Patent Exhaustion, Implied License
and the Strategic use of Nonasserts in Agreements

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I. INTRODUCTION

In a paper presented by the author at last Fall's AIPLA Conference entitled "Responding to Patent Assertions, Cease and Desist Letters, and Indemnity Demands"[2], the affect of a patent assertion on the potential exposure of a company to the offered patent was explored. Discussed there was how the patent assertion may start the clock running on damages, willful infringement, indemnification rights and obligations, insurance rights and obligations, on making claims against an escrow account, triggering of SEC reporting requirements and other duties with respect to counseling of management, public relations, customer relations and other relationships. One of the defenses to a patent assertion noted in that paper is that your company may have rights to the asserted patent under an existing license. Through the use of over sixty case study examples, this paper explores patent exhaustion, implied license and the strategic use of non-asserts in agreements, including its use in cutting-off a license defense.

II. PATENT EXHAUSTION AND IMPLIED LICENSE

A. Patent Exhaustion

1. What Is Patent Exhaustion and Its Legal Effect?

The doctrine of patent exhaustion derives from the statutory grant of exclusivity to the patentee. *Bloomer v. McQuewan*, 44 U.S. 439, 459, 14

[1] The author has been a practicing patent attorney for 20 years, beginning his career at Pennie & Edmonds in New York and continuing on to work for such companies as W.R. Grace, International Paper, Timex, Nokia, and most recently Symbol Technologies, Inc. where he is Vice President – Intellectual Property & Assistant General Counsel. This paper represents the views and analysis of the author alone and not of Symbol Technologies, Inc. or any other company. The author thanks Danny Williams of Williams, Morgan & Amerson, Houston, TX for reviewing the text and providing valuable feedback.

[2] "Responding to Patent Assertions, Cease and Desist Letters, and Indemnity Demands", presented by Paul R. Juhasz at the 2002 AIPLA Annual Meeting , OCT 17-19, 2002, Grand Hyatt, Washington, D.C.

L. Ed. 532 (1852). It is well settled that an authorized sale of a patented product places that product beyond the reach of the patent. See *Anton/Bauer, Inc. v. PAG, Ltd.*, 329 F.3d 1343, 2003 U.S. App.LEXIS 9826, 66 U.S.P.Q.2d (BNA) 1674 (Fed. Cir. 2003); *Intel Corp. v. ULSI Sys. Tech., Inc.*, 995 F.2nd 1566, 1568, 27 USPQ2nd 1136,1138 (Fed. Cir. 1993). Once the patentee gives away this right to exclusivity through an unconditional sale of a patented device, the patentee's right to control the purchaser's use of the device is exhausted. *Intel*, supra.

For patent exhaustion to apply: (a) the product must be covered by the patent and (b) the sale of the product must be authorized by the patent holder. *Intel*, supra.

2. How Does It Arise?

Patent exhaustion may arise when the asserted patent has been licensed and the licensor later tries to assert the patent against a customer of licensee. Exhaustion occurs here because licensee was licensed to sell the product under the license

It may also arise where the patent holder asserts the patent against a customer who is purchasing from the patent holder the products giving rise to the exhaustion.

3. Effects of Exhaustion

Under the weight of authority, when there has been an authorized sale of a product, the purchaser of the product may use the product free of any patent liability with respect to device claims wholly embodied in the product. Neither method claims nor combination claims, however, will be exhausted. *Anton/Bauer v. PAG, Ltd.*, 2002 U.S. Dist. LEXIS 11583, 2002 WL 1359673 (D. Conn. June 13, 2002); *Met-Coil Systems Corp. v. Korners Unlimited, Inc.*, 803 F.2d 684 (Fed. Cir. 1986); *Bandag Inc. v. Al Bolser's Tire Stores, Inc.*, 750 F.2d 903, 925 (Fed. Cir. 1984); *Glass Equip.*, 174 F3d 1337 (Fed. Cir. 1999).

Some decisions have found patent exhaustion to reach beyond the product sold. These cases have extended patent exhaustion to cover an infringing combination if there are no uses of the "essential" component sold but for in the infringing combination. See *LG Elecs., Inc. v. Asustek Computer, Inc.*, 2002 U.S. Dist. LEXIS 25956 (N.D. Cal. 2002); *reaffirmed, summary judgment motions granted by, in part* 248 F. Supp. 2d 912 LEXIS 8924 (N.D. Cal. 2003) (In *LG Electronics*, the Court found that where an "essential"[3] component is found to contributorily infringe a combination,

[3] It is unclear what makes a component "essential". Is a contributorily infringing component in and of itself "essential" since the component has no use but in the infringing combination. Or does

the exhaustion of the “essential’ contributory component will exhaust the infringing combination.”)[456]; *Cyrix Corp. v. Intel Corp.*, 846 F. Supp. 522 (E.D. Tex. 1994).[7]

However, the Federal Circuit has recently made clear it clear that the license outside the product sold[8] (i.e., to the infringing combination) turns

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the contributorily infringing component need to itself be “essential” to the infringing combination before the combination is exhausted? For instance, a contributorily infringing microprocessor may be “essential” because the infringing combination cannot be practiced without it. But is that so for a contributorily infringing component (such as a shielded computer screw) where the infringing combination (such as a computer) can be practiced without it (such as with a non-shielded screw). The Federal Circuit left this question as it arose in the implied license context for another day. *Anton/Bauer*, supra.

[4] In *LGE,* Intel had a license to sell microprocessor and other chips to its customers. In connection with sales of these products, Intel was required and did give notice to its customers that Intel’s license with LGE did not expressly or by implication extend to the combination of the Intel products with non-Intel products. As the chip level claims were licensed to Intel and hence exhausted, LGE sued Intel’s customers for infringement of “higher order” combination and method patents. Patent exhaustion was raised as a defense to the infringement charges.

The defendants in *LGE* pointed to *Univis* in arguing that LGE’s license to Intel authorizing the sale of microprocessor and chipsets exhausted the “higher order” combination and method patents in suit because the microprocessor and chips had no use but in the infringing combination. In contraposition, LGE argued that the sale of the microprocessor and chipset cannot exhaust the combination and method patents.

[5] Citing the very same cases of *Met-Coil*, supra; *Bandag*; *Glass Equip.*, supra in support of this view which after the LGE Court’s decision, in a later case, the Federal Circuit in *Anton/Bauer*, supra construed to the contrary.

[6] The *LGE* Court found that the microprocessor and chipset have no use but in the infringing combination. Accordingly, sale of the microprocessor and chipset patents exhausted more than just the microprocessor and chipset patents held by LGE. Sale of the microprocessor and chipset exhausted the very computer combination claims in which the microprocessor and chipset were used inasmuch as the computer combination is what give the microprocessor and chipset their useful function.

“We think that all the considerations which support these results lead to the conclusion that where 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.” LGE,* supra.
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[7] At issue in *Cyrix*, supra, were microprocessors that ST and TI manufactured and sold to Cyrix under a license from Intel. Cyrix combined the microprocessors with memory chips and sold the combination. Intel sued Cyrix for patent infringement. Intel stipulated exhaustion of the independent microprocessor claim so that the issue before the Court was infringement by Cyrix of two dependent claims directed to the combination of microprocessor and memory. The court found that because all microprocessors must be combined with external memory to be useful, a claim describing a device consisting of a claim 1 microprocessor and external memory would be exhausted by the sale of the claim 1 microprocessor.

on implied license principles and not on principles of patent exhaustion *Anton/Bauer*, supra ("The statements in Univis[9] demonstrate how closely related the exhaustion doctrine is to implied license. Indeed, they suggest that an implied license stems from the exhaustion of a patent.")

In so doing, the Federal Court first stated the proposition for which the Supreme Court decision of *Univis* stands:

> "Where 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."

Univis, 316 U.S. at 251, 53 USPQ at 408.

The Federal Circuit then went on to frame the question before it as one requiring an implied license analysis:

> "[In the case at hand] [w]e must determine whether there are noninfringing uses of the female plate sold by Anton/Bauer and whether circumstances surrounding sales of the plate suggest that a license is implied."

Carborundum, 72 F.3d at 878, 37 USPQ2d at 1172.

In determining whether an authorized sale has exhausted the patent, the court will look to the authorized sale to see whether the patent holder has received the reward for his use of the invention. As stated in *Univis*:

> "Our decisions have uniformly recognized that the purpose of the patent law is fulfilled with respect to any particular article when the patentee has received his reward for the use of his invention by the sale of the article, and that once that purpose is realized that

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[8] The product sold may itself be a combination in which event exhaustion would apply to that combination sold. As to use of that sold combination as a component in a "higher order" combination, principles of implied license will apply.

