No. 06-937

IN THE

Supreme Court of the United States

QUANTA COMPUTER, INC., QUANTA COMPUTER USA, INC.,
Q-LITY COMPUTER, INC.,
Petitioners,

v.

LG ELECTRONICS, INC.,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES
COURT OF APPEALS FOR THE FEDERAL CIRCUIT

BRIEF OF MPEG LA LLC AS *AMICUS CURIAE* IN SUPPORT OF RESPONDENT

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STATEMENT OF INTEREST OF *AMICUS CURIAE* [1]

MPEG LA LLC ("MPEG LA") is the administrator of worldwide patent pools for numerous standardized technologies, including the patent pool for the MPEG-2 digital compression technology (the "MPEG-2 Pool").[2] MPEG-2 is a core platform technology used in every DVD player, DVD-enabled personal computer, DVD movie disc, digital cable box, and satellite television receiver sold in the United States and in certain other locations, as well as in all HDTV television sets.[3] Collectively, the sales of these products account for billions of dollars

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[1] Pursuant to Rule 37.6, counsel certifies that this brief was not authored, in whole or in part, by counsel for any party, and no person or entity other than *amicus* and its counsel contributed monetarily to the preparation or submission of the brief. Both Petitioners and Respondent have consented to the filing of any *amicus* brief and their letters of consent have been filed with the Clerk of the Court.

[2] MPEG LA currently administers nine patent pool programs. Two additional programs are in active development. *See* www.mpegla.com (last visited December 6, 2007).

[3] MPEG-2, adopted jointly by the International Organization of Standards (an entity organized under the auspices of the United Nations) and the International Telecommunications Union-Telecommunications Sector, is a flexible and open standard which eliminates redundant information from a digital video signal to conserve transmission resources and storage space on storage media such as optical discs. Without a compression technology such as MPEG-2, a two-hour movie would require approximately six or seven DVD discs.

of consumer spending every year. The vast majority of these products are licensed through the MPEG-2 Pool. So-called next-generation digital video formats, such as Blu-ray® Disc and HD DVD, also rely on MPEG-2 patents, as does the digital broadcast standard (ATSC) mandated by the Federal Communications Commission. The MPEG-2 Pool license offered by MPEG LA provides a convenient, cost-effective and procompetitive means by which manufacturers wishing to make MPEG-2 products can obtain in a single license the right to use hundreds of patents essential to MPEG-2. Patent licenses such as the MPEG-2 Pool license, which has been signed by more than 1,300 manufacturers worldwide, may be implicated by a ruling in this case.

The MPEG-2 Pool was created in 1997 when Columbia University, Fujitsu Limited, General Instrument Corporation, Matsushita Electric Industrial Co., Ltd., Mitsubishi Electric Corporation, Philips Electronics N.V., Scientific-Atlanta, Inc., and Sony Corporation — all of which held patents essential to the MPEG-2 technology — agreed to license their patents on standard nondiscriminatory terms in a single patent portfolio license. The formation of the MPEG-2 Pool was a complex undertaking. Among other issues, the participating patentees had to agree on standard license terms, license duration and rates, and division of any royalties received. Once formed, however, the MPEG-2 Pool yielded a number of procompetitive benefits recognized by, among others, the Antitrust Division of the United States Department of Justice

("Antitrust Division") and the competition authorities of the European Union.[4]

Pivotal among the procompetitive benefits of the MPEG-2 Pool, and many other patent pools administered by MPEG LA, is the elimination of many patent "blocking positions" that could be asserted against any user of a technology by any patentee owning essential patents. Other benefits of the MPEG-2 Pool and other patent pools include: (1) reducing the uncertainty of whether patent licenses are in fact being made available by patent owners; (2) reducing the royalties that likely would

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[4] The MPEG-2 Pool received a Business Review Letter from the Antitrust Division stating that the MPEG-2 Pool is

> likely to provide significant cost savings to Licensors and licensees alike, substantially reducing the time and expense that would otherwise be required to disseminate the rights to each MPEG-2 Essential Patent to each would-be licensee. Moreover, the proposed agreements that will govern the licensing arrangement have features designed to enhance the usual procompetitive effects and mitigate potential anticompetitive dangers.

