LICENSING OF INTELLECTUAL PROPERTY AND OTHER INFORMATION ASSETS

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LICENSING OF INTELLECTUAL PROPERTY AND OTHER INFORMATION ASSETS

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III. WHAT LAW APPLIES WITHIN A STATE

Page 33. Add the following before the Zapatha *case:*

COCA-COLA BOTTLING CO. v. COCA COLA CO.
696 F. Supp. 57 (D. Del. 1988)

OPINION

MURRAY M. SCHWARTZ, Chief Judge.

There are several motions now pending before the Court in this case (the "Coke case") and in two other cases (C.A. Nos. 83–95 and 83–120, the "diet Coke cases"), involving, inter alia, contract claims between The Coca–Cola Company (the "Company") and certain of its bottlers (the "bottlers"). The bottlers brought the Coke case in 1981, charging that the Company had breached its agreements with them by supplying Coca–Cola syrup sweetened with fructose (high-fructose corn syrup or "HFCS") rather than sucrose—without the bottlers' consent. The bottlers also claim the Company has overcharged them for syrup and injured them in other ways.

In part the Coke and diet Coke cases have their genesis in earlier contract litigation between the Company and then-existing "parent" bottlers in 1920 and 1921 (the "1921 litigation"). The parties resolved the 1921 litigation through consent decrees (the "Consent Decrees"), which incorporated as a judgment of this Court the amended contracts between the parent bottlers and the Company and resolved the major issue between the Company and the parent bottlers concerning the term of the contracts. In keeping with the initial ruling of the Court on the plaintiff parent bottlers' preliminary injunction motion and prior to any decision on appeal, the Company accepted the bottlers' position that their contracts were perpetual, rather than terminable at will. The contracts between the parent bottlers and the "actual," or "first-line" bottlers, who were more or less the predecessors of the current plaintiffs, were also amended as a result of the 1921 litigation. The contracts now in force between the plaintiffs and the Company derive from the 1921 contracts, and as a result are perpetual as well. Consequently, this court has acknowledged, and the parties apparently agree, that the Consent Decrees retain vitality despite the intervening years and the gradual acquisition of the parent bottlers by the Company.

However, several questions regarding the enforceability of the decrees by these particular plaintiffs remain…. Company has moved for summary judgment on certain aspects of the plaintiffs' contract claims. In particular, the Company requests this Court to rule as a matter of law that (1) the plaintiffs are not entitled to any damages under Count One of their amended complaint (the "unjust enrichment" count); (2) the plaintiffs' assertions concerning the construction of the term "standard Coca–Cola Bottling Syrup" in connection with Count Two[2] (the "standard syrup" count) be rejected; (3) the applicable statute of limitations bars all or part of the plaintiffs' claims under Count Three (the "market price" count); (4) the plaintiffs are not entitled to any recovery from the fund received by the Company in settlement of sugar industry antitrust litigation (the "*Western Sugar* " count); and (5) the plaintiffs lack standing to enforce the 1921 consent decrees. …

I. BACKGROUND

A. *The Genesis of the Bottling System*

[There is an intriguing 140 year history of the relationship between the company and its bottlers set out in the opinion if you would like to see the background.]

III. THE COMPANY'S SUMMARY JUDGMENT MOTION

The Company moves for summary judgment "in whole or in part" on a number of the plaintiffs' claims. First, the Company contends that the plaintiffs' "unjust enrichment" theory of recovery under Count One is deficient as a matter of law because the plaintiffs sue on express contracts. …. Third, the Company contends that the plaintiffs' claims for damages resulting from the alleged improper calculation of syrup price are barred by the applicable statute of limitations. … The plaintiffs vigorously oppose the Company's motion. They have launched a broad defense to the motion in the form of a remarkable argument that "[a]s a result of the special relationship between the Company and the bottlers, The Coca–Cola Company owes the bottlers higher fiduciary duties than the duties associated with ordinary contracts, and must account to the bottlers for any profits obtained in breach of those duties without their consent."

Because the plaintiffs' fiduciary duty theory, if valid, will affect dramatically the analysis of four out of the five major Company arguments, I will address this theory first. …

A. *Fiduciary Duty*

The plaintiffs base their assertion that the Company and the bottlers have formed a fiduciary relationship on two grounds: (1) the wide scope of the relationship, which is "immeasurably broader than the mere purchase and sale of syrup"; and (2) the characterization by the Company of the relationship as a "partnership." The effect of this fiduciary relationship between the bottlers and the Company, according to the plaintiffs, is to create obligations between the two sides which are greater than ordinary contractual duties.

The Court finds the plaintiffs' arguments concerning the existence of a fiduciary relationship largely unpersuasive. The first prop supporting the plaintiffs' argument falls when one considers the law concerning the creation of a fiduciary relationship in the plaintiffs' jurisdictions. For example, under California law …the existence of a fiduciary relationship "arises only when the person in whom confidence is reposed acquires some control over the affairs of the other."

A careful examination of the law relied upon by the plaintiffs, fails to bolster plaintiffs' argument that a fiduciary relationship exists between the Company and the bottlers. The majority of that law concerns what fiduciary duties are owed once the requisite relationship is found. That relationship does not exist here. The Company and the bottlers, although bound together by their common interest in promoting the sale of Coca–Cola, are arms-length bargaining parties, not partners.

Other authorities relied upon by the plaintiffs likewise miss the point. For example, *Arnott v. American Oil Co.,* 609 F.2d 873, 881 (8th Cir.1979), *cert. denied,* 446 U.S. 918, 100 S. Ct. 1852, 64 L.Ed.2d 272 (1980), which holds that a fiduciary relationship inheres in a franchise relationship, has been interpreted "as resting on the implied covenant of good faith and fair dealing." *Cambee's Furniture v. Doughboy Recreational, Inc.,* 825 F.2d 167, 171 (8th Cir.1987) (citing *Bain v. Champlin Petroleum Co.,* 692 F.2d 43, 47–48 (8th Cir.1982)). These ordinary implied duties are not contested by the Company. *Cambee's* then states that "a franchise or other ordinary business relationship does not alone create fiduciary duties." *Id.* Additionally, *ABA Distributors, Inc. v. Adolph Coors Co.,* 542 F. Supp. 1272 (W.D.Mo.1982), which relies on *Arnott,* characterizes the "fiduciary duty" between a brewer and its distributor as one of "good faith and fair dealing."

In *Carter Equipment v. John Deere Industrial Equipment Co.,* 681 F.2d 386, 391 (5th Cir.1982), the court held that "[a] fiduciary relationship arises only if the activity of the parties goes beyond their operating on their own behalf and the activity is for the benefit of both." Because the relationship between the Company and the bottlers is both independent and interdependent, the Court is willing to assume that this necessary precondition for the finding of fiduciary relationship has been met. However, the *Carter Equipment* court proceeds to emphasize the importance of one party "repos[ing] trust or confidence in [the other]," as "critical to an ultimate determination regarding the existence of a fiduciary relationship." *Id.* *Phillips v. Chevron, U.S.A., Inc.,* 792 F.2d 521 (5th Cir.1986), in discussing *Carter Equipment,* qualifies the language in the decision concerning the requirement that neither party in a fiduciary relationship "take selfish advantage of [the other's] trust or deal ... in such a way as to benefit himself or prejudice the other except in the exercise of the utmost good faith," *id.* at 524, by stating that "[t]his generalized duty of good faith and fair dealing is, however, limited by the terms of the franchise agreement." *Id.*

The plaintiffs in this case, despite their long and mutually profitable relationship with the Company, are far from reposing in it complete trust and confidence of the sort which engenders a fiduciary relationship.

By referring to the relationship between the bottlers and the Company as a "special partnership," the Company has not created a legal partnership with associated fiduciary duties. The necessary indicia of a legal partnership, or for that matter of a joint venture, for the most part are absent. These indicia include one party having a voice in the management of the other's manner of conducting business, sharing of risks, and joint control or ownership of assets. *See, e.g., Circo v. Spanish Gardens Food Manufacturing Co.,* 643. 51 (W.D.Mo.1985) (distributors bringing action against manufacturer for breach of constructive partnership agreement failed to establish requisite indicia of joint venture or partnership). Although through contractual provisions the Company exercises some control over the bottlers' methods of bottling the product, this control is distinct from control over management of the bottlers' affairs. Similarly, the common fortunes of the Company and the bottlers may ride to an extent on the demand for Coca–Cola, but this does not amount to risk-sharing of the requisite kind. Finally, with the possible exception of certain trademark rights, the parties do not jointly own any assets. *See Satellite Financial Planning v. First National Bank of Wilmington,* 633. 386, 401 & 401 n. 20 (D.Del.1986) (neither partnership nor joint venture created absent association "to carry on a business for profit as co-owners") (relying on Delaware law).

One must strain to find a resemblance between the parties' relationship and a partnership: if a faint resemblance does exist, it is far too weak to give rise to special fiduciary duties. Moreover, there is an arguable resemblance to a partnership in any franchising or manufacturer/distributor relationship. Courts in the plaintiffs' states which have addressed the question have generally found that such relationships are not fiduciary, although the conventional implied duty of good faith and fair dealing applies to these relationships.

Significantly, cases finding fiduciary responsibilities between, e.g., franchisors and franchisees, frequently arise in the context of a franchise termination where the franchisee has invested a considerable amount in the franchise. Moreover, the analysis in *Shell Oil* appears to turn more on contract of adhesion principles rather than on the existence of fiduciary duties.

In addition, the rationale underlying basic fiduciary doctrine weighs heavily against the plaintiffs' assertion that the Company owes them "duties ... that are much higher than those that apply to ordinary business contracts." Dkt. 811, at 34. Generally, courts in the plaintiffs' states limit the application of fiduciary standards to situations where "one party is so situated as to exercise a controlling influence over the will, conduct, and interest of another or where, from a similar relationship of mutual confidence, the law requires the utmost good faith, such as the relationship between partners, principal and agent, etc." ….

In sum, the plaintiffs' argument that the relationship between the Company and the bottlers is a fiduciary one is unpersuasive. The Court agrees, as does the Company, that the Company is under an implied duty of good faith and fair dealing. This implied duty, however, does not create the kind of strict fiduciary responsibilities alleged by the plaintiffs. Even accepting the facts as plaintiffs present them, the law simply is that no fiduciary relationship arises from such facts.

….