[9] *United States v. Univis Lens Co.*, 316 U.S. 241, 86 L. Ed. 1408, 62 S. Ct. 1088, 1942 Dec. Comm'r Pat. 789 (1942). In *Univis*, a patent holder sold "blank" optical lenses to two tiers of licensees (i.e., "wholesalers" and "finishing retailers") for finishing into "finished" optical lenses. Univis further licensed a third tier licensee (i.e., "prescription retailer") to adjust only the "finished" lenses they bought from licensed wholesalers. They could not "finish" the lenses. The decision assumes the Univis patent claims go to the "finished" lenses. The question presented in *Univis* was whether the sale by Univis of "unfinished" lenses exhausted the rights of the patent holder to claims directed to a "finished" lens.

patent law affords no basis for restraining the use and enjoyment of the thing sold. *Adams v. Burke*, supra, 456; *Keeler v. Standard Folding Bed Co.*, 157 U.S. 659; *Motion Picture Co. v. Universal Film Co.*, 243 U.S. 502; and see cases collected in, 305 U.S. 124, 128, n.1. In construing and applying the patent law so as to give effect to the public policy which limits the patented monopoly strictly to the terms of the statutory grant, *Morton Salt Co. v. Suppiger Co.*, 314 U.S. 488, the particular form or method by which the monopoly is sought to be extended is immaterial. The first vending of any article manufactured under a patent puts the article beyond the reach of the monopoly which the patent confers. *Whether the licensee sells the patented article in its completed form or sells it before completion for the purpose of enabling the buyer to finish and sell it, he has equally parted with the article, and made it the vehicle for transferring to the buyer ownership of the invention with respect to that article.* To that extent he has parted with his patent monopoly in either case, and has received in the purchase price every benefit of that monopoly which the patent law secures to him. If he were permitted to control the price at which it could be sold by others he would extend his monopoly quite as much in the one case as in the other, and he would extend it beyond the fair meaning of the patent statutes and the construction which has hitherto been given to them." (Emphasis added[10])

This is because exhaustion goes to preventing a patent holder from receiving two royalties or tokens on his single patented invention. Of keeping the patent holder "double taxing" his single patented invention. *Univis*, supra. Consequently, when a patent holder asserts a patent against products he has sold or has authorized to be sold, courts will look at the sale to see whether the patent holder has carved out from the sale the very patents being asserted.

In the final analysis, the question becomes whether the price of the sale includes a mark-up for the patents incorporated in that product. *Univis*, supra. While the contractual language governing the sale provides a signpost as to whether the patent holder has carved out his patents from the sale, it is not dispositive on the question.[11] See, for example, *AMP Inc.*

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[10] *Univis* speaks to both what is exhausted by the sale (i.e., the blank by transfer of complete ownership) and implied license (i.e. that which was impliedly licensed). *Anton/Bauer*, supra. When the patent holder has been compensated for both, his monopoly is exhausted.

[11] It is clear that a patent holder can place restrictions on his sale. Still the notion that you can sell a product and at the same time holdback the patents exhausted and license them separately can be an unsettling one. The exhaustion occurs by operation of law and so it may seem that exhaustion should not be defeatable by contract. Still, the courts have confirmed that reasonable restrictions on the sale can defeat exhaustion. See, for instance, *Mallinckrodt, Inc., v. Medipart, Inc.*, 976 F2d

v. United States, 389 F.2d 448 (Ct. Cl. 1968) (where a provision in a contract expressly carving out an implied license was deemed to not preclude a finding of an implied license) If there is double taxation by the patent holder, the authorized sale will have exhausted the patents to the extent of the mark-up notwithstanding language in the contract to the contrary.[12] *Bloomer v. McQuewan*, 14 How. 539, 549 ("This Court has consistently refused to allow the form into which the parties chose to cast the transaction to govern. The test has been whether or not there has been such a disposition of the article that it may fairly be said that the patentee has received his reward for the use of the article.")

B. Implied License

1. What Is Implied License and Its Legal Effect?

The implied doctrine derives from principles of equity. The authorized sale of the product to a company may give rise to an implied license. *Anton/Bauer*, supra. For a license to be implied there must be: (a) an authorized sale of a product, (b) the sale was made under circumstances that indicate a license should be implied (e.g., no restrictions placed on use of the product)(or customer believes he has the right to use the product); and (c) the product sold has no substantial use other than in infringing the now-asserted patent (i.e., substantially no non-infringing use). *Anton/Bauer*, supra ("We must determine whether there are noninfringing uses of the female plate sold by Anton/Bauer and whether circumstances surrounding sales of the plate suggest that a license is implied.")

In *Anton/Bauer*, the patent holder held a combination patent on a female/male connector which allowed a battery pack to be attached to a camera. Neither the female or male components were separately patented. Anton/Bauer sold the female connectors to the video camera companies. Anton/Bauer separately sold battery packs having the male connector to its customers. PAG sold a competing battery pack with male connector which allowed the pack to be connected to the Anton/Bauer female plate. Anton/Bauer sued PAG for contributory and induced infringement. The District Court rejected all of PAG's defenses including patent exhaustion

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700, 708 (Fed. Cir. 1992) ("single-use only" restriction placed by patent holder in sale of a patented medical device was a permitted exercise of patent holder's exclusive right to use the patented invention."). If, however, the restriction is an unreasonable one, you likely can't defeat the exhaustion.

[12] The use by the patent holder of contractual language (such as no patents are exhausted by this sale") can create a presumption that the authorized sale of the product does not exhaust the patent. But if the authorized sale price includes a mark-up for the patents, the authorized sale will exhaust the patents notwithstanding the express contractual language to the contrary. *Univis*, supra

and implied license and granted Anton/Bauer's motion for a preliminary injunction.

The Federal Circuit reversed. The Court found that Anton/Bauer places on the market one component of a patented combination that has no other use than to complete the patented combination with a second unpatented component. The Court also found that sales of the female plate to Anton/Bauer customers were authorized and that Anton/Bauer placed no express restrictions on the use of the female plates it sells or that it requires that manufacturer to whom it sells female plates to expressly restrict the grant of a license upon sale of the finished camera product that incorporates the plate. Under these circumstances, the Court found Anton/Bauer customers to have an implied license. Because there was no direct infringement, PAG could not be found to have contributed to or induced infringement of the patent.[13][14] See also *Univis*.[15]

2. Effects of an Implied License

Under the implied license doctrine, when the foregoing conditions have been met, the purchaser of a product having no substantial use other than in infringing the now-asserted patent may use the product free of any liability with respect to the asserted patent. *Anton/Bauer*, supra.

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[13] The Court did not address the question of whether the grant of a license to practice a patented combination may be inferred from the sale of any component, however minor or essential it may be to the combination. *Anton/Bauer*, supra.

[14] This case does not spell the end of the law on contributory infringement. Rather, it stands for the proposition that a patentee's ability to assert contributory infringement will be limited where the patentee has chosen to sell part, but not all, of its patented combination. As stated by the Court, "[I]t is the involvement of the patentee in this case that saves PAG from being a contributory infringer." *Anton/Bauer*, supra.

[15] The *Univis* Court found that the only use to which the blank could be put and the only object of the sale is to enable the finisher to grind and polish it for use as a lens by the prospective wearer and so the authorized sale of the lens blank was a complete transfer of ownership of the blank and a license to practice the final stage of the patent procedure.
"But in any case it is plain that where the sale of the blank is by the patentee or his licensee - - here the Lens Company - - to a finisher, the only use to which it could be put and the only object of the sale is to enable the latter to grind and polish it for use as a lens by the prospective wearer. An incident to the purchase of any article, whether patented or unpatented, is the right to use and sell it, and upon familiar principles 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. *Letich Mfg. Co. v. Barber Co.*, 302 U.S. 458, 460-61; *B. B. Chemical Co. v. Ellis*, 314 U.S. 495. Sale of a lens blank by the patentee or by his licensee is thus in itself both a complete transfer of ownership of the blank, which is within the protection of the patent law, and a license to practice the final stage of the patent procedure. In the present case the entire consideration and compensation for both is the purchase price paid by the finishing licensee to the Lens Company. We have no question here of what other stipulations, for royalties or otherwise, might have been exacted as a part of the entire transaction, which do not seek to control the disposition of the patented article after the sale. The question is whether the patentee or his licensee, no longer aided by the patent, may lawfully exercise such control."