Letter of Joel I. Klein, Esq., Assistant Attorney General, Department of Justice, to Garrard R. Beeney, Sullivan & Cromwell LLP (June 26, 1997) *available at* http://www.usdoj.gov/atr/public/busreview/215742.htm ("Business Review Letter"). The MPEG-2 Pool also received a comfort letter from the competition authorities of the European Union. Letter of John Temple Lang, Director, European Commission, Directorate-General IV-Competition, to Garrard R. Beeney, Sullivan & Cromwell LLP (Dec. 14, 1998) (on file with author).

be payable if each essential patent holder licensed its patent(s) on its own rather than in a pool; (3) reducing the substantial cost for each licensee of determining on its own the identity of essential patent holders from whom a license must be obtained; (4) reducing other transaction costs of negotiating and executing multiple licenses; (5) reducing the cost of providing licenses, thereby allowing licenses to be offered at a lower price; and (6) offering the same royalty to all interested licensees on nondiscriminatory terms so that no entity manufacturing or selling MPEG-2 products will be disadvantaged as a result of entering into an MPEG-2 patent license. *See* Business Review Letter at 9-10.

In order to encourage patentees to provide these procompetitive benefits and eliminate, to the extent possible, "patent thickets" that would retard the adoption of new technologies and the offering of innovative products, the MPEG-2 Pool — and other pool licenses — rely on certain license structures potentially implicated by the issues in this case. As explained below, those license structures enable, through conditional licenses, the limited use of patented inventions at certain stages of the product distribution chain, while preserving the ability to collect royalties at other stages and to enforce patent rights by way of claims of infringement.

In MPEG-2 technology — as with many, if not all, standard technologies — a single patent claim may be infringed by activities at various levels of the distribution chain for a single product. From the fabrication of a chip, to its incorporation in a circuit board, to the manufacture, sale and use of a finished product, each activity may constitute a separate act of infringement of the same patent claim. While each independent party in the product chain may desire a license to avoid allegations regarding infringement, a patent pool licensing program with many licensees will typically direct its royalty-bearing licensing activities to a single stage of the distribution process. By focusing on a single point in the distribution chain, confusion is avoided over what product is and is not licensed. The MPEG-2 Pool accomplishes this by generally providing royalty-bearing licenses only for products in the form in which they are used by consumers. In order to provide "comfort," however, to others in the distribution chain who are engaged in infringing activities, the MPEG-2 Pool also offers royalty-free limited licenses to intermediate product makers, *i.e.*, those who provide one or more components of finished products. While offering licenses under the same patents to both component manufacturers and finished product sellers who incorporate such components into a finished product, MPEG LA collects only a single royalty for each product.

In addition to facilitating patent pools, the ability to license patents at one stage of the distribution chain while retaining the right to collect royalties on the same patents at other stages is crucial in many other respects. *See* pages 23-26, *infra*. An automatic exhaustion rule such as that advocated by Petitioners would needlessly hinder the ability of patentees to provide patent pools and the procompetitive benefits they offer.

MPEG LA regularly presents its views on important public policy issues that impact patent rights, competition and the technology industries. In that context, MPEG LA is appearing as *amicus curiae* in this Court in support of Respondent.

STATEMENT OF THE CASE

Amicus curiae MPEG LA states the case as follows insofar as it is relevant to MPEG LA's argument:

1. Intel Corporation ("Intel") and Respondent LG Electronics, Inc. ("LG") entered into a License and a Master Agreement providing, among other things, the following:

   a. Intel shall have "the right to 'make, use, sell (directly or otherwise), offer to sell, import or otherwise dispose of' all Intel Licensed Products." Pet'rs Br. at 8 (citing JA 145-73 (¶ 3.2(a))).

   b. No license "is granted by either party hereto . . . to any third party for the combination by a third party of Licensed Products of either party with items, components, or the like acquired . . . from sources other than a party hereto, or for the use, import, offer for sale or sale of such combination." Pet'rs Br. at 8 (citing JA 164 ¶ 3.8)).

c. "Notwithstanding anything to the contrary contained in this Agreement, the parties agree that nothing herein shall in any way limit or alter the effect of patent exhaustion that would otherwise apply when a party hereto sells any of its Licensed Products." Pet'rs Br. at 8 (citing JA 164 (¶ 3.8)).

d. Intel was required to send a "notice" to its customers informing them that they did not receive any "license" from LG to use products purchased from Intel in any product that combines "an Intel product with any non-Intel product." Pet'rs Br. at 8-9 (citing JA 198).