D. *Count Three: the Market Price Count*

Count Three of the plaintiffs' complaint alleges that the Company has miscalculated the market price of sugar under the contracts by using official list prices rather than lower actual prices made known by sugar refiners to purchasers. In *Coke III,* the Court found that "market price" as used in the decrees meant:

> an average of the price per pound for refined granulated sugar of the grade and in the packaging unit in which it is principally sold to industrial users upon inquiry prior to sale by the ten refineries in the United States with the largest capacity and output during the first seven days of each calendar quarter, less any discounts, allowances, or rebates from that price which are available to industrial users or are made known to them upon inquiry prior to sale, but not including a standard two percent cash discount or any individually negotiated discounts, allowances, or rebates. *Coke III,* at 1418.

The market price provision only became operative when the price of sugar rose above seven cents per pound. The price of sugar hovered around two or three cents per pound from a few years after the entry of the decrees until the early 1940's. The market price determination thus did not activate after 1924 until late in 1940's. During the first years of the decrees, the parent bottlers and the Company disagreed over whether the syrup price should be calculated based on the actual selling price of sugar or the higher official list price. Those differences were never definitively resolved because sugar remained below seven cents per pound. After World War II, when the market price provision again became relevant, the Company followed a policy, known to the bottlers, of using the list price as a ceiling, but utilizing the lower actual selling price where ascertainable.

In ascertaining whether a refiner is selling below its "list" or "quoted" price, the Company has traditionally made direct inquiry of the refiner. There is no evidence that the Company asked the refiner whether this lower selling price was available to all industrial users of sugar, however. Rather, it appears the Company has used the greatest discount, rebate, or allowance available. The only criterion for whether the Company would use a particular selling price is whether the refiner would represent to the Company that sugar was being sold at that price.
Coke III, 654 F. Supp. at 1418.

In 1969, the Company's procedure for calculating market price changed from "an independent investigation into the 'market price,' " to the use of official list prices. The plaintiffs must still prove that the Company in fact deviated from the directive to use market price, however. In particular, the plaintiffs must bring forward evidence that lower prices than those used by the Company for each of the quarters since the change in procedure were available upon inquiry. The Company believes that even if the plaintiffs have evidence sufficient to meet their burden, they are barred, either completely or partially, from pursuing their claim under this count by the applicable statutes of limitations.

The first question presented on this count is which statute of limitations applies to the plaintiffs' market price claims. The parties agree that the Delaware borrowing statute, applies to the bottlers' contract claims for these purposes. The borrowing statute dictates use of the shorter of (1) the applicable Delaware statute of limitations, or (2) "the time limited by the law of the state ... where the cause of action arose." *Id.* The defendant argues that applying the borrowing statute results in the choice of Delaware's Uniform Commercial Code (U.C.C.) statute of limitations, which limits actions "for breach of any contract for sale" to within four years of accrual. The plaintiffs protest that the applicable limitations period for the purposes of the borrowing statute is twenty years, the period governing contracts under seal. The parties do agree, however, that in the event the U.C.C. statute applies, it applies to all plaintiffs, because it is as short or shorter than the comparable statutes in plaintiffs' states.

The Company bases its argument on three grounds:

> 1. Plaintiffs' claims under their first-line bottling contracts are subject to the shorter of (a) the four-year statute of limitations of the Delaware Uniform Commercial Code or (b) the statute of limitations of the respective states in which their causes of action arose. Since none of the latter are shorter than the four year Delaware statute, the applicable limitations period for all Plaintiffs is four years.
>
> 2. At a minimum, Plaintiffs are barred from recovering damages for any period beyond the period beginning four years before the filing of their Complaints.

> 3. Because Plaintiffs' claims under Count Three allege a consistent and uniform misapplication of the pricing formula beginning in 1969, the statute of limitations in fact began to run in 1969. Therefore, Plaintiffs' claims under Count Three are barred in their entirety.

Previously the Court has held that the bottlers whose contracts predate the enactment of the U.C.C. were not governed by it. This holding was not made, however, in the context of determining whether the U.C.C. might apply to bar causes of action arising subsequent to its enactment on contracts entered into before its enactment, as the defendant now contends. Therefore it does not necessarily control the present question. Additionally, there are at least three bottlers whose contracts date from after 1967, when Delaware enacted the U.C.C. The dates of their contracts, according to the Company, prevent them from sidestepping the application of § 2–725 by arguing, as the other bottlers do, that their contracts are not governed by retroactive application of the U.C.C. Because the plaintiffs argue that their contracts are outside the coverage of the U.C.C. in any case, though, the strength of that argument could direct the outcome for both pre–U.C.C. and post–U.C.C. bottlers.

The statute of limitations inquiry ordinarily would follow this course: (1) are the plaintiffs' contracts, both before and after 1967, outside the scope of the U.C.C.?; (2) if not, should the U.C.C. statute of limitations apply retroactively to bottlers whose contracts were executed prior to 1967?; and (3) if the four year statute does apply, did the plaintiffs' claims accrue in 1969 so that they are completely barred? However, the resolution of the first question renders reaching the second and third questions unnecessary.

U.C.C. § 2–102 states that article 2 applies to "transactions in goods" only. Del. Code Ann. tit. 6, § 2–102 (1975). The contracts between the Company and the bottlers certainly involve more than the ordinary sale of goods contemplated by the U.C.C. However, that law might still apply if the contracts are primarily for the sale of goods. *See Glover School and Office Equipment Co. v. Dave Hall, Inc.,* 372 A.2d 221, 223 (Del.Super.1977) ("Where a mixed contract [for goods and services] is involved, it is necessary that the Court review the factual circumstances surrounding the negotiation, formation and contemplated performance of the contract to determine whether the contract is predominantly or primarily a contract for sale of goods of for services.").

Judge Morris faced a very similar question under the 1899 contracts in *Coke 1920,* 269 F. at 808:

> What was the paramount purpose of the contract, as ascertained from the agreement as a whole? In my opinion it was the establishment of the business of bottling the Coca–Cola drink.... A contract merely for the purchase and sale of syrup would not be a repository for covenants making obligatory on the part of the purchaser the establishment of bottling plants having a capacity sufficient to supply the greater part of the nation and restricting the resale of the syrup, "except after it is carbonated and bottled"; nor would it be a repository for a grant of the sole and exclusive right to use the trade-mark of the vendor, not upon the syrup, but upon the product of those bottling plants.
>
> I find nothing in the contract or the circumstances attending its making to indicate that these covenants are subordinate or incidental to the covenant for the purchase and sale of syrup. On the other hand, the contract and the surrounding circumstances show that such covenants and the covenants to purchase and sell syrup are co-ordinate and of equal rank. A contract so constituted shows an essential object and purpose immeasurably broader than the mere purchase and sale of syrup. Its real purpose neither lies in nor is revealed by any single covenant or provision; but is evinced by the result obtained by combining all the covenants. That result is the sale and purchase of a potential business and the establishment of an actual business. This result is the whole, of which each covenant is merely a part. To this whole each covenant, when separately considered, is ancillary and incidental....

Id.

The Court finds Judge Morris's reasoning on this question persuasive. The contracts impose obligations on both sides that are different in kind from the traditional sales contract contemplated by the

U.C.C. As Judge Morris found, the balance between the "goods" and "non-goods" portions of the contracts is even: neither the sales aspects nor the other aspects of the contracts predominate. *See id.*

The defendant predicates its arguments on the classification of the parties' contractual relationship as fundamentally a transaction in sales, claiming that the plaintiffs have asserted that the U.C.C. applies in previous briefing, and that the Court previously has so held. *See Coke V,* 668. at 918 (stating that two bottlers had U.C.C.–governed contracts). Neither the plaintiffs' reliance on U.C.C. cases to support their implied duty of good faith and fair dealing argument, nor the Court's statement in *Coke V* in connection with the same subject, however, were dependent on an explicit finding that the U.C.C. governs the bottlers' contracts.

It is true that in many cases involving franchises, distributorships, or other "mixed" goods and services contracts, courts have found these contracts within the U.C.C. *See Sally Beauty Co. v. Nexxus Products Co.,* 801 F.2d 1001, 1005 (7th Cir.1986) ("[T]he rule in the majority of jurisdictions is that distributorships (both exclusive and non-exclusive) are to be treated as sale of goods contracts under the UCC.") (citing cases from, inter alia, Kentucky, Pennsylvania, and California); *Bonebrake v. Cox,* 499 F.2d 951 (8th Cir.1974); *Warner Motors, Inc. v. Chrysler Motors Corp.,* 5 U.C.C. Rep. (Callaghan) 365 (E.D.Pa.1968). Other cases, however, have taken the opposite position, holding that the importance of the service aspects of some mixed contracts places them outside the scope of Article 2. *See, e.g., Wagstaff v. Protective Apparel Corp.,* 760 F.2d 1074, 1076–77 (10th Cir.1985) (distributorship agreement not within U.C.C.) (applying Oklahoma law); *Wells v. 10–X Manufacturing Co.,* 609 F.2d 248, 254 (6th Cir.1979) ("[T]he fact that the party supplying a service does so in conjunction with the delivery of goods does not necessarily mean that the transaction comes within the [U.C.C.]."); *see also Tele–Radio Systems Ltd. v. De Forest Electronics, Inc.,* 92 F.R.D. 371, 374 (D.N.J.1981) (genuine issue of material fact prevented summary judgment on application of U.C.C. § 2–725 to alleged breach of franchise agreement).

The Court concludes that the determination of whether a mixed contract falls within the U.C.C. depends heavily on the facts and terms peculiar to that contract. Here the contracts involved are ancient, perpetual, and involve divisions of trademark rights, shared advertising, and the transfer of "the business of bottling." These factors establish a service orientation of the contracts that is much more than "merely incidental or collateral to the sale of goods.".

In reaching this conclusion, the Court is mindful of the principle that the "scope of coverage of 'goods' is not to be given a narrow construction but instead should be viewed as being broad in scope so as to carry out the underlying purpose of the Code of achieving uniformity in commercial transactions." Indeed, it would be disingenuous to contend that the subject contracts do not involve the sale of "goods" within the meaning of U.C.C. § 2–102. Nevertheless, the importance of the non-sales aspects of the contracts mandates the conclusion that the contracts fall outside the coverage of the U.C.C.

[The court went on to deny summary judgment on Count 3 on grounds that are not material to our course.]

Page 47. Add the following before the Microsoft *case:*

SYSTEMS UNLIMITED v. CISCO SYSTEMS
228 Fed. Appx. 854 (11th Cir. 2007) (cert. denied)

PER CURIAM:

Following the settlement of a dispute between Systems Unlimited, Inc. and Cisco Systems, Inc. over the ownership of certain intellectual property, Cisco agreed to covey the property to Systems. In the resulting bill of sale, Cisco:

> granted, bargained, sold, transferred and delivered, and by these presents does grant, bargain, sell, transfer and deliver unto [Systems], its successor and assigns, the following:

> Any and all of [Cisco]'s right, title and interest in any copyrights, patents, trademarks, trade secrets and other intellectual property of any kind associated with any software, code or data, including without limitation host controller software and billing software, whether embedded or in any other form (including without limitations, disks, CDs and magnetic tapes), and including any and all available copies thereof and any and all books and records related thereto by [Cisco]....