C. Estoppel

1. What Is Estoppel and Its Legal Effect?

It has been said that estoppel is deemed to be the very basis of the implied license defense. ("The relatively few instances where implied licenses have been found rely on the doctrine of equitable estoppel." *LG*, supra See also, *Wang Laboratories, Inc., v. Mitsubishi Elecs. Am., Inc.*, 103 F.3d 1571 (Fed. Cir. 1997).

Any language used by the owner of the patent, or any conduct on his part exhibited to another from which that other may properly infer that the owner consents to his use of the patent in making or using it, or selling it, upon which the other acts, constitutes a license and a defense to an action for a tort. *Wang*, supra. ("An implied license arises by acquiescence, by conduct, by equitable estoppel, or by legal estoppel.")[16] *Wang*, Id.

Equitable estoppel is an estoppel *in pais*, that is, an estoppel based on a false representation. *AMP Incorporated v. United States*, 389 F.2d 448 (Ct. Cl. 1968) An implied license by equitable estoppel requires that: (1) the patentee, through statements or conduct, gave an affirmative grant of consent or permission to make, use, or sell to the alleged infringer; (2) the alleged infringer relied on that statement or conduct; and (3) the alleged infringer would, therefore, be materially prejudiced if the patentee is allowed to proceed with its claim. *Winbond Elecs Corp. v.* Int'l Trade Comm'n, 262 F.3d 1363 (Fed. Cir. 2001). ("The alleged infringer must have knowledge of the patentee and its patent and must reasonably infer that the patentee acquiesced to the allegedly infringing activity for some time. *Wang*, supra.

Legal estoppel involves a situation where a licensor (or assignor) has licensed or assigned a definable property right for valuable consideration, and then sought to derogate or detract from that right.[17] *AMP*, infra. (Notwithstanding a carve-out from the license grant to use the Subject Invention, Licensor estopped from denying the Government the use of the inventions based upon an after-acquired patent.) As the predecessor court to the Federal Circuit, the Court of Claims, said "I find no equity in a bill in which the complainant seeks substantially to keep what it has sold and to prevent the defendant from having what it has bought." *AMP*, supra.

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[16] These labels describe not different kinds of licenses, but rather different categories of conduct which lead to the same conclusion; an implied license. The label denotes the rationale for reaching the legal result. *Wang*, Id.

[17] A species of legal estoppel is estoppel by warranty where the licensor is prevented from destroying his own grant appearing in the deed" *AMP*, infra.

The principles of estoppel will lead to an implied license. Consequently, the product purchased will be immune from suit and hence immunized from patent infringement charges.

D. Failed Express Notice of an Implied License Carve-out

It is well settled that if a patent holder makes a sale to a customer, the failure of the patent holder to expressly notify the customer that implied rights are carved out of the terms of the sale could lead to the customer stepping into an implied license. *Anton/Bauer*, supra. Where, however, a customer is purchasing the product from a licensee under a license that has expressly carved out implied rights from the grant, this is less clear. The question presented thus becomes whether the failure on the part of the licensee to expressly notify the customer of the carve-out from his license grant gives rise to an implied license in favor of the customer notwithstanding the express language in the license to the contrary.

On the one hand, a licensee cannot transfer rights that it does not have. So if implied rights have been carved out of the license by the licensor, no implied rights would seem to transfer to the customer of the licensee as a result of the sale. On the other hand, it cannot be said that the licensee is not speaking for the licensor when it comes to notifying the customer what rights are carved out from the sale. As far as the customer is concerned, the licensee is acting as an agent for the patent holder. It is the licensor's action or inaction that binds the purchase. If the patent holder does not require the licensee to expressly notify the customers of the licensee, then how can the licensor complain about it? By not requiring the express notice, it is as though the licensor (and not the licensee) has failed to notify the customer. Consequently, just as the failure of a patent holder to notify his customer that the terms of sale do not include any implied license can give rise to an implied license, so too could the failure of a patent holder to require his licensee to do the same when selling its products to its customers under the patent holder's patents be deemed to give rise to an implied license.

The rationale for reaching this result could be founded on equitable estoppel principles. If not on the basis of an estoppel that is predicated on the conduct of the patentee on whom when, acting through its licensee in making the sale of the patented product, the customer of licensee relied. The equities in this case are likely to override the contract.

This author believes that where a patent holder has failed to require his licensee to communicate to its customers the fact that implied rights have been expressly carved out of the license, a fair inference from the transaction could be that an implied license should be implied notwithstanding an express carve-out from the license to the contrary.

E. What is an Authorized Sale that will Trigger Patent Exhaustion, Implied License and Collateral Estoppel?

For patent exhaustion to apply, the sale must be an "unconditional" sale. *B. Braun Medical, Inc. v. Abbott Lab.*, 124 F.3d 1419, 1426 (Fed. Cir. 1997) ("[it is] an unconditional sale of a patented device [or its essential components that] exhausts the patentee's right to control the purchaser's use of the device thereafter.")

An "unconditional sale" is one in which "the patentee has received his reward for the use of his invention by the sale of the article." *Univis*, supra. Once that has occurred, any further charges by the patent holder would be a double royalty on his single patented invention which is the very thing the doctrine is designed to prevent. Conversely, where the patent holder has carved out from the sale the very reward for his invention, that sale is a conditional sale for which exhaustion will not apply.[18]

This longstanding principle also applies to a sale of a patented product manufactured by a licensee acting within the scope of its license. *Unidisco., Inc. v. Schattner*, 824 F.2d 965, 968, 3 U.S.P.Q.2d 1439, 1441 (Fed. Cir. 1987), cert denied, 484 U.S. 1042, 108 S. Ct. 774, 98 L. Ed. 2d 860 (1988). See also *United States v. Masonite Corp.*, 316 U.S. 285, 278, 86 L. Ed. 1461, 62 S. Ct. 1070 (1942) ("This Court has quite consistently refused to allow the form into which the parties chose to cast the transaction to govern. The test has been whether or not there has been such a disposition of the article that it may fairly be said that the patentee has received his reward for the use of the article.")

In a recent decision, the Federal Circuit went so far as to suggest that a license is nothing more than a covenant not to sue. *Jim Arnold Corp. v. Hydrotech Sys., Inc.*, 109 F.3d 1576 (Fed. Cir. 1997)("licenses are considered as nothing more than a promise by the licensor not to sue the licensee.") It follows that an authorized sale under a covenant not to sue can be an authorized sale for which exhaustion would apply.

The Federal Court has also suggested that an implied license stems from the exhaustion of a patent right. *Anton/Bauer*, supra. So it too follows that an authorized sale for purposes of patent exhaustion is an authorized sale for purposes of the implied license doctrine.

[18] For instance, a patent holder can restrict the sale to a single use. *Mallinckrodt, Inc., v. Medipart, Inc.*, 976 F2d 700, 708 (Fed. Cir. 1992) ("single-use only" restriction placed by patent holder in sale of a patented medical device was a permitted exercise of patent holder's exclusive right to use the patented invention.")

F. Scope of Any Implied Rights?

If a company succeeds in arguing that they are licensed to some of patent holder's patents by the purchase of a product, that company must then define the scope of rights that have been licensed. See *Carborundum v. Molting Metal Equipment Innovations*, 72 F.3d 872, 878 (Fed. Cir. 1995) (Once a license grant should be inferred, court looks to circumstances of the sale to determine the scope of the implied license).

In *Met-Coil Systems Corp. v. Korners Unlimited, Inc.*, 803 F.2d 684 (Fed. Cir. 1986), the Federal Circuit noted that "[w]e must further look to the circumstances of the sale to determine the scope of the implied license. Citing *Edison Elec. Light Co. v. Peninsular Light, Power & Heat Co.*, 101 F. 831, 836 (6^{th} Cir. 1900). This determination is based upon what the parties reasonably intended as to the scope of the implied license based on the circumstances of the sale. *Met-Coil*, supra. One party's unilateral expectations as to the scope of the implied license are irrelevant. *Stickle v. Heublein, Inc.*, 716 F.2d 1550, 1559 (Fed. Cir. 1983).

In determining the scope of rights, the courts will look to the applicable agreements underlying the sale. If the sale is made by the patent holder, the terms of sale will be scrutinized. It follows that if the sale is made under a license agreement, the terms of the license and sale will be scrutinized. The license will be only so narrow as required to allow the purchaser to make use of the product acquired. See, *Met-Coil*, supra ("unless the circumstances indicate otherwise, an implied license arising from the sale of a component to be used in a patented combination extends only for the life of the component whose sale and purchase created the license") (no implied license beyond the life of the pump).