2. LG did not sell any articles at issue in this case. Rather, LG acted only in the capacity of licensor and contracting party. All sales of allegedly infringing articles were made by the licensee, Intel, and its customers.

3. Under the claims of the LG patents at issue, Intel, by its sale of components, would be a contributory infringer but for its license from LG. Intel, but for its license, would contributorily infringe by manufacturing and selling components having no substantial non-infringing use. The Intel components are subsequently combined with non-Intel products by Petitioners to form a product that independently infringes LG's patents.

4. In proceedings below, the lower courts did not explicitly determine whether (1) the various

relevant provisions in the LG-Intel License and Master Agreement constituted a full grant of LG's patent rights which were then limited by contractual undertakings or, conversely, (2) LG granted to Intel a conditional license of less than all of LG's patent rights. The record is unclear as to how this issue should be resolved.

SUMMARY OF ARGUMENT

Petitioners urge this Court to adopt what is essentially an "automatic exhaustion" rule that could eliminate many procompetitive and customary transactions, and which would ignore the desires of contracting parties. Under Petitioners' proposed rule, a patentee could not license a chip maker or sell a chip under terms that reflect the agreed upon value of that transaction while retaining the right to assert reserved patent rights with respect to the finished product. A patentee also could not license a third party to conduct research only while reserving other parts of the patent monopoly, such as the right to sell, for a later time if and when an infringing product was developed and sold. For at least the reasons stated below, the Court should not adopt an exhaustion rule that automatically applies upon the sale of a patented article. Rather, patentees and their contracting parties should be free to sell products or enter into licenses that reflect the bargain they have reached for the particular rights they wish to offer and accept. If a counterparty neither needs nor wants to pay to acquire the entire patent monopoly of a patentee, no rule should require it.

1. Petitioners' proposed rule directly conflicts with the clear language of the patent statute, and *no* language of the statute is cited in support of the proposed rule. Section 271(d) of the patent statute, 35 U.S.C. § 271(d), explicitly authorizes a patent holder to seek additional royalties from a licensee's customers when the licensee sells components that but for the license would contributorily infringe. In this case, LG is authorized by Section 271(d) to seek relief for infringement or contributory infringement against finished product sellers such as Petitioners, despite having licensed Petitioners' supplier, Intel, to practice the patents. Petitioners' proposed rule would render this section of the patent statute meaningless.

2. The Court's decisions do not support Petitioners' "automatic exhaustion" rule. As the Court has long instructed, patent rights are exhausted upon an "authorized" sale. A sale or license which specifically does not transfer certain rights inherent in the patent grant is not "authorized" to the extent of those patent rights specifically retained by the patentee, whether acting as seller or licensor. Similarly, a sale made by a licensee or purchaser that either breaches the licensing or sales agreement, or purports to sell more of a property interest in the patented good than the licensee owns, is not authorized and may be addressed by the patentee asserting that part of the patent monopoly not yet conveyed. Consistent with Section 271(d), the Court has never held that a patentee who grants only part of the make, use and

sell rights inherent in a patent may not later enforce that portion of the patent right retained against purchasers of patented articles.

While Petitioners assert that the Court has allowed enforcement of restrictions placed on licensee-sellers but not restrictions placed by patentee-sellers, the Court's cases with respect to patentees selling patented articles and licensees selling such articles are not in conflict. The distinction asserted by Petitioners requiring an intervening licensee should not be adopted by the Court. The patent statute makes no such distinction between a patentee-seller and a licensee-seller, and such a distinction could easily be overcome.[5] Rather, the distinction inherent in the patent statute and consistent with the Court's interpretation of the statute is that patent rights are exhausted upon the authorized sale of an article, but only to the extent of such authorization. If certain patent rights inherent in the patent are clearly retained in connection with a transfer or license, such transfer or later sale by the licensee cannot and does not exhaust those rights retained by the patentee.