Cisco never delivered [copies of] any of the software to Systems. Alleging that it had been damaged by the non-delivery, Systems sued Cisco for breaching the bill of sale contract and for violating the attendant obligations to deliver the software under the Uniform Commercial Code.

.....

II.

Systems … contends that the district court erred in granting summary judgment in favor of Cisco because: (1) the plain language of the bill of sale required Cisco to deliver the software; (2) the bill of sale, when read in conjunction with other contemporaneous agreements, required delivery; and (3) the UCC, which governs the bill of sale, requires that all goods be delivered at a reasonable time. Systems is wrong on each point.

The bill of sale is interpreted in accord with its plain language absent some ambiguity. *See* Cal. Civ. Code § 1638 ("The language of a contract is to govern its interpretation, if the language is clear and explicit, and does not involve an absurdity."); *Whitley v. Royal Trails Prop. Owners' Ass'n, Inc.,* 910 So.2d 381, 383 (Fla. 5th DCA 2005) ("The parties' intention governs contract construction and interpretation; the best evidence of intent is the contract's plain language."). Here, the parties agree that the bill of sale is clear and unambiguous.

The bill of sale provides that Cisco will "grant, bargain, sell, transfer and deliver unto [Systems] ... [a]ny and all of [Cisco]'s right, title and interest in any copyrights, patents, trademarks, trade secrets and other intellectual property of a kind associated with any software, code or data." As the district court explained, this language unambiguously means that Cisco was required by the bill of sale to transfer to Systems all of its rights in intellectual property associated with certain software and data. There is no mention in the plain language of the contract itself of Cisco being obligated to transfer the actual software, and we will not imply any such obligation absent some good reason under law.

Systems says there are two good reasons to imply an obligation by Cisco to transfer the software. First, Systems argues that the bill of sale must be interpreted in conjunction with the settlement agreement between Systems and Cisco and other documents relating to the intellectual property. These other agreements, Systems claims, include an obligation by Cisco to deliver the software with any conveyance of intellectual property.

Assuming without deciding that the other agreements include language requiring Cisco to deliver the software, they are not relevant here because Systems has never alleged Cisco violated these other agreements. Systems' complaint alleges only a violation of the bill of sale contract, and there is no obligation in that contract to deliver the software. The bill of sale does not reference or incorporate any other agreement. *Cf. Williams Constr. Co. v. Standard–Pac. Corp.,* 254 Cal.App.2d 442, 61 Cal. Rptr. 912, 920 (1967) ("For the terms of another document to be incorporated into the document executed by the parties the reference must be clear and unequivocal, the reference must be called to the attention of the other party and he must consent thereto, and the terms of the incorporated document must be known or easily available to the contracting parties." (quotation omitted)); *Collins ex rel. Dixie Plywood Co. of Tampa v. Nat'l Fire Ins. Co. of Hartford,* 105 So.2d 190, 194 (Fla. 2d DCA 1958) ("Where a written contract refers to and sufficiently describes another document, that other document or so much of it as is referred to, may be regarded as a part of the contract and therefore is properly considered in its interpretation.").

To get around this point, Systems argues that "when instruments relate to the same matters, are between the same parties, and made part of substantially one transaction, they are to be taken together." It is true that this is one of the canons for construing a contract under California law. *See* Cal. § 1642 ("Several contracts relating to the same matters, between the same parties, and made as parts of substantially one transaction, are to be taken together."). But it is also true that this canon, as with most others, is inapplicable where the contract that is alleged to have been breached is unambiguous. *Sonoma Falls Developers, LLC v. Nev. Gold & Casinos, Inc.,* 272 F.Supp.2d 919, 924 (N.D.Cal.2003) (section 1642 "is applicable only if there is ambiguity concerning the interpretation of a contract"). Here, the language of the bill of sale is unambiguous. Thus, there is no need to apply any canons of construction, including particularly section 1642.

Systems also argues that the UCC imposes a duty on Cisco to deliver the software. We will assume without deciding that Systems' reading of the UCC is correct. Even so, the provisions of the UCC only apply to contracts that deal predominately with "transactions in goods." Cal. Com. Code § 2102; Fla. Stat. § 672.102. The sale of intellectual property, which is what is involved here, is not a transaction in goods. *See Lamle v. Mattel, Inc.,* 394 F.3d 1355, 1359 n. 2 (Fed.Cir.2005) (applying California law) ("a license for intellectual property ... is not a sale of goods"); *see generally* Daniel R. Cahoy, *Oasis or Mirage?: Efficient Breach as a Relief to the Burden of Contractual Recapture of Patent and Copyright Limitations,* 17 Harv. J.L. & Tech. 135, 163 (Fall 2003) ("intellectual property or other information cannot be a 'good' as defined by the UCC"). Thus, the UCC does not apply. Accordingly, the plain language of the bill of sale governs and, as the district court held, it does not include a provision requiring Cisco to deliver any software.

AFFIRMED.

Chapter 4

EXCLUSIVE LICENSES

II. LICENNSEE'S OBLIGATIONSAND RIGHTS

B. Standing to Sue for Infringement

Page 161. Below the title to subsection B, insert the following:

The following statutes relate to the cases on standing we will discuss. The relevant copyright language is in the notes on pages 180-81.

SELECTED PATENT LAW SECTIONS

35 U.S.C. § 100 Definitions

....

(d) The word "patentee" includes not only the patentee to whom the patent was issued but also the successors in title to the patentee

35 U.S.C. § 281 Remedy for Infringement of Patent

A patentee shall have remedy by civil action for infringement of his patent.

SELECTED TRADEMARK STATUTES

15 U.S.C.A. § 1114 (Lanham Act 32) Remedies for Trademark Infringement

(1) Any person who shall, without the consent of the registrant [shall use a mark in commerce in a manner that infringes the mark] shall be liable in a civil action by the registrant for the remedies hereinafter provided.

…

11 USC § 1125 (Lanham Act 43a) False Designation of Origin

(a) Civil action

(1) Any person who, on or in connection with any goods or services, or any container for goods, uses in commerce any word, term, name, symbol, or device, or any combination thereof, or any false designation of origin, false or misleading description of fact, or false or misleading representation of fact, which—

(A) is likely to cause confusion, or to cause mistake, or to deceive as to the affiliation, connection, or association of such person with another person, or as to the origin, sponsorship, or approval of his or her goods, services, or commercial activities by another person … shall be liable in a civil action by any person who believes that he or she is or is likely to be damaged by such act.

(c) Dilution

Subject to the principles of equity, the owner of a famous mark that is distinctive, inherently or through acquired distinctiveness, shall be entitled to an injunction against another person who, at any time after the owner's mark has become famous, commences use of a mark or trade name in commerce that is likely to cause dilution by blurring or dilution by tarnishment of the famous mark, regardless of the presence or absence of actual or likely confusion, of competition, or of actual economic injury.

PROBLEM 1

In reviewing the cases, consider the following two scenarios:

1. S distributes its SkiDaddle (SD) product through ten independent sales providers (ISP's) each of which is granted an exclusive right to sell the SD product within designated territories. SD is covered by several valid patents. D begins selling a competing product throughout the U.S. S sues for patent infringement. The ISP's join. D seeks to dismiss their claims for lack of standing. What result?

2. P grants L an exclusive license covering all rights in the U.S. in P's patented software. P had previously given a nonexclusive license to use the software make widgets in Texas. X, without anyone's consent, uses the software in its own company. L sues. X objects on grounds of standing. What result? Would the result change if there was no patent, but the software was copyrighted?

III. GRANTING CLAUSES: DEFINING THE SUBJECT MATTER

A. Scope as Compared to Covenant

Page 217. Insert the following above Problem 5.8:

MDY INDUSTRIES, LLC v. BLIZZARD
629 F.3d 928 (9th Cir. 2011)

OPINION

CALLAHAN, Circuit Judge:

Blizzard Entertainment, Inc. ("Blizzard") is the creator of World of Warcraft ("WoW"), a popular multiplayer online role-playing game in which players interact in a virtual world while advancing through the game's 70 levels. MDY Industries, LLC and its sole member Michael Donnelly ("Donnelly") (sometimes referred to collectively as "MDY") developed and sold Glider, a software program that automatically plays the early levels of WoW for players.

MDY brought this action for a declaratory judgment to establish that its Glider sales do not infringe Blizzard's copyright or other rights, and Blizzard asserted counterclaims under the Digital Millennium Copyright Act ("DMCA"), and for tortious interference with contract under Arizona law. The district court found MDY and Donnelly liable … We reverse the district court except as to MDY's liability for violation of DMCA § 1201(a)(2) and remand for trial on Blizzard's claim for tortious interference with contract.

I.

A. World of Warcraft

In November 2004, Blizzard created WoW, a "massively multiplayer online role-playing game" in which players interact in a virtual world. WoW has ten million subscribers, of which two and a half million are in North America. The WoW software has two components: (1) the game client software that a player installs on the computer; and (2) the game server software, which the player accesses on a subscription basis by connecting to WoW's online servers. WoW does not have single-player or offline modes.

WoW players roleplay different characters, such as humans, elves, and dwarves. A player's central objective is to advance the character through the game's 70 levels by participating in quests and engaging in battles with monsters. As a player advances, the character collects rewards such as in-game currency, weapons, and armor. WoW's virtual world has its own economy, in which characters use their virtual currency to buy and sell items directly from each other, through vendors, or using auction houses. Some players also utilize WoW's chat capabilities to interact with others.

B. Blizzard's use agreements

Each WoW player must read and accept Blizzard's End User License Agreement ("EULA") and Terms of Use ("ToU") on multiple occasions. The EULA pertains to the game client, so a player agrees to it both before installing the game client and upon first running it. The ToU pertains to the online service, so a player agrees to it both when creating an account and upon first connecting to the online service. Players who do not accept both the EULA and the ToU may return the game client for a refund.

C. Development of Glider and Warden

Donnelly is a WoW player and software programmer. In March 2005, he developed Glider, a software "bot" (short for robot) that automates play of WoW's early levels, for his personal use. A user need not be at the computer while Glider is running. Glider ... moves the mouse around and pushes keys on the keyboard. You tell it about your character, where you want to kill things, and when you want to kill. Then it kills for you, automatically. You can do something else, like eat dinner or go to a movie, and when you return, you'll have a lot more experience and loot.

