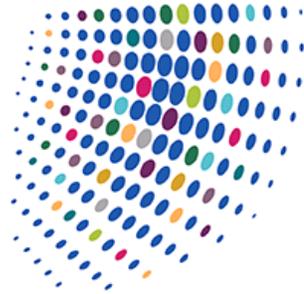


Alerts & Publications



Sales Under an Unconditional Covenant Not to Sue are Authorized and Exhaust Patent Rights, Court Holds

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Recent Supreme Court and Federal Circuit cases suggest a more expansive view on the scope of the patent exhaustion doctrine, and patent owners are well advised to draft their license and settlement agreements carefully to prevent unintended loss of patent rights.

The patent exhaustion doctrine and its potential effects on the assertion of patent rights against downstream customers of licensees have recently received much attention in the wake of the Supreme Court's 2008 affirmation of such doctrine in *Quanta Computer, Inc. v. LG Electronics, Inc.* [1] The Federal Circuit recently provided yet another reason for companies to carefully consider applicable restrictions in their licenses and covenants not to sue to prevent unintended loss of patent rights vis-à-vis such downstream customers. *Transcore, LP et al. v. Electronic Transaction Consultants Corp.* [2] In *Transcore*, the court found that an unconditional covenant not to sue authorized sales and thus triggered patent exhaustion, barring patent claims against downstream customers. [3]

TransCore had previously filed suit against its competitor Mark IV Industries ("Mark IV"), alleging infringement of several TransCore patents relating to automated toll collection products. That action was resolved by a settlement agreement, under which TransCore granted Mark IV a release of all existing claims and an unconditional covenant not to sue. That covenant read, in part, as follows:

TransCore] hereby agrees and covenants not to bring any demand, claim, lawsuit, or action against Mark IV for future infringement of any of [certain listed U.S. patents]....

Later, Electronic Transaction Consultants Corp. ("ETC") purchased products from Mark IV, and TransCore sued ETC for infringement of three patents that had previously been in suit against Mark IV as well as a related patent that was pending before the Patent and Trademark Office but had not yet issued at the time of the TransCore-Mark IV settlement. ETC responded that its activities were permitted by the TransCore-Mark IV settlement agreement under the doctrine of patent exhaustion. The district court agreed with ETC and TransCore appealed to the Federal Circuit.

In its decision, the Federal Circuit cited the holding in *Quanta* that a sale of a patented item authorized by the patent holder terminates all patent rights to that item. The remaining question before the Federal Circuit was thus whether an unconditional covenant not to sue granted by a patent holder authorizes sales by the covenantee for the purpose of patent exhaustion. The court held that it did, agreeing with the district court, and finding that Mark IV's sales were authorized by the settlement agreement and that such authorized sales exhausted TransCore's patent rights, thus barring TransCore's claims against ETC. [4]

For the purposes of patent exhaustion, the court rejected any distinction between nonexclusive patent licenses and covenants not to sue, noting that the difference is one of “form, not substance” and viewed both as proper “authorizations” for patent exhaustion analysis. [5] The court emphasizes that the pertinent question is whether the language of the covenant not to sue authorized **sales**. The court noted that the language of the covenant not sue did not include any apparent restriction or limitation and it thus authorized all acts that would otherwise be infringements: making, using, offering for sale, selling, or importing. [6] Given the unconditional nature of the covenant not to sue, the court concluded that such covenant did constitute an authorization to sell. [7]

The court also rejected any analysis of the parties’ intent with respect to the covenant applying to any party other than Mark IV, citing *Quanta* for the proposition that the parties’ intent with respect to downstream customers is of no significance in a patent exhaustion analysis. [8]

The Federal Circuit also affirmed the district court’s holding that TransCore’s rights in a later-issued patent which was not included in the TransCore-Mark IV settlement agreement were nonetheless exhausted by Mark IV’s sales under an “implied license” to practice that patent by virtue of legal estoppel. The court held that, because the later-issued patent was broader than, and necessary to practice, at least one of the patents included in the settlement agreement, in order to preserve the benefit of Mark IV’s bargain, TransCore was legally estopped from asserting the later-issued patent against Mark IV, and making Mark IV, in turn, an implied licensee of such patent, with rights coextensive with those received under the settlement, including the right to sell. [9] Notably, the court held that language in the settlement agreement which stated that “[t]his Covenant Not to Sue shall not apply to any other patents...to be issued in the future,” did not preclude such legal estoppel and implied license. [10]

Transcore demonstrates the importance to a patent holder of carefully enumerating both specifically included and excluded rights that the patent holder intends to grant whether drafted as a license or a covenant not to sue in a settlement agreement. In particular, for purposes of patent exhaustion, a patent holder should carefully consider any language that can be construed as an authorization to sell. Such attention to drafting will best preserve a patent holder’s patent rights with respect to downstream resellers, OEMs and users.

[1] 128 S. Ct. 2109 (2008).

[2] No. 2008-1430 (Fed. Cir. April 8, 2009).

[3] *Id.* at 4-8.

[4] *Id.* at 2.

[5] *Id.* at 7.

[6] *Id.* at 8.

[7] *Id.* at 7-8.

[8] *Id.* at 4-5.

[9] *Id.* at 11-13.

[10] *Id.* at 13.