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## Supreme Court Decision in *Quanta* Case Clarifies Patent Exhaustion

2008-06-11

On June 9, 2008, the Supreme Court issued its decision in *Quanta Computer, Inc. v. LG Electronics, Inc.*, and held that the "authorized sale of an article that substantially embodies a patent exhausts the patent holder's rights and prevents the patent holder from invoking patent law to control postsale use of the article." Relying in large measure on *United States v. Univis Lens*, 316 U.S. 241 (1942), the Court sought to clarify the law of patent exhaustion. The *Quanta* decision will have significant implications across many industries, particularly on technology transactions and licenses.

In *Quanta*, LG Electronics, Inc. (LG) owned a large portfolio of patents covering numerous aspects of computer systems, and had entered into a broad cross-license agreement with Intel, Inc. (Intel) that authorized Intel to sell chips and chipsets manufactured under LG's patents. The agreement between LG and Intel contained an explicit disclaimer--the license to practice LG's system and method patents did not extend to any third parties to whom Intel might sell computer chips. As required by LG, Intel informed purchasers of Intel chips that LG owned system and method patents that covered the combination of computer components, and that LG was not granting the purchasers a license to practice these patents. Quanta Computers (Quanta) purchased chips and chipsets from Intel and combined them with other components to make fully-functioning computers that were within the scope of the LG system and method patents. LG sued Quanta for patent infringement.

The doctrine of patent exhaustion, or the "first sale" doctrine, has long limited the rights of a patentee following the first sale of a patented article. See, e.g., *Adams v. Burke*, 84 U.S. 453 (1873). The question before the Supreme Court was whether Intel's sale of the chips to Quanta exhausted not only the LG patents that covered the chips themselves, but also other LG patents that covered the manufacture, use, and sale of Quanta computers containing the chips. The Court held that it did.

Citing its decision in *Ethyl Gasoline Corp. v. United States*, 309 U.S. 436 (1940), the Court first said that it has "repeatedly held" that the exhaustion doctrine applies not only to product claims, but also to method claims: although "a patented method may not be sold in the same way as an article or device . . . methods nonetheless may be 'embodied' in a product, the sale of which exhausts patent rights."

The Court next considered under what circumstances the sale of a product triggers exhaustion, not only of the patent that actually covers the product, but also of some other related method or apparatus patent. The Court used a two-part test it had articulated in *Univis*: "[E]xhaustion was triggered by the sale of the [products] because their only reasonable and intended use was to practice the patent and because they 'embodie[d] essential features of [the] patented invention.'"

Finding that LG's downstream system and method patents were exhausted, the Court was clear that the first part of the test was satisfied: "[T]he only apparent object of Intel's sales to Quanta was to permit Quanta to incorporate the Intel Products into computers that would practice the patents." The Court also held that the Intel chips substantially embodied LG's patents: "[T]he only step necessary to practice the patent is the application of common processes or the addition of standard parts. Everything inventive about each patent is embodied in the Intel Products." The Court stressed the importance of the *nature* of the final steps in a related apparatus or method patent: if the final steps of the method or apparatus patent are "common and noninventive," and involve the "application of common processes or the addition of standard parts," then the patent is exhausted by the sale of the component article.

Finally, citing *General Talking Pictures Corp. v. Western Electric Co.*, 304 U.S. 175 (1938), the Court reaffirmed that the patentee must have authorized a sale for that sale to trigger exhaustion. In *Quanta*, the Court found that the sale from Intel to Quanta was authorized--the agreements between LG and Intel did not restrict "Intel's right to sell ... to purchasers who intend to combine [the Intel chips] with non-Intel parts." A major question expressly left unanswered by the Court is how "exhaustion" affects possible contract rights. The Court "note[d] that the authorized nature of the sale to Quanta does not necessarily limit LGE's other contract rights" and "express[ed] no opinion on whether contract damages might be available even though exhaustion operates to eliminate patent damages."

The implications of the *Quanta* decision will extend across many industries. Patentees and licensees will want to reexamine their licensing arrangements and practices to determine whether the relevant patents are exhausted by the form of a sale. Even if patent rights are exhausted, a patentee may still be able to enforce restrictions through contractual terms, although the Court did not address the permitted scope of such terms. The permissible scope of such terms will need to await later decisions.

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