Glider does not alter or copy WoW's game client software, does not allow a player to avoid paying monthly subscription dues to Blizzard, and has no commercial use independent of WoW. Glider was not initially designed to avoid detection by Blizzard.

The parties dispute Glider's impact on the WoW experience. Blizzard contends that Glider disrupts WoW's environment for non-Glider players by enabling Glider users to advance quickly and unfairly through the game and to amass additional game assets. MDY contends that Glider has a minimal effect on non-Glider players, enhances the WoW experience for Glider users, and facilitates disabled players' access to WoW by auto-playing the game for them.

In summer 2005, Donnelly began selling Glider through MDY's website for fifteen to twenty-five dollars per license. Prior to marketing Glider, Donnelly reviewed Blizzard's EULA and client-server manipulation policy. He reached the conclusion that Blizzard had not prohibited bots in those documents.

In September 2005, Blizzard launched Warden, a technology that it developed to prevent its players who use unauthorized third-party software, including bots, from connecting to WoW's servers. Warden was able to detect Glider, and Blizzard immediately used Warden to ban most Glider users. MDY responded by modifying Glider to avoid detection and promoting its new anti-detection features on its website's FAQ. It added a subscription service, Glider Elite, which offered "additional protection from game detection software" for five dollars a month.

Thus, by late 2005, MDY was aware that Blizzard was prohibiting bots. MDY modified its website to indicate that using Glider violated Blizzard's ToU. In November 2005, Donnelly wrote in an email interview, "Avoiding detection is rather exciting, to be sure. Since Blizzard does not want bots running at all, it's a violation to use them." Following MDY's anti-detection modifications, Warden only occasionally detected Glider. As of September 2008, MDY had gross revenues of $3.5 million based on 120,000 Glider license sales.

D. Financial and practical impact of Glider

Blizzard claims that from December 2004 to March 2008, it received 465,000 complaints about WoW bots, several thousand of which named Glider. Blizzard spends $940,000 annually to respond to these complaints, and the parties have stipulated that Glider is the principal bot used by WoW players. Blizzard introduced evidence that it may have lost monthly subscription fees from Glider users, who were able to reach WoW's highest levels in fewer weeks than players playing manually. Donnelly acknowledged in a November 2005 email that MDY's business strategy was to make Blizzard's anti-bot detection attempts financially prohibitive:

> The trick here is that Blizzard has a finite amount of development and test resources, so we want to make it bad business to spend that much time altering their detection code to find Glider, since Glider's negative effect on the game is debatable.... [W]e attack th[is] weakness and try to make it a bad idea or make their changes very risky, since they don't want to risk banning or crashing innocent customers.

E. Pre-litigation contact between MDY and Blizzard

In August 2006, Blizzard sent MDY a cease-and-desist letter alleging that MDY's website hosted WoW screenshots and a Glider install file, all of which infringed Blizzard's copyrights. Donnelly removed the screenshots and requested Blizzard to clarify why the install file was infringing, but Blizzard did not respond. In October 2006, Blizzard's counsel visited Donnelly's home, threatening suit unless MDY immediately ceased selling Glider and remitted all profits to Blizzard. MDY immediately commenced this action.

II.

On December 1, 2006, MDY filed an amended complaint seeking a declaration that Glider does not infringe Blizzard's copyright or other rights. In February 2007, Blizzard filed counterclaims and third-party claims against MDY and Donnelly for, *inter alia,* contributory and vicarious copyright infringement, violation of DMCA § 1201(a)(2) and (b)(1), and tortious interference with contract.

In July 2008, the district court granted Blizzard partial summary judgment, finding that MDY's Glider sales contributorily and vicariously infringed Blizzard's copyrights and tortiously interfered with Blizzard's contracts. The district court also granted MDY partial summary judgment, finding that MDY did not violate DMCA § 1201(a)(2) with respect to accessing the game software's source code.

In September 2008, the parties stipulated to entry of a $6 million judgment against MDY for the copyright infringement and tortious interference with contract claims. They further stipulated that Donnelly would be personally liable for the same amount if found personally liable at trial. After a January 2009 bench trial, the district court held MDY liable under DMCA § 1201(a)(2) and (b)(1). It also held Donnelly personally liable for MDY's copyright infringement, DMCA violations, and tortious interference with contract.

On April 1, 2009, the district court entered judgment against MDY and Donnelly for $6.5 million, an adjusted figure to which the parties stipulated based on MDY's DMCA liability and post-summary judgment Glider sales. The district court permanently enjoined MDY from distributing Glider. MDY's efforts to stay injunctive relief pending appeal were unsuccessful. On April 29, 2009, MDY timely filed this appeal. On May 12, 2009, Blizzard timely cross-appealed the district court's holding that MDY did not violate DMCA § 1201(a)(2) and (b)(1) as to the game software's source code.

IV.

We first consider whether MDY committed contributory … infringement … of Blizzard's copyright by selling Glider to WoW players. [This will occur if the customers infringed the WOW copyright and MDY knowingly (or with reason to know) substantially contributed to the infringement.]

As a copyright owner, Blizzard possesses the exclusive right to reproduce its work. 17 U.S.C. § 106(1). The parties agree that when playing WoW, a player's computer creates a copy of the game's software in the computer's random access memory ("RAM"), a form of temporary memory used by computers to run software programs. This copy potentially infringes unless the player (1) is a licensee whose use of the software is within the scope of the license or (2) owns the copy of the software. As to the scope of the license, ToU § 4(B), "Limitations on Your Use of the Service," provides:

> You agree that you will not ... (ii) create or use cheats, bots, "mods," and/or hacks, or any other third-party software designed to modify the World of Warcraft experience; or (iii) use any third-party software that intercepts, "mines," or otherwise collects information from or through the Program or Service.

By contrast, if the player owns the copy of the software, the "essential step" defense provides that the player does not infringe by making a copy of the computer program where the copy is created and used solely "as an essential step in the utilization of the computer program in conjunction with a machine." 17 U.S.C. § 117(a)(1). … [The court held that the customers were not owners of a copy of the software and, thus, not entitled to protections under first sale doctrine or 17 USC 117. We discuss this issue elsewhere in the course.]

Contractual covenants vs. license conditions

"A copyright owner who grants a nonexclusive, limited license ordinarily waives the right to sue licensees for copyright infringement, and it may sue only for breach of contract." *Sun I,* 188 F.3d at 1121. However, if the licensee acts outside the scope of the license, the licensor may sue for copyright infringement. Enforcing a copyright license "raises issues that lie at the intersection of copyright and contract law."

We refer to contractual terms that limit a license's scope as "conditions," the breach of which constitute copyright infringement. We refer to all other license terms as "covenants," the breach of which is actionable only under contract law. We distinguish between conditions and covenants according to state contract law, to the extent consistent with federal copyright law and policy.

A Glider user commits copyright infringement by playing WoW while violating a ToU term that is a license condition. To establish copyright infringement, then, Blizzard must demonstrate that the violated term—ToU § 4(B)—is a condition rather than a covenant. Blizzard's EULAs and ToUs provide that they are to be interpreted according to Delaware law. Accordingly, we first construe them under Delaware law, and then evaluate whether that construction is consistent with federal copyright law and policy.

A covenant is a contractual promise, i.e., a manifestation of intention to act or refrain from acting in a particular way, such that the promisee is justified in understanding that the promisor has made a commitment. A condition precedent is an act or event that must occur before a duty to perform a promise arises. Conditions precedent are disfavored because they tend to work forfeitures. Wherever possible, equity construes ambiguous contract provisions as covenants rather than conditions. However, if the contract is unambiguous, the court construes it according to its terms.

Applying these principles, ToU § 4(B)(ii) and (iii)'s prohibitions against bots and unauthorized third-party software are covenants rather than copyright-enforceable conditions. *See Greenwood v. CompuCredit Corp.,* 615 F.3d 1204, 1212, (9th Cir.2010) ("[H]eadings and titles are not meant to take the place of the detailed provisions of the text," and ... "the heading of a section cannot limit the plain meaning of the text." Although ToU § 4 is titled, "Limitations on Your Use of the Service," nothing in that section conditions Blizzard's grant of a limited license on players' compliance with ToU § 4's restrictions. To the extent that the title introduces any ambiguity, under Delaware law, ToU § 4(B) is not a condition, but is a contractual covenant.

To recover for copyright infringement based on breach of a license agreement, (1) the copying must exceed the scope of the defendant's license and (2) the copyright owner's complaint must be grounded in an exclusive right of copyright (e.g., unlawful reproduction or distribution). Contractual rights, however, can be much broader:

> [C]onsider a license in which the copyright owner grants a person the right to make one and only one copy of a book with the caveat that the licensee may not read the last ten pages. Obviously, a licensee who made a hundred copies of the book would be liable for copyright infringement because the copying would violate the Copyright Act's prohibition on reproduction and would exceed the scope of the license. Alternatively, if the licensee made a single copy of the book, but read the last ten pages, the only cause of action would be for breach of contract, because reading a book does not violate any right protected by copyright law.

Consistent with this approach, we have held that the potential for infringement exists only where the licensee's action (1) exceeds the license's scope (2) in a manner that implicates one of the licensor's exclusive statutory rights.

Here, ToU § 4 contains certain restrictions that are grounded in Blizzard's exclusive rights of copyright and other restrictions that are not. For instance, ToU § 4(D) forbids creation of derivative works based on WoW without Blizzard's consent. A player who violates this prohibition would exceed the scope of her license and violate one of Blizzard's exclusive rights under the Copyright Act. In contrast, ToU § 4(C)(ii) prohibits a player's disruption of another player's game experience. *Id.* A player might violate this prohibition while playing the game by harassing another player with unsolicited instant messages. Although this conduct may violate the contractual covenants with Blizzard, it would not violate any of Blizzard's exclusive rights of copyright. The antibot provisions at issue in this case, ToU § 4(B)(ii) and (iii), are similarly covenants rather than conditions. A Glider user violates the covenants with Blizzard, but does not thereby commit copyright infringement because Glider does not infringe any of Blizzard's exclusive rights. For instance, the use does not alter or copy WoW software.

Were we to hold otherwise, Blizzard—or any software copyright holder—could designate any disfavored conduct during software use as copyright infringement, by purporting to condition the license on the player's abstention from the disfavored conduct. The rationale would be that because the conduct occurs while the player's computer is copying the software code into RAM in order for it to run, the violation is copyright infringement. This would allow software copyright owners far greater rights than Congress has generally conferred on copyright owners.