G. Burden is On Defendant

Whether the defense is based on patent exhaustion or implied license, the alleged infringer bears the burden to show the court that their activities with regard to the patented articles are permissible activities. See *Metcoil Systems Corp. v. Korners Unlimited Inc.*, 803 F.2d 684, 687 (Fed. Cir. 1986)

However, if defendant makes out a prima facie case of double taxation by the patent holder, the burden of rebutting that evidence shifts to the patent holder to demonstrate that it is not extracting double royalties from its authorized sales of product. *Univis*, supra. Having a licensing program that establishes pricing valuations for respective patents separate and apart from the pricing models used with the product before any patent mark-up can go far in meeting this burden.

H. When Does an Authorized Sale Give Rise to Patent Exhaustion, Implied License, or Estoppel – Some Case Studies

1. Case Study 1

Company X sells Baseband A Chip to Company Z. Chip A has no use but with Radio B chip in terminal AB. Company X has patents on Chip A, Chip B and Terminal AB.

Here, the authorized sale of chip A exhausts device claims wholly embodied in Chip A. Combination claims AB and device claims residing *in part* or *in whole* outside of Chip A (e.g., Chip B and Terminal AB claims) as well as method patents are not exhausted.

An authorized sale of a product under circumstances that indicate that a license should be implied where the product has substantially no non-infringing use will result in an implied license. Here, there were no restrictions on the sale (e.g., no notice from Company X to Company Z that Chip A could not be used without Chip B and Terminal AB without an express license). Nor did the circumstances of the sale indicate other than that an implied license will be implied (e.g., Company Z believed that he could use Chip A with Chip B in Terminal AB without a license). Chip A having substantially no non-infringing uses but with Chip B in Terminal AB, a license under Chip B, Terminal AB patents and method patents required to use Chip A will be implied.

2. Case Study 2

Same facts as Case Study 1 except that Company X has no patents on Chip A and so there are no patents to exhaust by the sale. But Company Z will have an implied license under Chip B, Terminal AB and method patents required to use Chip A for the reasons given in Case Study 1.

3. Case Study 3

Same facts as Case Study 1 except that Company X has no patents on Chip A or Chip B. As in Case Study 2, Company X has no patents in product sold (i.e., chip A) to exhaust. But also as in Case Study 2, Company Z will have an implied license under Terminal AB patents and method patents required to use Chip A. See *Anton/Bauer*, supra.

4. Case Study 4

Same facts as Case Study 1 except that Baseband Chip A can be used with Radio C Chip in Terminal CD. Company X has no patents on Radio C Chip or Terminal CD. As in Case Study 1, the patents Company A has on

Radio A Chip are exhausted by the sale. However, Radio Chip A no longer has no substantial non-infringing use because it can be used with non-patented Radio C Chip in Terminal CD. Consequently, Company Z will have no implied license to Radio B and Terminal AB patents of Company X which Company Z will need to separately license. That is unless the circumstances of the sale of Chip A demonstrate that Chip A would not have been purchased but for use of Chip A with Radio A in Terminal AB. In that instance, the courts may estop Company A from asserting it's Radio A, Terminal AB and method patents required to use Chip A against Company Z because of an implied license. As to these patent rights, Company Z will be immunized.

5. Case Study 5

Same facts as Case Study 4 except that Company X also has patents on Radio C Chip and Terminal CD. As in Case Study 4, the patents wholly embodied in Baseband A Chip will be exhausted by the sale. Unlike Case Study 4, here Company Z has no substantial non-infringing use because either use (i.e., with either Radio B or C in either Terminal AB or CD) would be an infringing one. Accordingly, a license will be implied based on the circumstances of the sale. If the circumstances of the sale indicated Company Z was buying the chips for use with Radio A in Terminal AB then the implied license may be so limited (i.e., Company Z will get no implied license under Radio C, Terminal CD and applicable method patents required to use Chip A).

6. Case Study 6

Same as Case Study 1 except that Company X secures improvement patents on Chip A, Chip B and Terminal AB. The chips that are sold to Company X do not include these improvements. Here, there is no exhaustion of the improvement patents because the chips do not incorporate the improvements. Nor would Company Z have a license as to the improvements since Chip A has substantial uses which do not infringe the improvement patents.

7. Case Studies 7 – 12

Same as Case Studies 1-6 except that Company X does not directly sell Baseband A Chips. Rather, Company X licenses Company Y to make, use and sell Baseband A Chips. Company X is likely to have exhausted the same patents and Company Z is likely to have the same implied license rights as described in corresponding Case Studies 1-6.

8. Case Studies 13-18

Same as Case Studies 7-12 except that Company X restricts Company Y's use of Baseband A Chip such that no license in any of Company X's patents are to be implied. The sale of Baseband A chip exhausted the patents wholly embodied in Chip A. As to implied license rights, licensee Company Y cannot transfer rights that it does not have and so Company Y cannot transfer any implied license to Company Z. However, while Company Y was restricted in its use, such a restriction was not expressly communicated to Company Z. The circumstances of the sale to Company Z were such that Company Z believed it had implied license rights. Accordingly, as to those Case Studies 7-12 where a license was implied, under corresponding cases 13-18 the author believes[19] Company X will likely be estopped from asserting its patents directed to Radio B Chip, Terminal AB, and method patents required to use Chip A. Such use by Company Z of its Baseband A Chip purchased will be so immunized.

9. Case Studies 19-24

Same as Case Studies 13-18 except that in addition to carving out all implied license rights from the license grant to Company Y, Company X requires Company Y to so notify its customers (e.g., Company Z) and Company Y does so. The sale of Chip A will exhaust patents wholly embodied in Chip A. In those cases among Case Studies 13-18 where licensed was implied, under corresponding cases Case Studies 19-24, Company Z will get no implied license. Express notice given by Company Y to Company Z has cut off any implied license rights. (But see *Met-Coil*, supra, where notice given *after* the sale did not cut off implied license rights.)

10. Case Studies 25-30

Same as Case Studies 19-24 except that Company Y fails to expressly notify Company Z (per the terms of the license) that Company Z gets no implied license. In the author's view[20], Company Z may still get immunized against an assertion by Company X because Company Z had no notice of the cutoff of implied license rights. That may leave Company X with only a cause of action against Company Y for breach of the license (i.e., for failing to give the express notice required by the terms of the license which would have cutoff implied license rights).

[19] See discussion above under Failed Notice of an Implied License Carve-Out, Section D of this paper.

[20] See footnote 18, supra.

11. Case Studies 31-36

Same as Case Studies 1-6 except that Company X expressly carves out from the sale to Company Z all patents that would otherwise have been exhausted by the sale of Baseband A Chip which Company Z is required to separately license. Under these circumstances, the sale of Chip A will not exhaust the patents wholly residing in Chip A which Company Z is required to separately license. Company Z will, however, have those implied license rights described in corresponding Case Studies 1-6.

12. Case Studies 37-42

Same as Case Studies 13-18 except that the license provides that Company X expressly carves out from the license all patents that would otherwise have been exhausted by the making, use and sale of Chip A which Company Z is to separately license. Company Y fails to make a similar carve-out in the terms of its sale of Chip A to Company Z. Under these circumstances, the sale by Company Y of Chip A was authorized with the sale exhausting those patents not held-back by Company X. Company X expressly held back patents wholly embodied in Chip A and so the authorized sale of Chip A to Company Z did not exhaust Chip A patents for purposes of patent exhaustion. However, in the author's view[21], the authorized sale by Company Y of Chip A under circumstances where Company Z believed it had a license, the Court may estop Company X from asserting its Chip A patents against Company Z on the basis that a license should be implied. Company Z will, however, also have those implied license rights described in corresponding Case Studies 1-6.

13. Case Studies 43-48

Same as Case Studies 7-12 except that Company X grants Company Y a non-assert to make, use and sell Baseband A Chips. Company X is likely to have exhausted the same patents and Company Z is likely to have the same implied license rights as described in corresponding Case Studies 7-12.

