

## Patent Exhaustion and Licensing Strategies

Leveraging Recent Decisions for Structuring Patent Licenses and Resolving Litigation

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Today's faculty features:

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# Patent Exhaustion and Licensing Strategies

Strafford CLE Webinar  
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# Context

- Supreme Court's continued skepticism regarding the Federal Circuit
  - Extends to PTO; Justice Kagan comments that the Office is "patent-happy"
  - Practical effect: no precedent relevant to the Court except its own
  - Continued evident disdain for patent law minutiae (aka the law itself)



# Themes

- Supreme Court's continued search for the right "balance"
- Court seemingly convinced the patents can harm innovation
- But also convinced patents can promote innovation
- Little apparent appreciation (even among the more conservative Justices) that patents relevant not to innovation but to commercialization



# “Goldilocks” Patent Law



- “As we have recognized before, patent protection *strikes a delicate balance* between creating ‘incentives that lead to creation, invention, and discovery’ and ‘imped[ing] the flow of information that might permit, indeed spur, invention,’ *Myriad*, citing *Mayo v. Prometheus*
- “Patent protection is, after all, *a two-edged sword*. On the one hand, the promise of exclusive rights provides monetary incentives that lead to creation, invention, and discovery. On the other hand, that very exclusivity can impede the flow of information that might permit, indeed spur, invention, by, for example, raising the price of using the patented ideas once created, requiring potential users to conduct costly and time-consuming searches of existing patents and pending patent applications, and requiring the negotiation of complex licensing arrangements.” *Mayo v. Prometheus*

# Patent Exhaustion

- Well-established concept in patent law, recently given new life by US Supreme Court
- 19<sup>th</sup> Century cases:
  - *Adams v. Burke* (1873): exhaustion throughout US despite limited geographical license
  - *Bloomer v. McQuewan* (1853): patent term extension irrelevant to use by prior purchasers
  - *Morgan Envelope v. Albany Perforated Wrapping* (1894): sale of fixture exhausted patent on unpatented toilet paper rolls
- 20<sup>th</sup> century cases
  - *U.S. v. Univis Lens* (1942): sale of patented article exhausts patent rights on use for any item that “substantially embodies” the patented invention

# Patent Exhaustion

- Supreme Court concerned with patent exhaustion
  - *Quanta Computer v. LG Electronics* (2008)
- Intel made computer chips under a license from LG, separate master agreement required Intel to tell its customers (Quanta) that the license did not extend to combining the licensed chips could with non-Intel components
- Exhaustion arises with the sale of a product that “substantially embodies” the claimed invention, sale also exhausts related methods
- Consistent with exhausting the “reasonable and intended use” of the invention



# Patent Exhaustion

- *Quanta* standard more stringent than Federal Circuit's "conditioned sales" standard in *Mallinckrodt v. Medipart* case (which permits patentees to condition sale of patented articles)
- Patent exhaustion principle applies to method claims as well as product claims
- Under *Quanta*, a patentee has no right to condition sale on uses of the patented article once there has been an authorized (and typically compensated) "first sale"

# Patent Exhaustion

- *Quanta* reinvigorates patent exhaustion doctrine, consistent with this Court's traditional antipathy to patents
- Applied *Univis* standard: a three-part test
  - the product sold does not have any reasonable noninfringing use,
  - the product sold substantially embodies the essential features of the patented invention, and
  - there is an authorized, unconditional sale of the patented invention.
- Different from situation where sale of an article is accompanied by a license to method claims for particular uses (PCR)

# Recent Federal Circuit Cases

- *Transcore v. Electronic Transaction Consultants* (Fed. Cir. 2009)
  - Patented invention: automated toll collection systems
  - Purchased from a third party who settled earlier patent infringement litigation with patentee
  - Covenant not to sue, no license
- Question: whether an unconditional covenant not to sue authorizes sales by the covenantee for purposes of patent exhaustion
- Answer: yes, a covenant not to sue is equivalent to a non-exclusive patent license

# Recent Federal Circuit Cases

- *Keurig v. Sturm Foods* (Fed. Cir. 2013)
  - Patented invention: single serving coffee makers
  - Accused infringing article: beverage cartridges
  - Claims: method claims for making beverages using single serving cartridges with machine
- Affirmed district court grant of summary judgment that sale of the coffee maker exhausted rights to the method using the unpatented beverage cartridge

# *Keurig v. Sturm Foods* (Fed. Cir. 2013)

- “The [*Quanta*] Court thus established that method claims are exhausted by an authorized sale of an item that substantially embodies the method if the item (1) has no reasonable noninfringing use and (2) includes all inventive aspects of the claimed method.
- Unconditioned sale of coffee maker relevant, suggesting notice might change result
- On point with *Morgan Envelope* rationale and Court’s concerns with tying unpatented article sales