Consistent with these cases and the patent statute, the Court regularly has held that a patent holder is not required to give up all of its monopoly

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[5] We question whether such a meaningless dichotomy would simply encourage patentees to place patent ownership in one entity, license an affiliate, and then place restrictions on products sold by the affiliate.

in a single transaction, nor must a licensee and/or purchaser pay for more than that part of the patent monopoly it desires in any single transaction. Licenses of partial rights are regularly upheld, and parties should remain free to structure transactions as they deem necessary. Petitioners themselves concede that patent licenses "can indeed carry conditions" and that "breach of those conditions can justify an infringement suit." Pet'rs Br. at 13.

3. Petitioners' automatic exhaustion rule is not supported by policy or economics. Instead of facilitating innovation, the very purpose of the patent grant, Petitioners' rule will stifle innovation and produce inefficient results.

Moreover, Petitioners' rule does not serve to reduce costs or prevent "super-monopoly" royalties. Only one royalty amount can be extracted from a patent monopoly. It is immaterial whether that royalty amount is paid by a single licensee or divided among several. A patentee is not able to extract some sort of "super-monopoly" royalty by dividing the payment over different steps in the product lifecycle. There is no evidence to support the notion that LG could or did pursue or obtain such a "super-monopoly" royalty. In fact, Petitioners concede that there is only one royalty sum payable for the license of the patent monopoly, regardless of the number of licensees which share the rights inherent in the patent grant.

ARGUMENT

I. PETITIONERS' "AUTOMATIC EXHAUSTION" RULE IS NOT SUPPORTED BY THE PATENT STATUTE OR THE DECISIONS OF THE COURT.

A. The Patent Statute Does Not Support an Automatic Exhaustion Rule; the Statute Authorizes Multiple Licenses at Different Stages of Product Distribution.

Petitioners urge the Court to drastically broaden the doctrine of patent exhaustion despite clear statutory language to the contrary. LG's claims of infringement against the Petitioners in this case, which Petitioners erroneously argue should be foreclosed, are, in fact, explicitly permitted by the patent statute. *See* 35 U.S.C. § 271(d).

Section 271(d) specifically allows for precisely the conduct LG exhibited in this case:

> No patent owner otherwise entitled to relief for infringement or contributory infringement of a patent shall be denied relief or deemed guilty of misuse or illegal extension of the patent right by reason of his having done one or more of the following: (1) derived revenue from acts which if performed by another without his consent would constitute contributory infringement of the patent; (2) licensed or authorized another to perform acts which if performed without his consent would constitute contributory infringement of the patent . . . .

35 U.S.C. § 271(d).[6] The statute thus specifically provides that a patent owner may seek royalties on the same patent for both a contributory infringer and a direct infringer.[7]

The language of the patent statute controls here. In this case, LG licensed another (Intel) to perform an act (sell chips) which, if performed without LG's consent, would constitute contributory infringement of the patent by Intel. Section 271(d) specifically provides that LG's licensing of the Intel chips does not foreclose the possibility of seeking relief against others who combine that chip into another product by way of an infringement action. The patent statute thus explicitly authorizes LG to seek additional royalties from Intel's customers notwithstanding the fact that Intel has paid a royalty to be free of contributory infringement.

In the Brief for the United States as *Amicus Curiae* supporting *certiorari* ("Gov't Cert. Br."), the Government conceded that Section 271(d) "might be construed to entitle a patentee in respondent's position to relief," Gov't Cert. Br. at 20 n.7, but argued that such a conclusion could be drawn only if

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[6] For ease of reference, the full text of the statute appears in the appendix to the Brief for Respondent.

[7] In addition to making clear that a patentee may license and obtain royalties at different steps of the distribution chain, the statute also and independently provides that it is neither misuse nor an extension of the patent monopoly to seek such royalties.

the statute was read "in isolation, and without an understanding of its context and purpose." *Id.*

Regardless of "context and purpose" (see below), the language of the patent statute is clear. The Court has long expressed reluctance at divining the "intent" of a statute when the legislative language is unambiguous. *See, e.g.*, *Am. Tobacco Co.* v. *Patterson*, 456 U.S. 63, 68 (1982).

