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The scope of patent exhaustion

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The basic idea of patent exhaustion is intuitive. If a company sells its patented product to a buyer, the company cannot sue the buyer for patent infringement for using the product. The company's patent rights are exhausted as to the particular item it sold. But like many legal principles, questions begin to arise as you move away from the basic fact pattern. For example, is there exhaustion if the patent is related to, but not the same scope as, the product? How does the exhaustion apply to other parties who provide complementary products or services? Can a patent holder avoid exhaustion by imposing restrictions on use of the product?

Questions as to the scope of patent exhaustion typically come up in two scenarios. The first is where the patent holder itself sells the patented product. The second is where the patent holder grants a licence under the patent giving the licensee the right to sell the patented product. In each scenario, there are three aspects of patent exhaustion that a patent holder or licensor should consider carefully: (1) which patents will be exhausted; (2) which types of users will be protected by the exhaustion; and (3) whether any uses of the product can be restricted. Addressing these questions at the outset will help to illuminate the probable extent of the exhaustion and may also enable the patent holder to limit its scope.

From the patent holder's perspective, the scope of exhaustion can matter a great deal because exhaustion generally means the elimination of a revenue stream. For example, in a sale by the patent holder of a machine that uses consumable components, the sale of the machine may eliminate the patent holder's ability to control the revenue stream for the consumables. Similarly, in the licensing context, granting too broad a licence to one company may eliminate the patent holder's ability to derive any revenue from other companies providing related, complementary products or services.

The LifeScan v Shasta case provides a good illustration of lost revenue.[1] LifeScan manufactured and sold blood glucose meters used by diabetic individuals to test the glucose level in their blood. LifeScan sold 40% of its meters at below cost and distributed the remaining 60% through healthcare providers that provided the meters to individuals for free. LifeScan also sold test strips used with the meters and its expectation was to derive its profit from the test strips. When its competitor, Shasta, began selling test strips for use with LifeScan meters, LifeScan sued Shasta alleging that the end users of LifeScan's meters directly infringed LifeScan's method patent and that Shasta indirectly infringed by selling the competing test strips. The question was whether LifeScan's distribution of the meter exhausted its method patent rights. Unfortunately for LifeScan, the Federal Circuit held that LifeScan's method patent rights were exhausted even though LifeScan made no money on its meters. Consequently, LifeScan was unable to prevent Shasta from selling the competing test strips where LifeScan expected to make its profit.

Another example is the Keurig v Sturm Foods case.[2] In that case, the Federal Circuit held that Keurig's patent, which included both apparatus claims and method claims, was exhausted by Keurig's sale of its coffee maker. The court also explained that exhaustion applies to a patent in its entirety, rather than on a claim-by-claim basis. As a result, patent exhaustion was a complete defense to Keurig's infringement claims and Keurig was unable to prevent Sturm Foods from selling competing cartridges for use with Keurig coffee makers.

So what are the rules that define the scope of patent exhaustion and what, if anything, can be done to control it?

The patents that are exhausted

First, it is important to consider which patents will be exhausted. The Supreme Court of the US in Quanta Computer v LG Electronics explained the standard for how closely related a patent needs to be to the product being sold in order for the sale to exhaust the patent: "The authorised sale of an article that substantially embodies a patent exhausts the patent holder's rights…"[3] In Quanta, the seller's products substantially embodied the patents because they had "no reasonable non-infringing use" and "included all the inventive aspects" of the patented methods.[4] The Supreme Court's standard defines which patents will be subject to exhaustion. It is possible, therefore, to preserve certain patent rights from being exhausted by analysing the different types of complementary products and services and devising a corresponding strategy for patent filing.

The Helferich case decided by the Federal Circuit earlier this year provides an example of a patent holder successfully shielding some of its patents from exhaustion.[5] Helferich had patents on handsets (eg, mobile phones) and had granted licences to handset manufacturers to make and sell handsets. Helferich also had patents on providing content (eg, articles published by publishers) to handsets, which represented a second potential revenue stream for Helferich in a complementary field.

After granting licences to essentially all the handset manufacturers, Helferich sued the content providers under its content patents. The content providers' defense was that Helferich could not assert its content patents against them because these patents all had been exhausted by authorised sales of the handsets which received the content. But the Federal Circuit did not accept such a broadly stated exhaustion defence. The court concluded that the two sets of patents were distinct, based on different claim elements and because the US Patent and Trademark Office had required the patent applicant to file separate patent applications. The court also noted that Helferich had gone to "painstaking efforts" to specify that the handset patents were licensed and the content patents were not. Hence, the court concluded that even though the handset patents were complementary to the content patents, the licensing of one did not exhaust the other. Helferich was successful in preventing the exhaustion because it had obtained different sets of patents and had drafted the licence grant to apply to only one.

These cases suggest a few practice tips for licensors:

- Consider the market and revenue streams early on. What types of companies are participants and what is the size of each revenue stream? File patent claims directed to each type of participant/revenue stream, particularly the significant ones (eg, consumables, monthly service fees, and other significant, recurring revenue streams).
- Identify and highlight patentable distinctions between different types of claims covering complementary products or services of the different market participants. Put different claim sets in different patents so as to avoid the Keurig principle that exhaustion applies to the entire patent.
- Draft the licence grant in a way that makes clear that only certain patents are licensed for certain participants and activities. Give the licensee enough rights to succeed, but no more.