We conclude that for a licensee's violation of a contract to constitute copyright infringement, there must be a nexus between the condition and the licensor's exclusive rights of copyright. Here, WoW players do not commit copyright infringement by using Glider in violation of the ToU. MDY is thus not liable for secondary copyright infringement, which requires the existence of direct copyright infringement.

….

V.

[The court concluded that there was a violation of DMCA § 1201(a)(2)involving circumvention of the Warden access control system.]

NOTES

1. MDY has not been followed on its manner of distinguishing covenant and condition. Is it consistent with *SunMicrosystems*?

2. In any event, the case does poorly in describing when the protection of a license can be or is withdrawn, does it not? Consider the following: LOR grants a license to LEE to use and reproduce its patented or copyrighted technology. In return, LEE makes various promises to LOR. LEE materially fails to perform those promises. LOR cancels the license and sues for infringement because LEE continued to use and copy the technology after cancelation. What result?

III. LICENSE, FIRST SALE, AND PATENT EXHAUSTION

A. Copyright First Sale

Page 279. Add the following after Problem 6.7:

VERNOR v. AUTODESK, INC.
621 F.3d 1102 (9th Cir. 2010)

OPINION

CALLAHAN, Circuit Judge:

Timothy Vernor purchased several used copies of Autodesk, Inc.'s AutoCAD Release 14 software ("Release 14") from one of Autodesk's direct customers, and he resold the Release 14 copies on eBay. Vernor brought this declaratory judgment action against Autodesk to establish that these resales did not infringe Autodesk's copyright. The district court issued the requested declaratory judgment, holding that Vernor's sales were lawful because of two of the Copyright Act's affirmative defenses that apply to owners of copies of copyrighted works, the first sale doctrine and the essential step defense.

Autodesk distributes Release 14 pursuant to a limited license agreement in which it reserves title to the software copies and imposes significant use and transfer restrictions on its customers. We determine that Autodesk's direct customers are licensees of their copies of the software rather than owners, which has two ramifications. Because Vernor did not purchase the Release 14 copies from an owner, he may not invoke the first sale doctrine, and he also may not assert an essential step defense on behalf of his customers. For these reasons, we vacate the district court's grant of summary judgment to Vernor and remand for further proceedings.

I.

A. Autodesk's Release 14 software and licensing practices

The material facts are not in dispute. Autodesk makes computer-aided design software used by architects, engineers, and manufacturers. It has more than nine million customers. It first released its AutoCAD software in 1982. It holds registered copyrights in all versions of the software including the discontinued Release 14 version, which is at issue in this case. It provided Release 14 to customers on CD-ROMs.

Since at least 1986, Autodesk has offered AutoCAD to customers pursuant to an accompanying software license agreement ("SLA"), which customers must accept before installing the software. A customer who does not accept the SLA can return the software for a full refund. Autodesk offers SLAs with different terms for commercial, educational institution, and student users. The commercial license, which is the most expensive, imposes the fewest restrictions on users and allows them software upgrades at discounted prices.

The SLA for Release 14 first recites that Autodesk retains title to all copies. Second, it states that the customer has a nonexclusive and nontransferable license to use Release 14. Third, it imposes transfer restrictions, prohibiting customers from renting, leasing, or transferring the software without Autodesk's prior consent and from electronically or physically transferring the software out of the Western Hemisphere. Fourth, it imposes significant use restrictions:

> YOU MAY NOT: (1) modify, translate, reverseengineer, decompile, or disassemble the Software ... (3) remove any proprietary notices, labels, or marks from the Software or Documentation; (4) use ... the Software outside of the Western Hemisphere; (5) utilize any computer software or hardware designed to defeat any hardware copy-protection device, should the software you have licensed be equipped with such protection; or (6) use the Software for commercial or other revenue-generating purposes if the Software has been licensed or labeled for educational use only.

Fifth, the SLA provides for license termination if the user copies the software without authorization or does not comply with the SLA's restrictions. Finally, the SLA provides that if the software is an upgrade of a previous version:

> [Y]ou must destroy the software previously licensed to you, including any copies resident on your hard disk drive ... within sixty (60) days of the purchase of the license to use the upgrade or update.... Autodesk reserves the right to require you to show satisfactory proof that previous copies of the software have been destroyed.

Autodesk takes measures to enforce these license requirements. It assigns a serial number to each copy of AutoCAD and tracks registered licensees. It requires customers to input “activation codes” within one month after installation to continue using the software. The customer obtains the code by providing the product's serial number to Autodesk. Autodesk issues the activation code after confirming that the serial number is authentic, the copy is not registered to a different customer, and the product has not been upgraded. Once a customer has an activation code, he or she may use it to activate the software on additional computers without notifying Autodesk.

B. Autodesk's provision of Release 14 software to CTA

In March 1999, Autodesk reached a settlement agreement with its customer Cardwell/Thomas & Associates, Inc. (“CTA”), which Autodesk had accused of unauthorized use of its software. As part of the settlement, Autodesk licensed ten copies of Release 14 to CTA. CTA agreed to the SLA, which appeared (1) on each Release 14 package that Autodesk provided to CTA; (2) in the settlement agreement; and (3) on-screen, while the software is being installed.

CTA later upgraded to the newer, fifteenth version of the AutoCAD program, AutoCAD 2000. It paid $495 per upgrade license, compared to $3,750 for each new license. The SLA for AutoCAD 2000, like the SLA for Release 14, required destruction of copies of previous versions of the software, with proof to be furnished to Autodesk on request. However, rather than destroying its Release 14 copies, CTA sold them to Vernor at an office sale with the handwritten activation codes necessary to use the software.

C. Vernor's eBay business and sales of Release 14

Vernor has sold more than 10,000 items on eBay. In May 2005, he purchased an authentic used copy of Release 14 at a garage sale from an unspecified seller. He never agreed to the SLA's terms, opened a sealed software packet, or installed the Release 14 software. Though he was aware of the SLA's existence, he believed that he was not bound by its terms. He posted the software copy for sale on eBay.

Autodesk filed a Digital Millennium Copyright Act (“DMCA”) take-down notice with eBay claiming that Vernor's sale infringed its copyright, and eBay terminated Vernor's auction. Autodesk advised Vernor that it conveyed its software copies pursuant to non-transferable licenses, and resale of its software was copyright infringement. Vernor filed a DMCA counter-notice with eBay contesting the validity of Autodesk's copyright claim. Autodesk did not respond to the counter-notice. eBay reinstated the auction, and Vernor sold the software to another eBay user.

In April 2007, Vernor purchased four authentic used copies of Release 14 at CTA's office sale. The authorization codes were handwritten on the outside of the box. He listed the four copies on eBay sequentially, representing, “This software is not currently installed on any computer.” On each of the first three occasions, the same DMCA process ensued. Autodesk filed a DMCA take-down notice with eBay, and eBay removed Vernor's auction. Vernor submitted a counter-notice to which Autodesk did not respond, and eBay reinstated the auction.

When Vernor listed his fourth, final copy of Release 14, Autodesk again filed a DMCA take-down notice with eBay. This time, eBay suspended Vernor's account because of Autodesk's repeated charges of infringement. Vernor also wrote to Autodesk, claiming that he was entitled to sell his Release 14 copies pursuant to the first sale doctrine, because he never installed the software or agreed to the SLA. In response, Autodesk's counsel directed Vernor to stop selling the software. Vernor filed a final counter-notice with eBay. When Autodesk again did not respond to Vernor's counter-notice, eBay reinstated Vernor's account. At that point, Vernor's eBay account had been suspended for one month, during which he was unable to earn income on eBay.

Vernor currently has two additional copies of Release 14 that he wishes to sell on eBay. Although the record is not clear, it appears that Vernor sold two of the software packages that he purchased from CTA, for roughly $600 each, but did not sell the final two to avoid risking further suspension of his eBay account.

II.

In August 2007, Vernor brought a declaratory action against Autodesk to establish that his resales of used Release 14 software are protected by the first sale doctrine and do not infringe Autodesk's copyright….

III.

Copyright is a federal law protection provided to the authors of "original works of authorship," including software programs. 17 U.S.C. §§ 101-103. The Copyright Act confers several exclusive rights on copyright owners, including the exclusive rights to reproduce their works and to distribute their works by sale or rental. *Id.* § 106(1), (3). The exclusive distribution right is limited by the **first sale doctrine,** an affirmative defense to copyright infringement that allows owners of copies of copyrighted works to resell those copies. The exclusive reproduction right is limited within the software context by the **essential step defense,** another affirmative defense to copyright infringement that is discussed further *infra.* Both of these affirmative defenses are unavailable to those who are only licensed to use their copies of copyrighted works.

This case requires us to decide whether Autodesk sold Release 14 copies to its customers or licensed the copies to its customers. If CTA owned its copies of Release 14, then both its sales to Vernor and Vernor's subsequent sales were non-infringing under the first sale doctrine. However, if Autodesk only licensed CTA to use copies of Release 14, then CTA's and Vernor's sales of those copies are not protected by the first sale doctrine and would therefore infringe Autodesk's exclusive distribution right.

….

B. Owners vs. licensees

We turn to our precedents governing whether a transferee of a copy of a copyrighted work is an owner or licensee of that copy. We then apply those precedents to CTA's and Vernor's possession of Release 14 copies.

1. *United States v. Wise,* 550 F.2d 1180 (9th Cir.1977)

In *Wise,* a criminal copyright infringement case, we considered whether copyright owners who transferred copies of their motion pictures pursuant to written distribution agreements had executed first sales. *Id.* at 1187. The defendant was found guilty of copyright infringement based on his for-profit sales of motion picture prints. *See id.* at 1183. The copyright owners distributed their films to third parties pursuant to written agreements that restricted their use and transfer. *Id.* at 1183-84. On appeal, the defendant argued that the government failed to prove the absence of a first sale for each film. If the copyright owners' initial transfers of the films were first sales, then the defendant's resales were protected by the first sale doctrine and thus were not copyright infringement.

To determine whether a first sale occurred, we considered multiple factors pertaining to each film distribution agreement. Specifically, we considered whether the agreement (a) was labeled a license, (b) provided that the copyright owner retained title to the prints, (c) required the return or destruction of the prints, (d) forbade duplication of prints, or (e) required the transferee to maintain possession of the prints for the agreement's duration. *Id.* at 1190-92. Our use of these several considerations, none dispositive, may be seen in our treatment of each film print.