Moreover, there is no evidence to support the Government's argument that the statute merely addresses "the relationship between the doctrines of patent misuse and contributory infringement." Gov't Cert. Br. at 20 n.7. While the statute provides that behavior such as that engaged in by LG here should not be deemed misuse, the statute also provides in the disjunctive ("or") that a patentee such as LG also should not be denied relief under the patent laws because of its upstream license to a contributory infringer such as Intel.[8]

Petitioners avoid any reference to this statutory language. Instead of citing the patent statute, Petitioners speculate that a mandatory first sale exhaustion rule "makes sound economic and policy sense." Pet'rs Br. at 15. According to Petitioners, a rule imposing the obligation on a patentee to part with the entire patent monopoly in a

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[8] *Dawson Chem. Co.* v. *Rohm & Haas Co.*, 448 U.S. 176, 200-13 (1980), cited by the Government, does not address the issue raised here.

single transaction "minimizes transaction costs by forcing the patent owner to exact the full value of its patent rights in one negotiation with the first purchaser, which can then share the burden with the rest of the distribution chain by charging a higher price." *Id.* In reality, such a rule, far from advancing efficiency, would require contracting parties to speculate about the value to strangers of certain rights, and cause a purchaser/licensee to price and pay for rights it neither requires nor desires. This proposed rule would restrain a patentee's well-established right to divide its monopoly among several infringers in the product distribution chain, taking into account the value to each licensee. *See also* pages 23-25, *infra*.

The patent statute simply does not require a patentee to part with its entire patent monopoly and receive the entire royalty therefrom in one and only one transaction. The statute clearly contemplates licenses of partial rights, in separate transactions with separate parties, involving the same allegedly infringing articles. Petitioners' proposed automatic exhaustion rule runs afoul of this clear legislative language.[9]

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[9] Petitioners' automatic exhaustion rule not only runs afoul of the plain language of the patent statute, but it also violates the well-settled rule that a licensee cannot convey in a subsequent sale more rights than it possesses. In *Mitchell* v. *Hawley*, 83 U.S. (16 Wall.) 548 (1872), this Court held that "[n]o one in general can sell personal property and convey a valid title to it

B. Patent Rights Are Exhausted Only After "Authorized" Sales.

"A patent-right is incorporeal property, not susceptible of actual delivery or possession . . . ." *Waterman* v. *Mackenzie*, 138 U.S. 252, 260 (1891). As such, and in accord with traditional notions of property rights, patent law grants a patent holder the "right to exclude others from making, using, offering for sale, or selling the invention . . . ." 35 U.S.C. § 154(a). A patentee's "title is exclusive, and so clearly within the constitutional provisions in respect of private property that he is neither bound

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unless he is the owner or lawfully represents the owner. *Nemo dat quod non habet* . . . . [N]o one can convey . . . any better title than he owns." *Mitchell*, 83 U.S. at 550. Accordingly, a manufacturing licensee cannot confer broader rights than it has been granted by the patent holder. *See*, *e.g.*, *Aro Mfg. Co.* v. *Convertible Top Replacement Co.*, 377 U.S. 476, 484 (1964). When a patentee does not convey its full patent monopoly in a sale or license, the purchaser/licensee cannot convey the patented article with greater patent rights than it obtained. Petitioners' argument, that a patent is necessarily exhausted when a patentee or manufacturing licensee sells a product — even in violation of the explicit sale or license terms that accompany such sale — violates this fundamental tenet of property law. Simply put, if LG did not convey to Intel the full patent monopoly LG possessed, Intel could not convey to its customers greater patent rights than it was permitted to convey. There is no doubt that the patentee and its contracting party may elect to enforce lawful restrictions through contract law rather than patent law, but there is no support for the rule that such restrictions are limited to contract law.

to use his discovery himself nor permit others to use it." *Heaton-Peninsular Button-Fastener Co.* v. *Eureka Specialty Co.*, 77 F. 288, 295 (6th Cir. 1896) (cited with approval in *E. Bement & Sons* v. *National Harrow Co.*, 186 U.S. 70, 90 (1902)).

Consistent with these principles, the Court for many years has instructed that under the doctrine of patent exhaustion, the patentee's authorized and *unconditional* sale of a patented article into the stream of commerce exhausts the patent holder's patent monopoly. *See*, *e.g.*, *United States* v. *General Electric Co.*, 272 U.S. 476, 489 (1926). This Court, however, has never held that rights specifically withheld in a transaction were nonetheless transferred and exhausted.