# *Keurig v. Sturm Foods* (Fed. Cir. 2013)

- Keurig put in evidence of substantial non-infringing use:
  - The brewers could be used with reusable cartridges having premade holes. The method claims require that the cartridge be pierced, and reusable cartridges with premade hole do not meet that limitation
- Court notes this fact but ignores the factor in the analysis

# Recent Federal Circuit Cases

- *Lifescan Scotland v. Shasta Technologies* (Fed. Cir. 2013)
  - Patented invention: blood glucose monitors
  - Accused infringing article: test strips
  - Claims: method claims for improved blood glucose detection using three-electrode strips
- Appeal of preliminary injunction reversed based on patent exhaustion defense defeating “reasonable expectation of success” requirement
- Vigorous dissent by Judge Reyna

## *Lifescan v. Shasta Technologies (Fed. Cir. 2013)*

- Majority find the “invention” embodied in the blood glucose meter, not in the strips (which are not patented)
- Lifescan sold 40% of meters and gave away 60% (profits on sale of the strips)
- Majority find sale is not the requirement, transfer of title sufficient to trigger exhaustion
- Consequently, what was transferred “substantially embodied” the invention
- “Inventive concept” language in opinion

## *Lifescan v. Shasta Technologies (Fed. Cir. 2013)*

- No “substantial non-infringing use” for the meters, and even if there were such use was not “intended” by the patentee
- Majority expressly concerned with tying, citing *Motion Picture Patents Co. v. Universal Film Mfg. Co.* (“unlawful [] to derive [] profit from the unpatented supplies with which the [patented product] is used”).
- Equitable subtext: Lifescan unable to obtain a patent on test strips

# *Bowman v. Monsanto*

- Latest in a series of cases involving recombinant soybeans (RoundUp® Ready seed)
- Soybeans carry a recombinant gene making them resistant to RoundUp® herbicide
- Permits plantings with greater yield due to effective use of RoundUp® herbicide without reduced soybean growth
- Sales accompanied by Technology License where farmers agree not to replant seed from planting from purchased seeds
- Several patent cases won by Monsanto vs. farmers



# *Bowman v. Monsanto*

- In *Bowman*, different facts: replanted seeds not directly used from planting from purchased seeds but rather from “commodity” seed sold to grain elevator
- No privity between original seller, grain elevator operator and infringing Farmer *Bowman* so only patent remedy
- District court found infringement in part based on Federal Circuit “conditioned sales” doctrine (opinion prior to *Quanta*)
- Federal Circuit affirmed, based on “repair” vs. “reconstruction” distinction

# “Repair” vs. “Reconstruction”

- Several cases (*Aro Mfg.*) make the distinction: while it is permissible to repair a patented article once it has been purchased, cannot “reconstruct” the article into a new article
- Federal Circuit based its decision in part on argument that the commodity seeds planted by Farmer Bowman were never the subject of an authorized sale
- Distinguished between “making” and “using” seed as distinct activities: while soybeans could be “used” in a non-infringing way (tofu), replanting was a “making” that constituted infringement

# Bowman v. Monsanto

- Solicitor General advised Supreme Court not to grant *certiorari*; they did
- Question Presented:

*Patent exhaustion delimits rights of patent holders by eliminating the right to control or prohibit use of the invention after an authorized sale. In this case, the Federal Circuit refused to find exhaustion where a farmer used seeds purchased in an authorized sale for their natural and foreseeable purpose -- namely, for planting.*

The question presented is:

*Whether the Federal Circuit erred by (1) refusing to find patent exhaustion in patented seeds even after an authorized sale and by (2) creating an exception to the doctrine of patent exhaustion for self-replicating technologies?*

# Decision: Affirmed

- Supreme Court affirms Federal Circuit in unanimous decision by Justice Kagan
- No patent exhaustion for “second generation” seed
- Based on conventional principles that sale of an article exhausts the patent right as to that article, but not as to additional copies of the article made by the infringer

# Decision: Affirmed

- Court does *not* broadly rule on application of exhaustion principles to all “self-replicating” technologies:

“We recognize that such inventions are becoming ever more prevalent, complex, and diverse. In another case, the article's self-replication might occur outside the purchaser's control. Or it might be a necessary but incidental step in using the item for another purpose. . . . We need not address here whether or how the doctrine of patent exhaustion would apply in such circumstances.”