13. Case Studies 49-54

Same as Case Studies 7-12 except that Company X grants Company Y a nonassert to make and sell Chip A as standalone products and Company X expressly states in the grant that it will not assert any claims against

[21] See discussion above under Failed Notice of an Implied License Carve-Out, Section D of this paper.

customers of Company Y except for essential patents[22][23] which customer must license from Company X. Company Y is required to expressly so notify its customers. Company Y sells Company Z Chip A and Company X asserts its essential patents, even those residing wholly in Chip A, against Company Z. Here, Company Y has a non-assert to the standalone product. As such, it could be deemed to have exhausted all device patents – essential and non-essential – that wholly reside in the stand-alone product (i.e., Chip A). That includes essential patents that wholly reside in Chip A. The non-assert granted to Company Y has also immunized Chip A with respect to method claims wholly residing in Chip A. In addition, the non-assert granted Company Z has immunized Company Z as to non-essential device and method claims applicable to the use of Chip A. That leaves patent holder Company X with only essential device and method claims that lie *in-part* (e.g., combination claims) or *in-whole* (patents other than those residing wholly in the chipset) outside Chip A to assert against Company Z. Accordingly, the authorized sale to Customer Z could have left Company X with nothing more than "essential" patents laying *in-part* or *in-whole* outside Chip A to assert. The express notice given by Company Y to Company Z is likely to have cut-off any implied license to these "essential" patents.

14. Case Studies 55-60

Same as Case Studies 49-54 except that instead of Company X non-asserting Y's make and sale of the chip as a "stand-alone" product, Company X expressly states in the grant that "no patents wholly residing in Chip A are exhausted and that no patents are to be implied by the sale of Chip A". Company Y sells Chip A to Company Z and so notifies Company Z in connection with such sale. Here, the licensee, Company Y, cannot transfer any rights greater than those received from Company X under the non-assert. By the express carve-out from the authorized sale of patents wholly residing in the chipset, Company Y received none of these patent rights that might otherwise have been exhausted. Consequently, none of these rights were exhausted by the sale by Company Y of the manufactured goods.

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[22] "Essential Patent" is typically understood to be a patent that reads on an industrial standard so that a product that is compliant with that standard infringes the essential patent.

[23] The reason a patent holder might choose to limit the carve-out to only the "essential patents" may be because the per chip price a customer pays for the chips will then include a mark-up for the non-essential patents. As such, the only unknown pricing to the customer will lie in the cost of licensing the essential patents which customer knows will be licensed on a fair and nondiscriminatory basis. If non-essential patents are also carved out from the sale, gone could be the fair and non-discriminatory pricing practices that add some certainty to royalty pricing. This could lead customer to buy the chip from another company which has more certain pricing.

The express notice given by Company Y to Company Z will likewise have cutoff any implied license rights Company Z might have in Chip A and their use.

15. Case Study 56

Company A enters into negotiations with Company B to divest certain of its patents. During negotiations, Company A enters into separate negotiations with Company C to settle a lawsuit brought by Company A against Company C. Before negotiations with Company C are completed, Company A closes its deal with Company B effectively divesting those certain patents. Later, Company A closes its license deal with Company C whereby Company C is now licensed under Company A's terminal patents. Still later, Company B sues Company C for infringement of the divested patents.

When it entered into a license with Company A, Company C thought it had everything it needed from Company A to make its terminals. Also, there are substantially no uses of the terminal that do not infringe the divested patent now being asserted. Here, the license to Company C was under circumstances that Company C believed it had all rights from Company A to make terminals under Company A's terminal patents and there are no noninfringing uses of the terminals made under the asserted terminal patent. Under the implied license doctrine, a license under the now asserted patent could be implied. But more likely and alternatively depending on the facts of the case, Company C may be able to immunize its product through an action against Company A based on a variety of theories such as for breach of warranty, fraud, or bad faith dealing in negotiating the license with Company C insofar as they divested a patent material to the license during licensing negotiations without advising Company C.

See also *AMP*, supra, where legal estoppel was found to keep a licensor of patents from asserting a subsequently acquired dominant patent against the licensee. ("I find no equity in a bill in which complainant seeks substantially to keep what it has sold, and to prevent the defendant from having what it has bought.")

16. Case Study 57

Companies A and B make competing chipsets in the marketplace that cost $7 to fabricate and that sell in the market for $14 before any mark-up in the sales price to account for patent rights held by the manufacturer. Company A has a patent portfolio that it figures adds $5 of patent value to its chipset. Company A sells its chipsets for $14 but carves out as terms of the sale all patents that would otherwise be exhausted or licensed (expressly or implied) by the manufacture, use or sale of the chipsets which the customer is required to separately license as a condition of such sale. The chips have no substantial use but for making terminals. Company A makes no delivery of the chipsets until the customer has paid the $5 per chipset for the bundle of patent rights. The Customer later challenges the separate royalty payments under patent exhaustion and implied license principles. In this instance, the $14 price of the chip includes no mark-up for the patent rights. In addition, payment of the $5 royalty is a condition on the sale of the chipset which expressly cuts-off patent exhaustion and implied rights. The patent rights only pass to Customer on making the $5 royalty payment. When after so doing the customer takes delivery of the chipsets, he has all patent rights. See *Univis*, supra.

17. Case Study 58

Same facts as Case Study 57 except that Company A sells its chipsets for $19 or more and delivers the chipsets to its Customer C without first collecting the $5 per chip royalty from Customer C. Customer C refuses to pay any royalty on the chipset level patents on the basis of patent exhaustion and implied license principles. Company A sues Customer C for patent infringement. In this case, the express language in the contract creates a presumption that patent rights have been carved out from the authorized sale. With the authorized sale having exhausted all patents but those carved out and with the express notice to Customer C that it had no implied license, the patents are neither exhausted nor implied. However, the agreements are not dispositive on this point. See, *AMP*, supra. If on scrutiny of the pricing model employed by Company A, the price that Customer C pays for the chipset is deemed to include a mark-up for the patents now being asserted, those patents that reside within the chip will be deemed to have been exhausted inasmuch as "the patentee has received his reward for the use of his invention by the sale of the article". In that case also, those chip and terminal device patents residing *in-part* or *wholly* outside of the product as well as chip and terminal method claims of Company A will be deemed to be implied to the extent needed to use Chip A.[24] See *Univis*, supra.

[24] This points to the need for your company to have a licensing program with clearly established royalty prices that are separate from any model your company may use to price its chipsets before any mark-up for patent rights. For patents that have been declared to read on an industrial standard (i.e., essential patents), the patent holder may be required to license his patents on a "fair and nondiscriminatory" basis. A licensing program with established data points taken from actual license deals may help the patent holder show compliance with such a duty. Even where a patent holder may not have such a duty, such as where a patent is not essential to a standard or a patent holder does not have a membership in the standards body that would obligate him to so license his patents, having such a licensing program in place can help withstand a challenge brought on exhaustion and implied license theories.

18. Case Study 59

Same facts as Case Study 58 except that Company A sells its chipsets for more than $14 but less than $19. Likely outcome will turn on the data points you have established for both your pricing and licensing model. If your list price does not include a mark-up for patent rights, then the sale of the chipset will be deemed to have not exhausted the patent rights residing in the chipset. Nor will rights to combination and method patents be implied. If, however, the list price includes a patent mark-up, those patent rights in the chip will be deemed to have been exhausted and the rights to the chip and terminal method and combination claims implied. This is notwithstanding express contractual language that suggests otherwise.

19. Case Study 60

Company A makes chipsets in the marketplace that cost $7 to fabricate and that sell in the market for $14 before any mark-up in the sales price to account for patent rights held by the manufacturer. Company A has a portfolio of chipset patents that it figures adds $5 of patent value to its chipsets. The chipsets have no use but in terminals manufactured by the industry. Company A itself manufactures terminals using its chipsets. Company A has terminal patents in its patent portfolio which Company A figures can support a 5% running royalty off of terminal product sales. Terminals typically list for $100. Company A sells its chipsets for $14 but carves out as terms of the sale all patents that would otherwise be exhausted or licensed (expressly or implied) by the manufacture, use or sale of the chipsets and use of those chipsets in making terminals. The customer is required to separately license the chip and terminal patents[25] as a condition of such sale. In this case, the customer is making a separate payment for the entire bundle of patent rights as part of the purchase of the chipset. The sale of the chipset is a conditional one where the patents are not exhausted or licensed until the Customer takes out the license that satisfies the condition of the sale.[26][27][28] When the customer takes delivery of the chipsets, he has all patent rights.

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[25] This conditioning of chipset sales on taking out a license under the “higher order” terminal patents would not run afoul of patent misuse principles so long as the terminals in which the customer is using the chips are covered by the combination patents licensed by Company A. If the terminals on which the customer is making payments have a substantial use that does not infringe the terminal patents held by Company A, however, then the conditional extraction by Company A at the point of sale of its chipsets of license royalties under its terminal patents may raise patent misuse questions.