For example, we reversed the defendant's conviction with respect to *Camelot*. *Id.* at 1194. It was unclear whether the *Camelot* print sold by the defendant had been subject to a first sale. Copyright owner Warner Brothers distributed *Camelot* prints pursuant to multiple agreements, and the government did not prove the absence of a first sale with respect to each agreement. *Id.* at 1191-92, 1194. We noted that, in one agreement, Warner Brothers had retained title to the prints, required possessor National Broadcasting Company ("NBC") to return the prints if the parties could select a mutual agreeable price, and if not, required NBC's certification that the prints were destroyed. *Id.* at 1191. We held that these factors created a license rather than a first sale. *Id.*

We further noted, however, that Warner Brothers had also furnished another *Camelot* print to actress Vanessa Redgrave. *Id.* at 1192. The print was provided to Redgrave at cost, and her use of the print was subject to several restrictions. She had to retain possession of the print and was not allowed to sell, license, reproduce, or publicly exhibit the print. *Id.* She had no obligation to return the print to Warner Brothers. *Id.* We concluded, "While the provision for payment for the cost of the film, standing alone, does not establish a sale, when taken with the rest of the language of the agreement, it reveals a transaction strongly resembling a sale with restrictions on the use of the print ." *Id.* There was no evidence of the print's whereabouts, and we held that "[i]n the absence of such proof," the government failed to prove the absence of a first sale with respect to this Redgrave print. *Id.* at 1191-92. Since it was unclear which copy the defendant had obtained and resold, his conviction for sale of *Camelot* had to be reversed. *Id.*

Thus, under *Wise,* where a transferee receives a particular copy of a copyrighted work pursuant to a written agreement, we consider all of the provisions of the agreement to determine whether the transferee became an owner of the copy or received a license. We may consider (1) whether the agreement was labeled a license and (2) whether the copyright owner retained title to the copy, required its return or destruction, forbade its duplication, or required the transferee to maintain possession of the copy for the agreement's duration. *Id.* at 1190-92. We did not find any one factor dispositive in *Wise:* we did not hold that the copyright owner's retention of title itself established the absence of a first sale or that a transferee's right to indefinite possession itself established a first sale.

2. *The "*MAI *trio" of cases*

Over fifteen years after *Wise,* we again considered the distinction between owners and licensees of copies of copyrighted works in three software copyright cases, the "*MAI* trio". *See MAI Sys. Corp. v. Peak Computer, Inc.,* 991 F.2d 511 (9th Cir.1993); *Triad Sys. Corp. v. Se. Express Co.,* 64 F.3d 1330 (9th Cir.1995); *Wall Data, Inc. v. Los Angeles County Sheriff's Dep't,* 447 F.3d 769 (9th Cir.2006). In the *MAI* trio, we considered which software purchasers were owners of copies of copyrighted works for purposes of a second affirmative defense to infringement, the essential step defense.

The enforcement of copyright owners' exclusive right to reproduce their work under the Copyright Act, 17 U.S.C. § 106(1), has posed special challenges in the software context. In order to use a software program, a user's computer will automatically copy the software into the computer's random access memory ("RAM"), which is a form of computer data storage. *See MAI,* 991 F.2d at 513. Congress enacted the **essential step defense** to codify that a software user who is the "owner of a copy" of a copyrighted software program does not infringe by making a copy of the computer program, if the new copy is "created as an essential step in the utilization of the computer program in conjunction with a machine and ... is used in no other manner." 17 U.S.C. § 117(a)(1).

The Copyright Act provides that an “owner of a copy” of copyrighted software may claim the essential step defense, and the “owner of a particular copy” of copyrighted software may claim the first sale doctrine. 17 U.S.C. §§ 109(a), 117(a)(1). The *MAI* trio construed the phrase “owner of a copy” for essential step defense purposes. Neither Vernor nor Autodesk contends that the first sale doctrine's inclusion of the word “particular” alters the phrase's meaning, and we “presume that words used more than once in the same statute have the same meaning throughout.” Accordingly, we consider the *MAI* trio's construction of “owner of a copy” controlling in our analysis of whether CTA and Vernor became “owner[s] of a particular copy” of Release 14 software.

In *MAI* and *Triad,* the defendants maintained computers that ran the plaintiffs' operating system software. When the defendants ran the computers, the computers automatically loaded plaintiffs' software into RAM. The plaintiffs in both cases sold their software pursuant to restrictive license agreements, and we held that their customers were licensees who were therefore not entitled to claim the essential step defense. We found that the defendants infringed plaintiffs' software copyrights by their unauthorized loading of copyrighted software into RAM. In *Triad,* the plaintiff had earlier sold software outright to some customers. 64 F.3d at 1333 n. 2. We noted that these customers were owners who were entitled to the essential step defense, and the defendant did not infringe by making RAM copies in servicing their computers. *Id.*

In *Wall Data,* plaintiff sold 3,663 software licenses to the defendant. The licenses (1) were non-exclusive; (2) permitted use of the software on a single computer; and (3) permitted transfer of the software once per month, if the software was removed from the original computer. *Id.* at 775 n. 5, 781. The defendant installed the software onto 6,007 computers via hard drive imaging, which saved it from installing the software manually on each computer. It made an unverified claim that only 3,663 users could simultaneously access the software. *Id.* at 776.

The plaintiff sued for copyright infringement, contending that the defendant violated the license by “over-installing” the software. *Id.* at 775. The defendant raised an essential step defense, contending that its hard drive imaging was a necessary step of installation. *Id.* at 776. On appeal, we held that the district court did not abuse its discretion in denying the defendant's request for a jury instruction on the essential step defense. *Id.* at 784. Citing *MAI,* we held that the essential step defense does not apply where the copyright owner grants the user a license and significantly restricts the user's ability to transfer the software. *Id.* at 784-85. Since the plaintiff's license imposed “significant restrictions” on the defendant's software rights, the defendant was a licensee and was not entitled to the essential step defense. *Id.* at 785.

In *Wall Data,* we acknowledged that *MAI* had been criticized in a Federal Circuit decision, but declined to revisit its holding, noting that the facts of *Wall Data* led to the conclusion that any error in the district court's failure to instruct was harmless. Even if the defendant owned its copies of the software, its installation of the software on a number of computers in excess of its license was not an essential step in the software's use. *Id.* at 786 n. 9 (citing Nimmer on Copyright § 8.08[B][1][c] at 8-136; *DSC Commc'ns Corp. v. Pulse Commc'ns, Inc.,* 170 F.3d 1354, 1360 (Fed.Cir.1999) (criticizing *MAI*)).

We read *Wise* and the *MAI* trio to prescribe three considerations that we may use to determine whether a software user is a licensee, rather than an owner of a copy. First, we consider whether the copyright owner specifies that a user is granted a license. Second, we consider whether the copyright owner significantly restricts the user's ability to transfer the software. Finally, we consider whether the copyright owner imposes notable use restrictions. Our holding reconciles the *MAI* trio and *Wise,* even though the *MAI* trio did not cite *Wise. See Cisneros-Perez v. Gonzales,* 451 F.3d 1053, 1058 (9th Cir.2006) (“[W]e are required to reconcile prior precedents if we can do so.”)

In response to *MAI,* Congress amended § 117 to permit a *computer owner* to copy software for maintenance or repair purposes. *See* 17 U.S.C. § 117(c); *see also* H.R. Rep. No. 105-551, pt. 1, at 27 (1998). However, Congress did not disturb *MAI's* holding that licensees are not entitled to the essential step defense.

IV.

A. The district court's decision

The district court interpreted *Wise* to hold that a first sale occurs whenever the transferee is entitled to keep the copy of the work. Since Autodesk does not require its customers to return their copies of Release 14, the district court found that Autodesk had sold Release 14 to CTA. It reasoned that thus, CTA and Vernor were successive "owner[s] of a copy" of the software and were entitled to resell it under the first sale doctrine. The district court also found that Vernor's customers' copying of software during installation was protected by the essential step defense.

….

B. Analysis

We hold today that a software user is a licensee rather than an owner of a copy where the copyright owner (1) specifies that the user is granted a license; (2) significantly restricts the user's ability to transfer the software; and (3) imposes notable use restrictions. Applying our holding to Autodesk's SLA, we conclude that CTA was a licensee rather than an owner of copies of Release 14 and thus was not entitled to invoke the first sale doctrine or the essential step defense.

Autodesk retained title to the software and imposed significant transfer restrictions: it stated that the license is nontransferable, the software could not be transferred or leased without Autodesk's written consent, and the software could not be transferred outside the Western Hemisphere. The SLA also imposed use restrictions against the use of the software outside the Western Hemisphere and against modifying, translating, or reverse-engineering the software, removing any proprietary marks from the software or documentation, or defeating any copy protection device. Furthermore, the SLA provided for termination of the license upon the licensee's unauthorized copying or failure to comply with other license restrictions. Thus, because Autodesk reserved title to Release 14 copies and imposed significant transfer and use restrictions, we conclude that its customers are licensees of their copies of Release 14 rather than owners.

CTA was a licensee rather than an "owner of a particular copy" of Release 14, and it was not entitled to resell its Release 14 copies to Vernor under the first sale doctrine. 17 U.S.C. § 109(a). Therefore, Vernor did not receive title to the copies from CTA and accordingly could not pass ownership on to others. Both CTA's and Vernor's sales infringed Autodesk's exclusive right to distribute copies of its work. *Id.* § 106(3).

Because Vernor was not an owner, his customers are also not owners of Release 14 copies. Therefore, when they install Release 14 on their computers, the copies of the software that they make during installation infringe Autodesk's exclusive reproduction right because they too are not entitled to the benefit of the essential step defense. 17 U.S.C. §§ 106(1), 117(a)(1).

Although unnecessary to our resolution of the case, we address the legislative history in order to address the arguments raised by the parties and amici. That legislative history supports our conclusion that licensees such as CTA are not entitled to claim the first sale doctrine. The House Report for § 109 underscores Congress' view that the first sale doctrine is available only to a person who has acquired a copy via an "outright sale".. No. 94-1476, at 79 (1976), *reprinted in* 1976 U.S.C.C.A.N. 5659, 5693. The report also asserts that the first sale doctrine does not "apply to someone who merely possesses a copy or phonorecord without having acquired ownership of it." *Id.*

Our conclusion that those who rightfully possess, but do not own, a copy of copyrighted software are not entitled to claim the essential step defense is also supported by the legislative history. Congress enacted § 117 following a report from the National Commission on New Technological Uses of Copyrighted Works ("CONTU") proposing Copyright Act amendments. *DSC Commc'ns Corp. v. Pulse Commc'ns, Inc.,* 170 F.3d 1354, 1360 (Fed.Cir.1999) (citing *Final Report of the National Commission on New Technological Uses of Copyrighted Works,* U.S. Dept. of Commerce, PB-282141, at 30 (July 31, 1978)). CONTU's proposed version of § 117 was identical to the version that Congress enacted with one exception. *Id.* CONTU's version provided, "[I]t is not an infringement for the rightful possessor of a copy of a computer program to make or authorize the making of another copy or adaptation of that program...." *Id.* Without explanation, Congress substituted "owner" for "rightful possessor." *Id.* This modification suggests that more than rightful possession is required for § 117 to apply-i.e., that Congress did not intend licensees subject to significant transfer and use restrictions to receive the benefit of the essential step defense.