In *Adams* v. *Burke*, 84 U.S. (17 Wall.) 453 (1873), the patentee sought to enforce a geographical restriction on the use of the patented article against Burke, who took title without any such restriction. While the geographical restriction was in an agreement between the patentee and his assignee, it was not in the sale contract to Burke. Burke's purchase and subsequent use outside the geographical restriction recited in an earlier transaction to which Burke was not a party was deemed not to constitute infringement as Burke's right to use was conveyed without any such limitations. While the restrictions could not be enforced against Burke, whose title was not "encumbered," the Court nevertheless stated that grants of patent rights may be restricted, divided and offered to different licensees: the "right to manufacture, the right to sell, and the right to use are each substantive rights, and may be granted or conferred *separately* by the patentee." *Id.* at 456 (emphasis added).

Similarly, in *Keeler* v. *Standard Folding-Bed Co.*, 157 U.S. 659 (1895), a geographical restriction was *not* recited in the sale agreement to Keeler, against whom the restriction was attempted to be enforced. The Court ruled that Keeler was authorized by his unrestricted purchase to sell wherever he chose, and vacated an award of damages. *Id.* at 666.

In *United States* v. *Univis Lens Co.*, 316 U.S. 241 (1942), the patentee sought to impose price restrictions on parties which had taken title to the lens products *after* all royalties due were paid by parties earlier in the title chain. Regardless of whether *Univis* is read as an "antitrust case" or a "patent case," the decision is consistent with the notion that restrictions may not be enforced against parties after authorized sales.[10]

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[10] Moreover, *Adams*, *Keeler*, *Univis*, and other cases which denied enforcement of alleged restrictions neither ruled on nor contemplated the circumstances here in which LG's patents are actually infringed by the combination of the licensed Intel component with a separate non-licensed component. Pet'rs Br. at 8 (citing JA 164 (¶ 3.8)); *id.* at 8-9 (citing JA 198). It may be one thing to find exhaustion from an authorized sale, but it is wholly another to deprive a patentee of its right to allege direct infringement by a third party.

The rule regarding exhaustion from authorized sales was stated in *Mitchell* v. *Hawley*, 83 U.S. (16 Wall.) 548 (1872). In *Mitchell*, the Court ruled that restrictions on purchases from the patentee could not be enforced, but limited such rule to unconditional sales. "[W]here the sale is absolute, and without any conditions, the rule is well settled that the purchaser may continue to use the implement or machine purchased until it is worn out . . . ." *Id.* at 548.

The Court's language limiting exhaustion to "absolute" sales and those without "conditions" was not superfluous. Indeed, in those cases in which the Court has upheld the effort to place restrictions inherent in patent rights on downstream purchasers, the transactions were accompanied by the restrictions at issue. For example, the Court upheld minimum price restrictions set out in the license to defendant in *E. Bement & Sons* because the defendant's sale in violation of those restrictions was, by definition, not authorized. 186 U.S. at 93.

The Court reached a similar conclusion in *General Talking Pictures* v. *Western Electric Co.*, 304 U.S. 175 (1938), *reh'g granted on other grounds*, 305 U.S. 124 (1938). When the customer of a licensee took title to certain amplifiers with restrictions against use in commercial theaters, the Court ruled that the licensee's customer was guilty of infringement because defendant's commercial use was not authorized.[11] The Court recognized that "[p]atent owners may grant licenses extending to all uses or limited to use in a defined field," 304 U.S. at 181, and went on to hold that defendant's sale in violation of the restriction was the same as if "no license whatsoever had been granted." *Gen. Talking Pictures Corp*. v. *Western Elec. Co*., 305 U.S. 124, 127 (1938).

In more recent cases, the Court has recognized that a patentee "may assign to another his patent, in whole *or in part*, and may license others to practice his invention." *Zenith Radio Corp.* v. *Hazeltine Research, Inc.*, 395 U.S. 100, 135 (1969) (emphasis added). The Court has regularly recognized the freedom of a patentee to limit others' use and enjoyment of his patent. *See*, *e.g.*, *Crown Die & Tool Co.* v. *Nye Tool & Machine Works*, 261 U.S. 24, 34 (1923) (listing cases); *Continental Paper Bag Co.* v. *Eastern Paper Bag Co.*, 210 U.S. 405, 424 (1908); *Waterman*, 138 U.S. at 255. As the Court has explained:

> the general rule is absolute freedom in the use or sale of rights under the patent laws of the United States. The very object of these laws

[11] *Motion Picture Patents Co.* v. *Universal Film Mfg. Co.*, 243 U.S. 502 (1917) is not to the contrary. In that case, the patentee attempted to impose restrictions beyond the grant of the patent. *Motion Picture Patents* does not stand for the proposition that rights inherent in the patent may not be withheld at the time of a sale.