[26] Licensing as much of your rights at the top of the food chain where the pricing is the highest holds the promise of creating the greatest royalty stream for your company. But this is also where you are likely to get the greatest pushback from your target on supplied components. Indemnity demands made by your target against its suppliers might bring other players into your patent assertion. This is also where you are likely to see defenses raised under “have made” rights (such as ODM and non-ODM supplied components), patent exhaustion and implied license. Your company may also have great exposure to the patents held by these targets and the result may be

20. Case Study 61

Same facts as Case Study 60 except that Company A licenses Company B to make and sell the chipsets. Company B is required to identify each customer to Company A before making a sale and the license prevents Company B from making any delivery of the chipsets until the customer has taken out a license under Company A's patents. Same result as in Case Study 60.[29]

21. Case Study 62

Same facts as Case Study 60 except that Company B pays all the licensing fees for its customers. Here, patents are exhausted and otherwise licensed. When Customer C takes delivery, Customer C has all patent rights.[30]

I. Practice Pointers

Patent exhaustion defenses stem from the failure of a patent holder to unequivocally carve-out patents from the sale or licensed sale of a product patents that would otherwise be exhausted by the sale. Accordingly, expressly carving-out from the agreement authorizing the sale (i.e., a sales contract if the patent holder is making the sale or a license or non-assert

litigation and a cross-license. If the company is also a customer, such as an operator using your terminal equipment, there may also be customer relation issues to consider in your assertion.

[27] Licensing mid-level players creates a mix of the risks and benefits from licensing either end of the food chain. A subassembly maker may push back on component claims by pushing those claims down to suppliers under indemnity. But a subassembly has fewer components and so there may be fewer suppliers to push down on. Suppliers of the sub assembler may also be located in regions of the world where enforcement of the indemnity obligation may be more difficult. Your company may also have less exposure to the patents of the sub assembler. Still the sub assembler may be high enough in the food chain that a healthy royalty stream can be created through a license.

[28] Because a competitor is likely to have patents applicable to your core business, asserting patents against a competitor may create the greatest exposure to your products.

[29] This type of a business model doesn't really work inasmuch as Company B's sales are pegged to the successful licensing activities of Company A. If the licensing goes slow, Company B's sales follow slowly. If the licensing doesn't happen, Company B could go out of business.

[30] While this solution seems to be the simplest, it requires Company B to pay the 5% running royalties off radar detector sales of its customers. In the example, at an average list price of $100, Company B will be paying $5 terminal royalty on top of the $5 chipset royalties it is already paying. Thus, simple a deal as this may seem, Company B will be paying $10 in royalties on top of $14 it pays for the chip which together is likely to erode the margins Company B hopes to make on its chips. The tension created here is between the higher terminal prices the patent holder would like to see his royalties based upon and the lower chipset prices the chipset supplier can afford to pay because it is lower in the food chain. For supplier to be able to afford the terminal royalties, the royalties likely need to be smaller. The tradeoff for the patent holder for accepting lower royalties is that all of the products using Company B's chipsets will be licensed.

agreement if the authorization to sell is being given to a licensee or non-assert grantee) patents that would otherwise be exhausted by the sale is something the patent holder should do to keep such patents from being exhausted.

Implied license defenses stem from an authorized sale under circumstances that an implied license should be implied. To keep an implied license from arising from an authorized sale, it is not enough for the patent holder to expressly carve out implied license rights from the agreement authorizing the sale. The customer must also be notified of the carve-out at the time of the purchase. For a sale made by patent holder, the law is well settled that this means that the patent holder must unequivocally communicate the carve-out to his customer. For a sale made by a licensee or grantee of a non-assert, the author believes[31] this means that the licensee or non-assert grantee must also so communicate this carve-out to its customers.

To keep an implied license from being implied, the patent holder needs to avoid agreements, conduct, equitable estoppel and legal estoppel pitfalls that can give rise to an implied license. *Wang*, supra. The patent holder also needs to ensure that the pricing of his products does not result in a double taxation. See *Univis*, supra. (a patent holder will not be permitted to collect two royalty tokens for the same invention)

In view of the above, a patent holder should expressly carve-out from the sale all patents that would otherwise be exhausted by the sale. The patent holder should also expressly carve-out all implied license rights. In addition, the patent holder should also expressly so notify its customers. And the patent holder should require as a condition of any license or non-assert grant that its licensees and grantees do the same in connection with any sales they make to any customer. Lastly, the patent holder should ensure that the pricing of his product does not already include a mark-up for patent rights that have been carved out from the sale. Otherwise, the patent holder could be deemed to have charged two royalty tokens for the same invention which can lead to patent exhaustion and an implied license.

J. Licensing Programs that Run Afoul of the Commitment and Notice Tests

A company should periodically audit its agreements to ensure that its sales contracts, license agreements and agreements to not assert its patents

[31] See discussion under Failed Notice of an Implied License Carve-Out, Section D of this paper.

include the required express carve-out of patents that might otherwise be exhausted or impliedly licensed and, with respect to sales made by the patent holder, the required notice to its customers regarding the carve-out or, with respect to sales made under a license or a non-assert, the obligation on the part of a licensee or grantee to do the same with its customers.

As to any agreement that is without these provisions, the company should take affirmative steps to correct these deficiencies. Failure to do so could continue to allow customers to continue to benefit from a patent exhaustion or implied license defense as to products they purchase going forward.

A patent holder may find in current agreements authorizing the sale (be it a sales contract or a license or non-assert agreement) an undertaking by the parties that they will take all further reasonable steps to ensure that the letter and spirit of the agreement is fulfilled. If so, a patent holder may be able to rely on such a provision to incorporate the carve-out and notice language into its own sales contracts or into a license or non-assert agreement so as to require the licensee or grantee to do the same.

If current agreements do not contain such a provision, the patent holder should flag those agreements that are defective in these respects for renegotiation.

K. Sales by Licensee to an Unlicensed Party – The Foundry Cases

In *Intel v. U.S. Intern. Trade Comm'n*, 946 F.2d 821, 826 (Fed. Cir. 1991), Sanyo entered into a broad licensing agreement with Intel. Under that license, Sanyo acted as a foundry for Atmel Corp. Sanyo manufactured EPROMs for Atmel that were designed by Atmel for sale to Atmel to sell as its own product. Looking to the language of the license, the Federal Circuit found that patent exhaustion did not apply based on an interpretation of the license to mean that only "licensed Sanyo products" were authorized to be sold under the license. To hold otherwise would allow any company in the world to get an Intel licensee like Sanyo to manufacture it's infringing parts without getting a license from Intel. *Intel Corp. v. ITC*, supra.

In *Cyrix Corp v. Intel Corp.*, 77 F.3d 1381, 1386 (Fed. Cir. 1996), in a similar foundry arrangement, the Federal Circuit reached a different holding because of the license language. Because the "IBM Licensed Products" in the license IBM had with Intel did not limit the products IBM was licensed to sell to those designed by IBM, IBM had the right to act as a foundry for the unlicensed parties. The unlicensed parties were not liable for patent infringement.

These foundry cases show the importance of limiting the scope of your license to products designed by the licensee. If not so limited, your licensees may become authorized to practice under your patents through foundry arrangements that exhaust your patent rights.

L. Sales to a Licensee - Have Made Rights.

It is well settled that rights to a third party can be conferred through the valid exercise of a licensee's "have made rights". See *Soutwire Co. v. United States Int. Trade Comm.* , 67 C.C.P.A. 141, 629 F.2d 1332, 1339 (C.C.P.A. 1980) (quoting Carey v. United states, 164 Ct. Cl. 304, 326 F.2d 975, 979-80 (C.C.P.A. 1964) ("have made" rights are distinguishable from rights to sublicense: if "production is . . . for the use of the original design," it is an exercise of a have made right, but if the production is for the unlicensed third party itself, it is a sublicense)). "Have made" rights stem from the basic rights to make, use, and sell that are typically granted in a patent license. "The [have made] license permits [the licensee] to engage others to do all the work connected with the production of the [licensed] article for him. *Carey*, 326 F.2d at 979.

While the sales here are to the licensee, similar issues to those addressed under foundry rights can be created if your "have made rights" are not appropriately limited to your licensee's designs. In particular, if those rights are not so limited, licensee may have an ODM[32] make the products for the licensee. In this instance, the original infringing designs of the ODM manufactured for the licensee could become immunized from infringement under the licensee's "have made rights".