The companies protected by exhaustion

A second consideration for the seller or licensor is what companies or entities may be protected by exhaustion. In the Helferich case, the Federal Circuit introduced the concept of an "authorised acquirer". The court explained that authorised acquirers are, "those who acquire title to the article at issue from the patentee or from a licensee authorised to sell, and those who acquire possession and operational control, as by lease, from such a person."[6] The content providers in Helferich were not authorised acquirers because they did not derive any rights from the patent holder, directly or indirectly. The patent holder had granted rights only to the handset manufacturers. Accordingly, licensors should consider the following practices:

- Draft the licence grant narrowly enough that it does not allow the licensee to pass on rights to other market participants. This may be best accomplished with definitions that are used in the licence grant. For example, the definitions of "Licensed Patents," "Licensed Products" and "Field of Use" can be drafted to cover the relevant patents and products of one type of market participant, but no broader.
- Include a disclaimer identifying the types of participants, products and services that are not licensed.

Enforceability of restrictions on use

A third aspect to consider is whether certain use restrictions that a seller or licensor attempts to impose on the end user are enforceable. Often they are not, and the current state of the law is uncertain on this point.

In general, the Supreme Court disfavours attempts to restrict a purchaser's post-sale use of an article. This was evident in the Court's discussion and treatment of the restrictions in Quanta.[7] In that case, it was clear that the licensor, LG Electronics, intended to restrict the licensee, Intel, from allowing the purchaser to combine non-Intel parts with the chips sold by Intel. Yet the Court focused only on the licence grant clause and found that the grant clause itself had no restrictions. Accordingly, restrictions that are not in the actual licence grant clause are much less likely to be enforceable.

On the other hand, field of use restrictions that are actually within the licence grant clause currently offer a means of limiting exhaustion. Field of use restrictions are effective because any sales outside the licence grant are unauthorised and infringing and thus do not trigger exhaustion.[8]

These cases suggest the following practice tips for licensors:

- If the licence grant clause itself is not restricted, there will likely be exhaustion because the sale will be authorised. Restrictions in other parts of the agreement may not be effective, as was the case in Quanta v LG Electronics.
- Field of use restrictions in the grant clause generally are enforceable under the General Talking Pictures case.

The other context in which use restrictions arise is in direct sales by the patent holder. One example of such a use restriction is the "single use only" restriction in the Mallincrodt v Medipart case decided by the Federal Circuit in 1992.[9] The Mallinckrodt case held that such use restrictions are enforceable as long as they are within the patent grant. However, cases subsequent to Quanta have suggested that Mallinckrodt was overruled sub silentio by Quanta.[10] The Federal Circuit will be deciding this issue in the near future.[11] Thus, it is currently unsettled whether a restriction accompanying a sale is enforceable, eg, can prevent patent exhaustion. Accordingly, sellers attempting to impose use restrictions should consider the following:

- Avoid relying on notice restrictions alone, at least until Lexmark v Impression Products is decided.
- If the enforceability of the restriction is important, include the restriction in a signed contract for the sale at the time of sale, if possible. A contract signed by the purchaser is more likely to be upheld than mere notice of the restriction.

There have been many recent developments in the patent exhaustion doctrine, and the Supreme Court's Quanta decision generally expanded its scope. Nevertheless, there are still principles that provide clarity as to its limits. By paying attention to the market participants, complementary products and services, revenue streams, patent claims and licence grants early on, a seller or licensor can enhance its ability to avoid exhaustion and benefit from different revenue streams.

Footnotes

1 LifeScan Scotland, Ltd et al v Shasta Technologies, LLC, 734 F.3d 1361 (Fed. Cir. 2013).

2 Keurig, Inc v Sturm Foods, Inc, 732 F.3d 1370 (Fed. Cir. 2013).

3 Quanta Computer, Inc v LG Electronics, Inc, 128 S. Ct. 2109, 2122 (2008) (emphasis added).

4 Id.

5 Helferich Patent Licensing, LLC v New York Times Company et al, 778 F.3d 1293 (Fed. Cir. 2015).

6 Helferich, 778 F.3d at 1297, n.1.

7 See Quanta, 128 S. Ct. at 2115 ("Although the Court permitted postsale restrictions on the use of a patented article in Henry v AB Dick Co, that decision was short lived."); see also United States v Univis Lens Co, 316 U.S. 241, 251 (1942) ("[T]he 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 realised the patent law affords no basis for restraining the use and enjoyment of the thing sold.").

8 See General Talking Pictures Corp v Western Electric Co et al, 304 U.S. 175 (1938).

9 Mallinckrodt, Inc v Medipart, Inc, 976 F.2d 700, 708 (Fed. Cir. 1992).

10 See Lexmark v Ink Technologies (S.D. Ohio 27 March 2014) ("[T]o the extent that Mallinckrodt holds that such post-sale use restrictions preclude patent exhaustion after an authorised sale, the Court agrees with the Static Control II court that Mallinckrodt was overruled by Quanta.").

11 See Lexmark International, Inc v Impression Products, Inc, Nos. 14-1617, 14-1619 (Fed. Cir. 14 Apr 2015) (Order for sua sponte hearing en banc; oral arguments conducted 2 October 2015).