> is monopoly, and the rule is, with few exceptions, that any conditions which are not in their very nature illegal with regard to this kind of property, imposed by the patentee and agreed to by the licensee for the right to manufacture or use or sell the article, will be upheld by the courts.

E. Bement & Sons, 186 U.S. at 91.

In *United States* v. *U.S. Gypsum Co.*, 333 U.S. 364, 380-82 (1948), the patentee granted many licenses, some for less than all of the rights inherent in the patent. Although the Court found that certain industry-wide license agreements violated the Sherman Act because the agreements, as a whole, were used to control both prices and distribution methods of gypsum, *id.* at 389, the Court took no issue with licenses that granted limited rights to make, use or sell. Moreover, *U.S. Gypsum Co.* left undisturbed the clear holding of *United States* v. *General Electric Co.*, 272 U.S. at 489, that "[t]he owner of a patent may assign it to another and convey . . . an undivided part or share of that exclusive right."

The Court's decisions thus permit a patentee to part with a portion of the patent monopoly, receiving in exchange a portion of the royalty fee, so long as the limiting conditions are explicit, and the restrictions are within the scope of the monopoly and do not contravene another body of law.

Petitioners and various *amici* argue that the holdings in the cases cited above are determined by whether the defendant has taken title directly from the patentee or from an intervening manufacturer-licensee, but the patent statute makes no such distinction. Rather, the Court's cases stand for the proposition that a restriction may not be imposed after an "authorized sale," but that transfers limited by lawful restrictions are not authorized and are thus enforceable by infringement actions. *Compare Bloomer* v. *Millinger*, 68 U.S. (1 Wall.) 340, 351 (1864) (holding that, after "a valid sale and purchase of the patented machine," that machine "is no longer specially protected by the laws of the United States . . . ."), *with E. Bement & Sons*, 186 U.S. at 91 (finding that "any conditions which are not in their very nature illegal with regard to this kind of property, imposed by the patentee and agreed to by the licensee for the right to manufacture or use or sell the article, will be upheld by the courts.").

Consistent with the patent statute and the Court's holdings, a patentee should not be required to convey the totality of its patent rights in any single transaction, and a clear limitation on the conveyance of those rights — whether the partial grant is accompanied by the patentee's sale of the infringing article — should be enforceable under patent law.[12]

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[12] While Petitioner and certain *amici* urge this Court to consider rules applicable to a patentee's sale of a patented article, we note that no such facts exist in this case. LG acted as pure licensor; only Intel, the licensee, sold the allegedly

II. PETITIONERS' MANDATORY EXHAUSTION RULE WOULD INTERFERE WITH MANY EFFICIENT TRANSACTIONS.

Nothing in the patent statute or in this Court's decisions suggest that a patentee or its licensee must necessarily part with all patent rights in the first sale of a patented article, provided the transfer of rights is explicitly restricted in a way that does not violate other substantive law. Moreover, there is no valid "policy" reason to create such a rule — which is contrary to the plain language of the statute (see pages 12-14, *supra*) — and there are many reasons to reject it.

As noted at pages 5-6, *supra*, MPEG LA and the patent pool structure it and others employ rely on the ability of patentees to provide licenses at various levels of the product distribution chain to, among other things, clear blocking positions, enable research, and allow upstream component manufacturers to make components without fear of infringement litigation. These licensors nevertheless recover the predominant value of the single patent

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infringing product. Moreover, we note that certain contractual language may be deemed to constitute the conveyance of all patent rights with contractual restrictions, while other contractual language may be deemed to convey less than all patent rights. There was no finding below as to whether the various provisions of the LG-Intel agreement constitute the former, the latter, or something else.

monopoly at a later stage of the product distribution process from sellers of finished products who may have purchased components from a supplier with a limited license and incorporated them into finished products. This process has, among other things, allowed hundreds of component makers to enter the market on terms that are both certain and acceptable, while at the same time granting more than 1,300 licensees[13] in the MPEG-2 Pool the right to sell higher value finished products under license from MPEG LA.