C. Vernor's four counterarguments are not persuasive

1. *The district court's decision concerning indefinite possession*

Vernor contends that the district court correctly concluded that (1) *Wise* is the controlling precedent and (2) under *Wise,* the key factor is whether transferees are entitled to indefinite possession of their copy of a copyrighted work. As explained *supra,* we disagree. In *Wise,* we utilized a multi-factor balancing test to distinguish between a first sale and a license of a copyrighted film print. We considered a transferee's ability to possess a print indefinitely as one factor in our analysis, but we did not treat it as dispositive. If we had, we would not have needed to consider other contractual provisions, such as retention of title, copying prohibitions, and lending restrictions. *Id.* Moreover, we held in *Wise* that two agreements were licenses rather than first sales, even though those agreements did not describe any provision requiring the transferee to return the prints to the copyright owners. *Id.* at 1192 (analyzing VIP agreements for *The Sting* and *Funny Girl*).

2. *Circuit split with the Federal and Second Circuits*

Vernor contends that reversing the district court will create a circuit split with the Federal and Second Circuits. *See DSC Commc'ns Corp. v. Pulse Commc'ns, Inc.,* 170 F.3d 1354 (Fed.Cir.1999); *Krause v. Titleserv, Inc.,* 402 F.3d 119 (2nd Cir.2005). We disagree.

In *DSC,* the Federal Circuit considered the essential step defense in a case in which the plaintiff and defendant sold competing telephone systems hardware cards. 170 F.3d at 1358. Rather than develop its own software, the defendant used its hardware to download plaintiff's software into RAM upon installation. *Id.* The plaintiff argued that this constituted copyright infringement, and the defendant countered that the relevant customers owned plaintiff's software, entitling them to an essential step defense. *Id.* at 1359-60. The court rejected the defendant's essential step defense, holding that plaintiff licensed its customers' use of their copies of the software in the relevant license agreement's transfer and use restrictions. *Id.* at 1360-61. Although the Federal Circuit rejected *MAI's* "characterization of all licensees as non-owners," it deemed *MAI* "instructive" and determined that the agreements there in issue were licenses. *Id.* at 1360. Although *DSC* is thus narrower than *MAI,* it does not conflict with our holding today that a software customer bound by a restrictive license agreement may be a licensee of a copy not entitled to the first sale doctrine or the essential step defense.

…

3. *The Supreme Court's holding in* Bobbs-Merrill

Vernor contends that *Bobbs-Merrill* establishes his entitlement to a first sale defense. *See Bobbs-Merrill Co. v. Straus,* 210 U.S. 339, 28 S. Ct. 722, 52 L. Ed. 1086 (1908). However, *Bobbs-Merrill* stands only for the proposition that a copyright owner's exclusive distribution right does not allow it to control sales of copies of its work after the first sale. *Id.* at 350. Decided in 1908, *Bobbs-Merrill* did not and could not address the question of whether the right to use software is distinct from the ownership of copies of software. Moreover, the Supreme Court in *Bobbs-Merrill* made explicit that its decision did not address the use of restrictions to create a license. *Id.* ("There is no claim in this case of contract limitation, nor license agreement controlling the subsequent sales of the book.")

4. *Economic realities of the transaction*

Finally, Vernor contends that "economic realities" demonstrate that Autodesk makes "first sales" to its customers, because Autodesk allows its customers to possess their copies of the software indefinitely and does not require recurring license payments. We held *supra* that neither of these factors is dispositive. Vernor cites no first sale doctrine case in support of this proposition. Rather, he cites *In re DAK Indus.,* 66 F.3d 1091, 1095 (9th Cir.1995), a case in which we interpreted the Bankruptcy Code to decide whether a particular transaction should be considered a pre-petition sale. We commented that "[w]hen applying the bankruptcy code to this transaction, we must look through its form to the 'economic realities of the particular arrangement.' " *Id.* Nothing in *DAK* is contrary to our reconciliation of *Wise* and the *MAI* trio.

V.

Although our holding today is controlled by our precedent, we recognize the significant policy considerations raised by the parties and amici on both sides of this appeal.

Autodesk, the Software & Information Industry Association ("SIIA"), and the Motion Picture Association of America ("MPAA") have presented policy arguments that favor our result. For instance, Autodesk argues in favor of judicial enforcement of software license agreements that restrict transfers of copies of the work. Autodesk contends that this (1) allows for tiered pricing for different software markets, such as reduced pricing for students or educational institutions; (2) increases software companies' sales; (3) lowers prices for all consumers by spreading costs among a large number of purchasers; and (4) reduces the incidence of piracy by allowing copyright owners to bring infringement actions against unauthorized resellers. SIIA argues that a license can exist even where a customer (1) receives his copy of the work after making a single payment and (2) can indefinitely possess a software copy, because it is the software code and associated rights that are valuable rather than the inexpensive discs on which the code may be stored. Also, the MPAA argues that a customer's ability to possess a copyrighted work indefinitely should not compel a finding of a first sale, because there is often no practically feasible way for a consumer to return a copy to the copyright owner.

Vernor, eBay, and the American Library Association ("ALA") have presented policy arguments against our decision. Vernor contends that our decision (1) does not vindicate the law's aversion to restraints on alienation of personal property; (2) may force everyone purchasing copyrighted property to trace the chain of title to ensure that a first sale occurred; and (3) ignores the economic realities of the relevant transactions, in which the copyright owner permanently released software copies into the stream of commerce without expectation of return in exchange for upfront payment of the full software price. eBay contends that a broad view of the first sale doctrine is necessary to facilitate the creation of secondary markets for copyrighted works, which contributes to the public good by (1) giving consumers additional opportunities to purchase and sell copyrighted works, often at below-retail prices; (2) allowing consumers to obtain copies of works after a copyright owner has ceased distribution; and (3) allowing the proliferation of businesses.

The ALA contends that the first sale doctrine facilitates the availability of copyrighted works after their commercial lifespan, by *inter alia* enabling the existence of libraries, used bookstores, and hand-to-hand exchanges of copyrighted materials. The ALA further contends that judicial enforcement of software license agreements, which are often contracts of adhesion, could eliminate the software resale market, require used computer sellers to delete legitimate software prior to sale, and increase prices for consumers by reducing price competition for software vendors. It contends that Autodesk's position (1) undermines 17 U.S.C. § 109(b)(2), which permits non-profit libraries to lend software for non-commercial purposes, and (2) would hamper efforts by non-profits to collect and preserve out-of-print software. The ALA fears that the software industry's licensing practices could be adopted by other copyright owners, including book publishers, record labels, and movie studios.

These are serious contentions on both sides, but they do not alter our conclusion that our precedent from *Wise* through the *MAI* trio requires the result we reach. Congress is free, of course, to modify the first sale doctrine and the essential step defense if it deems these or other policy considerations to require a different approach.

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UMG RECORDINGS v. AUGUSTO
628 F.3d 1175 (9th Cir. 2011)

OPINION

CANBY, Circuit Judge:

UMG Recordings appeals the district court's grant of summary judgment in favor of defendant Troy Augusto on UMG's claim of copyright infringement in violation of § 501 of the Copyright Act, which entitles copyright owners to institute an action for infringement of the exclusive right to distribute copies of the copyrighted work. The copies in issue comprise eight specially-produced compact discs, each embodying a copyrighted sound recording. UMG, the copyright owner, used the discs solely for marketing purposes, sending them unsolicited to individuals such as music critics and radio disc jockeys. Although Augusto was not one of those individuals, he managed to obtained the discs from various sources. He later sold them at auction, an act which UMG contends infringed its exclusive right to distribute the discs.

Augusto asserts that UMG's initial distribution of the discs effected a transfer of ownership of the discs to the recipients, rendering the discs subject to the "first sale" doctrine, which permits one who has acquired ownership of a copy to dispose of that copy without the permission of the copyright owner. *See id.* § 109(a). UMG argues that the statements on the discs and the circumstances of their distribution granted only a license to each recipient, not a transfer of ownership (or "sale") of the copy. Absent a sale, UMG remained the owner of the discs and, accordingly, the defense of the first sale doctrine would be out of Augusto's reach. We conclude that the mailing indeed did effect a sale of the discs to the recipients for purposes of the first sale doctrine, and we affirm the order of the district court.

BACKGROUND AND PROCEDURAL HISTORY

The material facts of the case are undisputed. UMG is among the world's largest music companies. One of its core businesses is the creation, manufacture, and sale of recorded music, or phonorecords, the copyrights of which are owned by UMG. These phonorecords generally take the form of compact discs ("CDs").

Like many music companies, UMG ships specially-produced promotional CDs to a large group of individuals ("recipients"), such as music critics and radio programmers, that it has selected. There is no prior agreement or request by the recipients to receive the CDs. UMG does not seek or receive payment for the CDs, the content and design of which often differs from that of their commercial counterparts. UMG ships the promotional CDs by means of the United States Postal Service and United Parcel Service. Relatively few of the recipients refuse delivery of the CDs or return them to UMG, and UMG destroys those that are returned.

Most of the promotional CDs in issue in this case bore a statement (the "promotional statement") similar to the following:

> This CD is the property of the record company and is licensed to the intended recipient for personal use only. Acceptance of this CD shall constitute an agreement to comply with the terms of the license. Resale or transfer of possession is not allowed and may be punishable under federal and state laws.

Some of the CDs bore a more succinct statement, such as "Promotional Use Only—Not for Sale."[1]

[1] [FN2] Despite the fact that the two types of statements bear little resemblance to each other, the parties unaccountably agree that both types have the same meaning (although they dispute what that meaning is).

Augusto was not among the select group of individuals slated to receive the promotional CDs. He nevertheless managed to acquire numerous such CDs, many of which he sold through online auctions at eBay.com. Augusto regularly advertised the CDs as "rare ... industry editions" and referred to them as "Promo CDs."

