir. 1991). This "due consideration" means that once it is determined that conduct is "within the patent grant" under the conditional sale doctrine, the patent owner's exclusivity is given significant (if not dispositive) weight. In contrast, as noted above, if the patentee has exhausted its patent rights under the first sale doctrine, restrictions on downstream use are analyzed under ordinary antitrust principles.[9]

[9] We note that use restrictions can provide a contractual means to supplement intellectual property of certain readily appropriated technologies that involve sales, without the necessity of altering the first use doctrine. For example, in cases such as the Federal Circuit's decision in *Monsanto Co. v. Scruggs*, 459 F.3d 1328 (Fed. Cir. 2006), which dealt with genetically modified seeds, a technology that is self-replicating and therefore readily misappropriated (like software), reasonable contractual restrictions consistent with patent law may be necessary. The policy issues raised by the specific technology in *Scruggs* do not, however, affect our arguments against the conditional sale doctrine. For a discussion of contractual restrictions in agribusiness, see Peter Carstensen, *Post-Sale Restraints via Patent Licensing: A "Seedcentric" Perspective*, 16 Fordham Intell. Prop. Media & Ent. L. J. 1053 (2006) (analyzing post-sale restrictions in agri-business to prevent self-replication) and Patterson, *supra*, at 213-25 (identifying potential use of use restrictions to limit free riding on self-replicating products). Reasonable restrictions on the use of self-replicating technologies, such as seeds or software, should be recognized as a legitimate use of contract to enforce intellectual property rights that do not give

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Finally, by turning a matter of contract and commercial law into an issue of patent infringement, the Federal Circuit has expanded its own jurisdiction over patent claims to federalize commercial and contract law. This intrusion of the Federal Circuit's jurisdiction into ordinary business transactions not only adds to the uncertainty of contractual negotiations involving technology, but also arguably expands the reach of the court's jurisdiction beyond the intent of Congress. *See Holmes Group, Inc. v. Vornado Air Circulation Systems, Inc.*, 535 U.S. 826, 829 (2002) ("[T]he Federal Circuit's jurisdiction is fixed with reference to that of the district court, and turns on whether the action arises under federal patent law.").

CONCLUSION

This case arrives before the Court in the line of recent cases in which the Court has corrected overexpansive readings of patent rights by the Federal Circuit that impair competition and innovation. *See, e.g., eBay Inc. v. Mercexchange, L.L.C.*, 126 S. Ct. 1837 (2006); *KSR International Co. v. Teleflex Inc.*, 127 S. Ct. 1727 (2007). The Court's recent patent jurisprudence has been important for lower courts in shaping their scrutiny of substantive patent law and

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rise to patent infringement claims if violated. If, in some contexts, contractual restrictions prove to be infeasible, it should be up to Congress to define appropriate exceptions to the well-settled first use doctrine. *See id.* at 224-25.

remedies. *See*, *e.g.*, *z4 Technologies, Inc. v. Microsoft Corp.*, 434 F. Supp. 2d 437 (E.D. Tex. 2006). In reviewing the Federal Circuit's conditional sale doctrine, this Court has the opportunity to continue correcting the expansive direction of patent law. By limiting a doctrine as fundamental as the first sale doctrine, the conditional sale doctrine allows a patent owner to upset a delicate balance between property and contract rights by allowing a patent owner to bring patent infringement actions against potentially anyone in the chain of manufacture and distribution. We urge the Court to restore the balance provided through the first sale doctrine by reversing the judgment of the court of appeals and abrogating the conditional sale doctrine.

Respectfully submitted,

Shubha Ghosh
Professor of Law
SMU Dedman School of Law
3315 Daniel Ave.
Dallas, Texas 75205
(214) 768-2598

Albert A. Foer
Counsel of Record
Richard M. Brunell
American Antitrust Institute
2919 Ellicott St., N.W.
Washington, D.C. 20008
(202) 276-6002