# *Kirtsaeng v. John Wiley*

- Copyright first sale case
- Wiley is a textbook manufacturer in the U.S. and abroad
- For textbooks published and sold abroad, Wiley often assigns its rights to a local subsidiary, they did so in the case of English-language textbooks being sold in Thailand by Wiley Asia

# *Kirtsaeng v. John Wiley*

- All of the Wiley Asia textbooks included a notation that they were not to be taken to the United States without the permission of the copyright holder
- Kirtsaeng was a Thai student studying in California. He had friends and family send him textbooks from Thailand
- He sold the books in the U.S., reimbursed his friends and family, and kept the profit

- Held that the “first sale” doctrine applies to copies of a copyrighted work lawfully made abroad.
  - Rejected a geographical limitation to the term “lawfully made under this title” in §109a.
- Further held that other sections had clear geographical limitations and that on last revision, many geographical limitations were explicitly removed to “equalize treatment” between domestically manufactured copies and those made abroad.

- Policy basis of the opinion:
  - Libraries and bookstores have countless works either made abroad or where origin cannot be determined and that "automobiles, microwaves, calculators, mobile phones, tablets, and personal computers" contain copyrightable software that would prevent the resale of even a car without permission of the rightholder of every copyrighted piece
- Thus, "reliance upon the 'first sale' doctrine is deeply embedded in the practices of those, such as book sellers, libraries, museums, and retailers, who have long relied upon its protection."

- Policy statement seems equally applicable to patent law, is there potential international patent exhaustion?
- Purchase of a vehicle in Japan having components patented in the U.S., if the car is imported to the U.S., can the owner and/or later purchaser rely on the protection of the first sale abroad?

- Copyright: international sale triggers first sale doctrine
- Trademark: international sale triggers first sale doctrine unless the imported goods differ materially from those the United States trademark owner sells domestically
- Patent?

- Federal Circuit refused to trigger first sale doctrine in *Jazz Photo Corp. v. International Trade Commission*, 264 F.3d 1094 (Fed. Cir. 2001).
  - Held that only cameras that were first sold in the United States triggered the patent exhaustion, cameras sold outside of the United States were held not to have exhausted the United States patent owner's rights.

# *Fujifilm Corp. v. Benun*

- Decided after *Quanta* but before *Kirtsaeng*
- Benun co-defendant was Jazz, a company formed after Jazz Photo went bankrupt
- Fuji produces patented lens-fitted film packages (LFFPs). A consumer takes photos then gives the LFFP to a processor to develop the file, the LFFP is not returned to the consumer.
- Jazz bought used LFFPs from processors, refurbished them, and sold them to consumers.

# *Fujifilm Corp. v. Benun*

- Question: whether *Quanta* eliminated the territoriality requirement for patent exhaustion announced in *Jazz Photo*?
  - Footnote 6 from *Quanta*: “Whether outside the country or functioning as replacement parts, the Intel Products would still be *practicing* the patent, even if not infringing it”
- Held: *Quanta* “did not eliminate the first sale rule’s territoriality requirement”
  - “Read properly [footnote 6] supports, rather than undermines, the exhaustion doctrine’s territoriality requirement.”
- Does *Kirtsaeng* change the result?

# Hypothetical #1

- Patents to reagent, method and apparatus
- “Label license” states that sale of the reagent authorizes practice of the method provided that the method is performed on the patented machine
- What is exhausted? What if any one or two of the components are unpatented?

# Hypothetical #2

- Patents to human embryonic stem cells
- “Field of use” restrictions on differentiated cell types, *e.g.* Company A licensed in field of neural cells, Company B licensed in Field of hematopoietic cells, Company C licensed in Field of pancreatic islet cells, etc.
- When would “sale” exhaust patentees right to limit Field company-to-company?

# Hypothetical #3

- Patent to 3-D printer
- Notice on machine that “Only to certified resin raw materials supplied by patentee can be used in this machine”
- Some of the raw materials used by the purchaser are not certified raw materials
- Permissible? Impact on warranty?

# Hypothetical #4

- Patent to blood glucose monitor to be used with consumable test strips comprising three electrodes and methods
- Monitor device configured to be used with (conventional) two-electrode or three-electrode test strips, three-electrode test strips more reliable/accurate
- How does this differ from *Lifescan*?

# Hypothetical #5

- Patent to methods and reagents for in vitro nucleic acid amplification
- Label license states “not for human diagnostic use”
- Can patentee sue testing lab use for humans?
- What about regulatory issues, i.e., if FDA prohibits human testing?

# Hypothetical #6

- Any difference in exhaustion analysis between primary and secondary sales?
  - Consumers?
  - Distributors?
  - Franchisees?



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