The effect of such an outcome could severely undercut your licensing program. The ODM could get immunized from suit by your company on the same license terms that you extended to the licensee. If the licensee received a favorable deal from you, such as through payment of a lower lump sum payment, etc. based on expected volumes, R&D overhead, and other competitive benchmarks, such as its products, its market, its customers, and its channels of trade, the ODM will have stepped into those favorable terms through your licensee's "have made" rights.[33] This could leave your company without the benefits your company would have negotiated had your company negotiated a license directly with the ODM in the first place. That includes securing a license grant-back from the ODM under the patents held by the ODM. As a result, if at some point your company finds that it has exposure under the ODM patents, your company may find itself weakened in it's ability to minimize that

[32] Original Design Manufacturer

[33] The ODM would still have exposure for products it sells to non-licensed companies.

exposure through assertions of its own patents against the ODM because the ODM products sourced to your licensee have been immunized.[34]

To keep a "have made" right from taking away the sword and shield you may find useful against an ODM, your company should limit it's "have made rights" to designs substantially made by the licensee.

M. Loss of License Rights in a Joint Venture

Your company should always be mindful of the many changes that companies undergo in today's ever-changing corporate landscape. Today's company may be a footnote in tomorrow's corporate story. Your licensing program should anticipate these changes and build those contingencies into your licensing program.

If your licensee merges with an unlicensed company, you may find that a license you made with the licensee now extends to the unlicensed company overnight. What may have been a lump sum paid up license enjoyed by your licensee based on projected volumes and the like could overnight become an immunization from charges of infringement of the additional volumes brought into the merger by the unlicensed company. And all this occurred without any remuneration to the patent holder. While the example given pertains to a merger, similar issues may be presented in joint venture or other corporate reorganizations.

There are several ways your company can minimize loss of patent rights through corporate organizations. You may want to consider building into your license a cutoff of the license rights in the event of certain events – such as the sale of licensee's business to a competitor. Alternatively, your program could build into the your license some cut-back in the rights that may be enjoyed by the resulting corporation. For instance, you could reduce the licensed products post-merger to the volume of licensee's product to the volume of the combined products of the company after the merger. That could allow your company to collect additional royalties for the increase in volumes due to the merger that were not previously licensed.

[34] Your company could find itself weakened to the extent that products supplied by the ODM to your licensee are immunized. The ODM could still face exposure under your patents for products the ODM supplies to its other customers.

N. Parallel Import[35] Exhaustion

Does the sale of a product abroad exhaust the rights of a patent holder in the United States? If the authorized sale abroad is made under a license grant that expressly carved out the U.S. territory from the grant, the sale into the U.S. of the product will not exhaust the patents of the licensor. *Ajinomoto Co. v. Archer-Daniels-Midland Co.*, 228 F.3d 1338 (Fed. Cir. 2000).

In *Ajinomoto*, ABP International was granted a license to make a patented bacterial strain outside of the U.S. Defendant Archer-Daniels (ADM) purchased the bacterial strain from ADP in Sweden and imported the same into the U.S. The patent holder sued ADM for infringement under 35 U.S.C. 271 (g)[36].

In finding that the sale by ADM of the bacterial strain into the U.S. amounted to infringement, the Federal Circuit looked to ADP's license which explicitly excluded the U.S. territory from the license grant The Court found the authorization to make the product outside the U.S. to be irrelevant to the inquiry. Section 271(g) applied to unauthorized actions in the U.S. Under the terms of the ABP license, ABP was not authorized to sell the bacterial strain into the U.S. Consequently, the sale by ADM of the bacterial strain into the U.S. was infringement. *Ajinomoto*, supra.

As to patent exhaustion, notwithstanding ABP's permitted sale of the bacterial strain in Sweden, the sale was not an "unconditional" one. Where, as here, the patent holder has carved out by territory from the sale the reward he is entitled to received in the U.S., that sale is a conditional sale for which exhaustion will not apply.

The holding in *Ajinomoto* confirms that territorial restrictions continue to be a permitted use restriction. It is a permitted exercise of patent holder's exclusive right to use the patented invention. It is a restriction that will

[35] Parallel importation refers to goods produced and sold legally, and subsequently exported. It refers to the importation of goods outside the distribution channels contractually negotiated by the manufacturer. Because the manufacturer/IP owner has no contractual connection with a parallel importer, the imported goods are sometimes referred to as "gray goods" – a misnomer since the goods themselves are original, only the distribution channel is not authorized.

[36] 35 U.S.C. Section 271(g) provides that whoever without authority imports into the United States or offers to sell, sells, or uses within the United States a product which is made by a process patented in the United States shall be liable as an infringer, if the importation, offer to sell, sale, or use of the product occurs during the term of the process patent . . . . A product which is made by a patented process will, for purposes of this title, not be so made after - - (1) it is materially changed by subsequent processes; or (2) it becomes a trivial and nonessential component of another patent."

make any authorized sale a conditional one. To the extent of the restriction, patent exhaustion will not apply.

Each company should be mindful of the valuable use of territorial restrictions in cutting off a patent exhaustion defense.[37]

III. NONASSERTS AND THEIR STRATEGIC USE IN AGREEMENTS

A. Is a Non-Assert a License?

Where at one time a nonassert was deemed to be separate and distinct from a license, recent decisions have suggested that in many ways the two may not be so dissimilar. In a recent decision, the Federal Circuit went so far as to suggest that a license is nothing more than a covenant not to sue. *Jim Arnold Corp. v. Hydrotech Sys., Inc.*, 109 F.3d 1576 (Fed. Cir. 1997)("licenses are considered as nothing more than a promise by the licensor not to sue the licensee.") Where in *Hilgraeve Corp. v. Symentec Corp.*, 265 F.3d 1336 (Fed. Cir. 2001) the issue was whether a covenant not to sue for patent infringement was equivalent to a freely transferable license to the patent, the Federal Circuit, after citing *Jim Arnold*, supra, for the foregoing proposition went on to hold that the covenant not to sue before it did not grant a *transferable* license to the patent. (Emphasis added)

There remain however key differences between the two. A covenant not to sue is founded on contract principles and limited to the promise not to sue. In contrast, a license can carry with it the incidents of property such as possession, transferability, right to enjoyment, and warranty rights. See, *Hilgraeve*, supra (a license may be a covenant not to sue but a covenant not to sue does not grant a transferable license). As such, the grant of a nonassert can be deemed to be narrower in scope than the grant of a license.

In addition, flowing from a license grant is the inference that a licensed product incorporates the patented technology licensed. The same cannot be said for a product that is made, used and sold under a covenant not to sue. Like a license, a covenant speaks to the promise by the licensor that he will not sue the licensee under the patent. But unlike a license, a covenant does not speak to the incorporation of the patented technology into the product. See *Red Wing Shoe Co. v. Hockerson-Halberstadt, Inc.*, 148 F. 3rd 1355 (Fed. Cir. 1998) (In deciding a personal jurisdiction question involving sales of shoe products by in-state licensees under a license granted by an out-of-state licensor who made no shoe

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[37] Depending on whether the country of importation applies the concept of national, regional or international exhaustion, the importation of the product might lead to a different result. Under national exhaustion, the patent holder cannot control the commercial exploitation of goods put on the domestic market by the patent holder but can oppose any importation into the nation on the basis of his patent right. Under regional exhaustion, exhaustion occurs in connection with even parallel imports within the region. Under international exhaustion, patent rights are exhausted once the product has been sold by the patent holder or with his consent in any part of the world.

product, the Federal Circuit found that "[licensor's] product [i.e., it's license grant] is a covenant not to sue, not a shoe incorporating the patented technology.")

As shown in the final two sections of this paper, the foregoing differences between the two grants can create significant strategic advantages when crafting a license.

B. Use of Assertions in Copyright Cases

In a deal involving software, a licensee may in addition to securing a software license grant, also ask for rights to practice under patents that cover the software. If care is not taken on how this kind of deal is structured, a company may end up giving away more IP rights than contemplated.

The starting point for this analysis is a copyright license which grants the company a right to practice the software in the same or substantially same form[38]. In contrast, a patent license grants the company the right to practice under patents covering that software.[39] On the other hand, a non-assert grants the company only the right that it will not be sued for use of the software.

