

Static Control Components v. Lexmark International: Patent Exhaustion Post Quanta

Introduction

The precedential effects of the Supreme Court's ruling on patent exhaustion in *Quanta Computer Inc. v. LG Electronics Inc.*, __ U.S. __, 128 S.Ct. 2109 (2008) continue to ripple through the Federal Courts. In light of *Quanta*, U.S. District Court Judge Gregory F. Van Tatenhove recently reversed the court's prior decision and found that a post-sale restriction on the use of a patented product failed to prevent patent exhaustion in the case of *Static Control Components v. Lexmark International*, __ F.Supp.2d __, 2009 WL 891811 (E.D. Ky. Mar 31, 2009).

The Supreme Court's Decision in *Quanta Computer Inc. v. LG Electronics Inc.*

In *Quanta Computer Inc. v. LG Electronics Inc.*, the U.S. Supreme Court found that an agreement attempting to impose restrictions on the post-sale use of a good failed to avoid the exhaustion of the patent holder's right to enforce control over the use of the good. The defendant computer makers in an infringement suit claimed they were protected by the doctrine of patent exhaustion when they purchased unpatented computer chips that when combined with other common computer components practiced the patented method in question. The computer makers purchased the chips from Intel, an authorized licensee of the patent holder. Intel's agreement with the patent holder contained a clause explicitly disclaiming the grant of any license under the patent to third parties who purchased the chips. Further, Intel was required to inform its customers that the sale of its chips did not create a license to combine the chips with other computer components to practice the patent.

The Court in *Quanta* found that the license agreement did not actually impose conditions on the sale of the chips. The Court pointed out that nothing in the license agreement restricted Intel from selling the computer chips to purchasers who intended to combine them with other computer components to practice the patent. Further, the Court found that while the license agreement stipulated that purchasers of the computer chips were not licensed to practice the patented invention, the authorized sale of the computer chips which substantially embodied the invention exhausted the patent holder's right to enforce the patent on the use of the chips purchased from the authorized dealer. As a result, even in the absence of a license, the actions of the computer manufacturers were deemed to not infringe the patent.

Background of *Static Control Components v. Lexmark International*

The dispute between Lexmark and Static Control Components centered on the remanufacture and refilling of spent toner cartridges. Lexmark sold patented toner cartridges under a "Prebate" program, whereby they would charge a lower price under an agreement restricting the purchasers to only a single use and then requiring the empty cartridges to be returned to Lexmark. These cartridges were sold through ordinary retailers with the terms of the agreement printed on the cartridges' boxes. Static Control Components sold parts and supplies used by unauthorized third parties to remanufacture toner cartridges, such as those sold by Lexmark. Lexmark brought a claim against Static Control Components alleging direct infringement and inducement predicated on the unauthorized remanufacture of toner cartridges sold under the "Prebate" program. Static Control Components responded with a declaratory judgment action. Among a myriad of issues, the district court initially found that the first sale of their toner cartridges did not exhaust Lexmark's patent rights due to the terms of the "Prebate" agreement. *Quanta Computer Inc. v. LG Electronics Inc.* was decided by the Supreme Court after this decision. In light of *Quanta*, Static Control Components filed a motion to reconsider, leading the district court to review its decision.

The *Static Control Components* Courts Application of *Quanta*

Upon reconsideration, Judge Van Tatenhove articulated that *Quanta* had reasserted a broad scope in the doctrine of patent exhaustion that had been previously narrowed by Federal Circuit case law. The court found patent exhaustion through the first sale of a product embodying a patent prevented a patent holder from asserting rights in the usage of the product so long as the first sale was authorized and not subject to conditions on the products use. The court acknowledged that state contract law may find that the requirement to only use the cartridges once and then return them was valid and enforceable. Yet, the court was not persuaded that the sales of the toner cartridges were conditional for the purposes of patent exhaustion, as Lexmark could not show a meeting of the minds between themselves and their customers where the conditions were merely printed on the box without any indication that the customers had read or agreed to the terms prior to making their purchases. The court, reasoning that Lexmark was impermissibly trying to enforce patent-based restrictions through post-sale terms on the "Prebate" cartridge boxes, reversed its prior decision and found that the sale of the toner cartridges exhausted Lexmark's patent-based right to prevent the cartridges from being remanufactured or refilled.

Impact and Lessons from *Static Control Components*

Though *Static Control Components v. Lexmark International* has little precedential authority in other jurisdictions, the case raises potential issues that will likely play out in the higher courts in the near future. The court cast serious doubt on the validity of post-sale conditions on the use of patented items. While acknowledging that state contract law may still provide for valid contract remedies against purchasers, the court unequivocally expressed a belief that cases, such as *Mallinckrodt v. Medipart*, 976 F.2d 700 (Fed. Cir

1992), that have found post-sale conditions could be used to preserve patent rights had been overruled *sub silentio* by the Supreme Court's decision in *Quanta*.

Another issue that was raised within the dicta of *Static Control Components* is the effect *Quanta* has on exhaustion through foreign sales. In cases such as *Jazz Photo v. Int'l Trade Comm'n*, 264 F.3d 1094 (Fed. Cir. 2001), the Federal Circuit had found that the patent holder's right to enforce their U.S. patents could only be exhausted through authorized sales within the jurisdiction of the U.S. patent laws. *Static Control Components* points to another district court case, *LG Electronics, Inc. v. Hitachi, Ltd.*, 2009 WL 667232, at *8 (N.D. Cal. March 13, 2009), in noting that "authorized sale" could be interpreted broadly to include "authorized foreign sales."

It is important to emphasize that the sale of patented goods that are clearly conditioned on terms of the purchase will avoid patent exhaustion. The *Static Control Components* court points to *Monsanto v. Scruggs*, 459 F.3d 1328 (Fed. Cir. 2006) in showing how licensing agreements can be used to avoid the exhaustion of patent rights. In *Monsanto*, the licensed seed supplier was explicitly restricted from selling to unauthorized customers. Monsanto brought multiple layers of the vertical market for their patented seed technology under their direct licensing control by requiring authorized customers to sign license agreements with explicit use restrictions prior to the purchase of seeds embodying their patented invention. As such, any sales to authorized customers were clearly conditioned on the adherence to the terms of the customers' license agreement and any sales to non-licensed parties were deemed unauthorized, thus avoiding exhaustion of Monsanto's patent rights.