In addition to adversely affecting these and other procompetitive transactions, Petitioners' mandatory exhaustion rule needlessly interferes with the rights of contracting parties to determine and pay for or sell only those rights they wish to acquire or impart. The right to make and sell a device may have one value, while the right to use that device may have completely different values to different parties. For example, certain patents may have one value to an integrated circuit manufacturer who sells chips for a few dollars, but a different, and substantially higher, value to a company that uses those chips to broadcast major sporting events, like the NFL, to millions of premium television subscribers. Both the chip maker and the broadcaster may infringe the same patent. Requiring the patentee and circuit manufacturer to

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[13] *See generally* www.mpegla.com (last visited December 6, 2007).

reflect the "use" value to a third party, such as the broadcaster, in their transaction only burdens the patentee-circuit manufacturer transaction with unnecessary complexity.[14]

The argument of Petitioners and certain *amici* that the full value of a patent *must* — notwithstanding the contracting parties' desire to the contrary — be reflected at the first sale of an article by a patentee or its licensee threatens to upset the reasonable expectations and prudent contract negotiations of thousands of parties to patent pools and other licenses who have relied on the ability of the patentee to transfer less than all its rights in a sale or license.

Furthermore, Petitioners and their *amici* offer no valid reason why, for example, an MPEG-2 chip manufacturer must negotiate and "pay" for that part of the patent monopoly it does not need, such as the right to sell or use a DVD player which is manufactured by a third party purchaser of the chip. Nor do Petitioners and their *amici* offer a valid reason why, if two pharmaceutical companies wish to cross-license each other to do research on a particular compound (but not to sell finished products), such a license must include the right to sell any product which contains such compound.

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[14] The exhaustion rule should be the same whether the patentee offers a conditional license for the chip or sells the chip with a conditional license.

While the adoption of Petitioners' rule would eliminate or retard many efficient transactions, it would not lower licensing costs or create other benefits. As Petitioners eloquently demonstrate, dividing the full value of a patent monopoly among different levels of the distribution chain depending on which rights are desired by which licensee does not add inefficiency or cost. No more than one complete value of the patent monopoly may be collected by the patentee regardless of whether royalties are sought at one step or at multiple steps in the product distribution chain. As Petitioners state:

> A rational patentee cannot obtain more by negotiating separately with the manufacturer, distributor, retailer and consumer than he could have obtained by charging the entire amount to the first party in the chain and relying on it to pass the cost along in the form of higher prices. There is only one monopoly profit to be obtained in any vertical distribution chain.

Pet'rs Br. at 49 (citations omitted). Importantly, there is no evidence whatsoever in this case that supports any claim to the contrary.

There is no sound basis to adopt Petitioners' rule and further burden licensing or sales negotiations which already involve significant transactions costs.[15] Petitioners' rule would mean that, in addition to a review of patent claims, validity issues, valuations of rights the parties wish to convey and obtain, and other matters, parties to a patent transaction which contemplates a sale of an article also would need to devote significant time and expense to evaluating and assigning value to rights relevant only to strangers to the transaction. Neither the patent statute nor the Court's precedents require this inefficient result.

While it is clear that the Court has not applied a mandatory exhaustion rule to conditional or unauthorized sales, it also is clear that the cases relied on by Petitioners and certain *amici* were decided against the backdrop of an economy that existed more than a century ago. Whatever the needs of contracting parties with respect to coffin lids, wardrobe beds or eyeglass lenses, patentees today, consistent with the patent statute, need to be able to clear blocking positions and provide certain parties patent rights to engage in limited activities while retaining other patent rights to assert at different levels of the product distribution chain. Particularly with no provision of the patent statute mandating otherwise — and Petitioners and their *amici* have cited no such language — the Court should decline the invitation to restrict the rights of

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[15] Robert P. Merges & Richard R. Nelson, *On the Complex Economics of Patent Scope*, 90 Colum. L. Rev. 839, 874 (May 1990).

private contracts and substantially and unnecessarily burden already complex transactions.

CONCLUSION

For the foregoing reasons, the judgment of the court of appeals should be affirmed.

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