A company may find that a patent non-assert can be a useful tool in limiting the freedom of movement of the grantee under the patents. It may address the concerns of the software licensee by giving him freedom of movement with respect to patents covering the software. At the same time, it allows your company to hold back the grant of a broader patent license.

When crafting the non-assert on the software, great care must be taken to appropriately limit the grant. If not limited, the licensee may step into the rights to practice not only the software in its current form but also alternative solutions that might otherwise infringe the patents. In that event, you could find the licensee no longer using your software in its products. Such a broad grant could allow the licensee to migrate to a software design of its own or provided by another vendor. The result could be a decrease in the presence of your software in the marketplace and the dependence of the industry on it.

[38] The starting point for the copyright analysis is the software which is the code that is laid out in a particular fashion. The code and its layout is the artistic expression in the magnetic medium that gives rise to the copyright.

[39] The code and its layout also provides the 112 support for the patent.

To keep this from happening, when crafting a patent non-assert you should consider:

1. Limiting the patent non-assert to only that technical implementation that is expressed by the software.

2. Limiting the patent non-assert to only that technical implementation that is wholly embodied in the software.

3. Cutting-off express and implied license rights so that the company can not lay claim to device claims that lie in whole or in part outside the software (i.e., combinations) or methods.

4. Making sure the patent non-assert is limited to ONLY THOSE PATENTS THAT WERE CREATED BEFORE THE DATE THE SOFTWARE WAS CREATED. If you don't include this limitation, the company could step into patents that were developed after the software your company licensed was created. And without this kind of limitation, the company could be getting rights under your company improvements without time limitation.

5. Conditioning the non-assert (and other rights, including copyright license) on the company not litigating against your company. If they litigate, these rights are terminated.

C. Patent Royalties, The Marking Statute and Nonasserts

Many "essential" patents are required to be licensed at a fair and nondiscriminatory royalty rate. In determining a fair and nondiscriminatory rate, the industry will look at every new license that your company negotiates as yet another data point to validate/challenge the royalty rate your company is currently charging for its essential patents. Consequently, your licensing program should value its essential patents separate and apart from its other patents. A licensing model should be developed that supports the royalty rate you are charging for your essential patents as being fair and nondiscriminatory.

There may be instances where your company creates some unfavorable licensing data points out of necessity that could serve to downwardly bias the royalty rate you have established for your licensing program. For instance, in settling a litigation, your company may be forced to extend a license that may be on terms and conditions that are less favorable than what you believe to be fair and nondiscriminatory. For a variety of reasons you settle on those terms anyways.

To minimize the effect of these kinds of data points on your royalty rate, you may consider granting a non-assert instead of a license. The non-assert may give the company you are settling with what it needs to continue its business. Yet at the same time, because the nonassert is a promise not to sue only and does not carry with it the other incidents of a license grant, it is possible that the royalty rate charged for that non-assert may be given a lesser weighting than the royalty rate exacted for a license. Accordingly, that rate may have less of a biasing effect on your licensing model and the royalty rates you are otherwise charging licensees under your essential patents.

One of the things a practitioner needs to pay particular attention to when using a nonassert is the patent marking statutes. 35 USC Section 287(a) limits damages for infringement of a *product* to the date of actual notice or the date of marking of a licensed device with the patent number.[40] [41] In order to preserve back damages for article claims as to "any patented article", a patentee and persons making, offering for sale, or selling within the United States *any patented article* for or under them or importing *any patented article* into the United States need to mark their products.[42]

While the Federal Circuit has drawn a corollary between a license and a nonassert grant, a covenant not to sue without more is no more than a promise by the licensor to not sue the licensee. It does not on its face speak to the technology incorporated into the article. In fact, one of the reasons that a grantee might want to have a nonassert granted instead of a license is to leave open the question of whether the technical implementation used in his product is in fact covered by the

[40] 35 USC §287(a) provides that "[p]atentee, and persons making, offering for sale, or selling within the United States any patented article for or under them or importing any patented article into the United States, may give notice to the public that the same is patented, either by fixing thereon the word "patent" or the abbreviation "pat", together with the number of the patent, or when, from the character of the article, this can not be done, by fixing to it, or to the package wherein one or more of them is contained, a label containing a like notice. In the event of failure so to mark, no damages shall be recovered by the patentee in any action for infringement, except on proof that the infringer was notified of the infringement and continued to infringe thereafter, in which event damages may be recovered only for infringement occurring after such notice. Filing of an action for infringement shall constitute such notice."

[41] Method claims would still be available for use in recovering past damages as they are not limited by the marking statute. *Bandag, Inc. v. Gerrard Tire Co., Inc.*, 704 F.2d 1578 (Fed. Cir. 1983). "Where, however, a patent contains both apparatus and method claims, to the extent that there is a tangible item to mark by which notice of the asserted method claims can be given, a party is obliged to do so if it intends to avail itself of the constructive notice provisions of Section 287(a)." *American Medical Sys. v. Medical Eng'g Corp.*, 6 F.3d 1523 (Fed. Cir. 1993).

[42] It is well settled that a licensee who makes or sells a patented article does so "for or under" the patentee, thereby limiting the patentee's damage recovery when the patented article is not marked. *Devices for Medicine, Inc. v. Boehl*, 822 F.2d 1062 (Fed. Cir. 1987). Even the sale by a patent holder of unpatented components for use in a patented combination can give rise to marking requirements where the sale of the unpatented component gave rise to an implied license under the patented combination. *Amsted Indus. v. Buckeye Steel Castings Co.*, 24 F3d 178 (Fed. Cir. 1994).

patent – namely, whether the product infringes the patent. These provide some compelling arguments why a nonasserted product is not a "patented article" for which the marking statutes would apply.[43]

Conversely, requiring a grantee of a non-assert to mark his products with patents can create an inference that the non-assert grant is a broader license. A broader license in turn could serve to create the unfavorable licensing data point that you may have sought to be avoided by the grant of the covenant.

By recognizing the narrow scope of a non-assert license, a patent holder can use the non-assert grant in lieu of a license to yield strategic dividends. A properly narrowed non-assert can significantly curtail the freedom of movement of the licensee that is operating under the grant. The non-assert can also minimize the impact of any unfavorable royalty streams derived from the non-assert on your licensing model. If the products that are non-asserted are not "patented articles" for which the marking statute would apply, the non-assert may even avoid triggering any marking requirement. Where your strategy revolves more around blocking future activities and less around collecting past patent damages – so that any concerns about the possibility of a non-assert triggering the marking requirements are of lesser concern, the non-assert grant, if effectively used, can yield additional strategic dividends. It could help neutralize even other terms or conditions in an unfavorable deal (such as an "unfavorable definition of net sales" or an "unfavorable most favorite nations" provision that you can't negotiate any better) that could be held against you in a future negotiation or litigation. Together with license grants that have been extended on the favorable deals, the strategic use of a non-assert on the unfavorable deals could give you greater flexibility in fashioning more favorable licensing deals going forward.

[43] But note that if the design used by the grantee on which the nonassert is being granted is the patented design of the grantor, the product is likely to be deemed to be a "patented article" for which the marking statutes would likely apply. Similarly, if a design being used by the grantee is one that the grantee has admitted to be infringing, the marking statute would likely apply.

IV. CONCLUSION

An authorized sale of a product can allow the purchaser of the product to use the product free of any patent liability with respect to device claims wholly embodied in the product. Neither method claims nor combination claims, however, will be exhausted. The purchaser can also step into implied license rights if the components authorized to be sold have substantial noninfringing uses and the circumstances surrounding the sale suggest that an implied license should be inferred. The implied license may reach outside the product sold to license combination and method patents. The courts may look to estoppel principles to keep the patent holder from asserting these patents against the customer.

Familiarity with these principles can help minimize your company's exposure to the loss of patent rights through authorized sales. Use of language to hold back patents that would otherwise be exhausted or implied can minimize the likelihood of a patent from being exhausted or implied. Expressly notifying the customer – whether the patent holder's or the licensee or grantee's – can further minimize the possibility of this happening. Getting licensees and customers of both patent holder and licensee/grantee to agree to the carve-out and still purchase the product at the agreed upon price goes far toward establishing that the patent holder has held back patents from the sale. But at the end of the day a court will likely look at the pricing of the product to see if it includes a mark-up for the patents. If it does, the pricing could lead to the authorized sale exhausting and impliedly licensing the patents notwithstanding contractual language to the contrary. Establishing a pricing for the sale of your product that is attributable to patent royalties separate and apart from the pricing of your product before any patent mark-up can help your company withstand a challenge based on these defenses.