After several unsuccessful attempts at halting the auctions through eBay's dispute resolution program, UMG filed a complaint against Augusto in the United States District Court for the Central District of California, alleging that Augusto had infringed UMG's copyrights in eight promotional CDs for which it retained the "exclusive right to distribute." The district court granted summary judgment in favor of Augusto, and UMG appealed. We have jurisdiction of the appeal pursuant to 28 U.S.C. § 1291.

DISCUSSION

…

Although UMG, as the owner of the copyright, has exclusive rights in the promotional CDs, "[e]xemptions, compulsory licenses, and defenses found in the Copyright Act narrow [those] rights." Augusto invokes the "first sale" doctrine embodied in § 109(a) of the Act. 17 U.S.C. § 109(a). He argues that the circumstances attending UMG's distribution of the discs effected a "sale" (transfer of ownership) of the discs to the original recipients and that, under the "first sale" doctrine, the recipients and subsequent owners of those particular copies were permitted to sell or otherwise dispose of those copies without authorization by the copyright holder.

In the alternative, Augusto argues that the original recipients were entitled to treat the CDs as gifts under the Unordered Merchandise Statute, enacted as part of the Postal Reorganization Act of 1970, and therefore had "the right to retain, use, discard, or dispose of [them] in any manner [they saw] fit," in this case, by selling those CDs to the thrift shops and second-hand stores where Augusto states he purchased them. *See* 39 U.S.C. § 3009(a), (b) (2006); *see also* Postal Reorganization Act of 1970, Pub. L. No. 91–375, 84 Stat. 719 (codified at 39 U.S.C. § 101).

UMG, on the other hand, contends that the promotional statement effected a license with the recipients and, because the recipients were not owners but licensees of the CDs, neither they nor Augusto were entitled to sell or otherwise transfer the CDs….

The Distribution of the Promotional CDs Effected a Sale

The first sale doctrine provides that "the owner of a particular copy or phonorecord lawfully made under [the Act], or any person authorized by such owner, is entitled, without the authority of the copyright owner, to sell or otherwise dispose of the possession of that copy or phonorecord." 17 U.S.C. § 109(a). Notwithstanding its distinctive name, the doctrine applies not only when a copy is first sold, but when a copy is given away or title is otherwise transferred without the accouterments of a sale. *See* 4 Patry on Copyright § 13:15; *see also United States v. Atherton,* 561 F.2d 747, 750 (9th Cir.1977) ("The 'sale' embodied in the first sale concept is a term of art."). "[O]nce the copyright owner places a copyrighted item in the stream of commerce ..., he has exhausted his exclusive statutory right to control its distribution." *Quality King,* 523 U.S. at 152, 118 1125. The seminal illustration of the principle is found in *Bobbs–Merrill Co. v. Straus,* 210 U.S. 339, 341, 28 722, 52. 1086 (1908), where a copyright owner unsuccessfully attempted to restrain the resale of a copyrighted book by including in it the following notice: "The price of this book at retail is $1 net. No dealer is licensed to sell it at a less price, and a sale at less price will be treated as an infringement of the copyright." *Id.* The Court noted that the statutory grant to a copyright owner of the "sole right of vending" the work did not continue after the first sale of a given copy. "The purchaser of a book, once sold by authority of the owner of the copyright, may sell it again, although he could not publish a new edition of it." The attempt to limit resale below a certain price was therefore held invalid.

The rule of *Bobbs–Merrill* remains in full force, enshrined as it is in § 109(a) of the Act: a copyright owner who transfers title in a particular copy to a purchaser or donee cannot prevent resale of that particular copy. We have recognized, however, that not every transfer of possession of a copy transfers title. Particularly with regard to computer software, we have recognized that copyright owners may create licensing arrangements so that users acquire only a license to use the particular copy of software and do not acquire title that permits further transfer or sale of that copy without the permission of the copyright owner. … All of these cases dealt with the question whether arrangements with consumers amounted to sales of copies, or succeeded in awarding only licenses. They recognized that the mere labeling of an arrangement as a license rather than a sale, although it was a factor to be considered, was not by itself dispositive of the issue.

The same question is presented here. Did UMG succeed in creating a license in recipients of its promotional CDs, or did it convey title despite the restrictive labeling on the CDs? We conclude that, under all the circumstances of the CDs' distribution, the recipients were entitled to use or dispose of them in any manner they saw fit, and UMG did not enter a license agreement for the CDs with the recipients. Accordingly, UMG transferred title to the particular copies of its promotional CDs and cannot maintain an infringement action against Augusto for his subsequent sale of those copies.

Our conclusion that the recipients acquired ownership of the CDs is based largely on the nature of UMG's distribution. First, the promotional CDs are dispatched to the recipients without any prior arrangement as to those particular copies. The CDs are not numbered, and no attempt is made to keep track of where particular copies are or what use is made of them. As explained in greater detail below, although UMG places written restrictions in the labels of the CDs, it has not established that the restrictions on the CDs create a license agreement.[2]

We also hold that, because the CDs were unordered merchandise, the recipients were free to dispose of them as they saw fit under the Unordered Merchandise Statute …

There are additional reasons for concluding that UMG's distribution of the CDs did not involve a consensual licensing operation. Some of the statements on the CDs and UMG's purported method of securing agreement to licenses militate against a conclusion that any licenses were created. The sparest promotional statement, "Promotional Use Only—Not for Sale," does not even purport to create a license. But even the more detailed statement is flawed in the manner in which it purports to secure agreement from the recipient. The more detailed statement provides:

> This CD is the property of the record company and is licensed to the intended recipient for personal use only. Acceptance of this CD shall constitute an agreement to comply with the terms of the license. Resale or transfer of possession is not allowed and may be punishable under federal and state laws.

It is one thing to say, as the statement does, that "acceptance" of the CD constitutes an agreement to a license and its restrictions, but it is quite another to maintain that "acceptance" may be assumed when the recipient makes no response at all. This record reflects no responses. Even when the evidence is viewed in the light most favorable to UMG, it does not show that any recipients agreed to enter into a license agreement with UMG when they received the CDs.[3]

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[2] [FN3] A few of the CDs are returned, and then destroyed by UMG. Needless to say, they were not the subjects of Augusto's resales. For the CDs that are not returned, UMG does not know the recipients' responses to the distribution or to the conditions UMG attempts to impose.

[3] [FN6] Although our result does not depend on the point, there is even doubt that a license contract could arise from the absence of response of the recipients. The general rule of contract law is that the "mere receipt of an unsolicited offer does not impair the offeree's freedom of action or inaction or impose on him any duty to speak." Restatement (Second) of Contracts § 69 cmts. a, c. "Nothing in contract law [can] force the parties into a contractual arrangement when they do not intend to be bound." Raymond T. Nimmer & Jeff Dodd, Modern Licensing Law § 3:17 (2010).

The commentary on section 69 of the Restatement offers a pertinent illustration: "A sends B a [book] with a letter, saying, 'If you wish to buy this book send me $6.50 within one week after receipt hereof, otherwise notify me and I will forward postage for return.' B examines the book and *without replying* carefully lays it on a shelf to await A's messenger. There is no contract." Restatement (Second) of Contracts § 69 cmt. e, illus. 8 (emphasis added). The Restatement does provide an exception to the rule that silence and inaction do not constitute assent when, "because of prior dealings or otherwise, it is reasonable that the offeree should notify the offeror if he does not intend to accept." *Id.* § 69(1)(c). The record as it stands does not suggest that UMG could avail itself of this provision.

Because the record here is devoid of any indication that the recipients agreed to a license, there is no evidence to support a conclusion that licenses were established under the terms of the promotional statement. Accordingly, we conclude that UMG's transfer of possession to the recipients, without meaningful control or even knowledge of the status of the CDs after shipment, accomplished a transfer of title.

AFFIRMED.

B. Patent Exhaustion

Page 293. Add the following after the note:

JAZZ PHOTO v. ITC
264 F.3d 1094 (Fed Cir. 2001)

PAULINE NEWMAN, Circuit Judge.

In an action brought under section 337 of the Tariff Act of 1930 as amended, 19 U.S.C. § 1337, Fuji Photo Film Co. charged twenty-seven respondents, including the appellants Jazz Photo Corporation, with infringement of fifteen patents owned by Fuji. The charge was based on the respondents' importation of used "single-use" cameras called "lens-fitted film packages" (LFFP's), which had been refurbished[1] for reuse in various overseas facilities. Section 337 makes unlawful "[t]he importation into the United States ... of articles that ... infringe a valid and enforceable United States patent ... [or that] are made, produced, processed, ... under, or by means of, a process covered by the claims of a valid and enforceable United States patent." 19 U.S.C. § 1337(a)(1)(B). Eight respondents did not respond to the Commission's complaint, ten more failed to appear before the Commission, and one was dismissed. Eight respondents participated in the hearing, and three have taken this appeal.

The Commission determined that twenty-six respondents, including the appellants, had infringed all or most of the claims in suit of fourteen Fuji United States patents, and issued a General Exclusion Order and Order to Cease and Desist.

The Commission's decision rests on its ruling that the refurbishment of the used cameras is prohibited "reconstruction," as opposed to permissible "repair." On review of the law and its application, we conclude that precedent does not support the Commission's application of the law to the facts that were found. We conclude that for used cameras whose first sale was in the United States with the patentee's authorization, and for which the respondents permitted verification of their representations that their activities were limited to the steps of (1) removing the cardboard cover, (2) cutting open the plastic casing, (3) inserting new film and a container to receive the film, (4) replacing the winding wheel for certain cameras, (5) replacing the battery for flash cameras, (6) resetting the counter, (7) resealing the outer case, and (8) adding a new cardboard cover, the totality of these procedures does not satisfy the standards required by precedent for prohibited reconstruction; precedent requires, as we shall discuss, that the described activities be deemed to be permissible repair.

DISCUSSION

…

I

The Patented Inventions

The LFFP is a relatively simple camera, whose major elements are an outer plastic casing that holds a shutter, a shutter release button, a lens, a viewfinder, a film advance mechanism, a film counting display, and for some models a flash assembly and battery. The casing also contains a holder for a roll of film, and a container into which the exposed film is wound. At the factory a roll of film is loaded into the camera. The casing is then sealed by ultrasonic welding or light-tight latching, and a cardboard cover is applied to encase the camera.

LFFPs are intended by the patentee to be used only once. After the film is exposed the photo-processor removes the film container by breaking open a pre-weakened portion of the plastic casing which is accessed by removal of the cardboard cover. Discarded LFFPs, subsequently purchased and refurbished by the respondents, are the subject of this action.

It is not disputed that the imported refurbished cameras contain all of the elements of all or most of the claims in suit.

The Accused Activities

The appellants import used LFFPs that have been refurbished by various overseas entities (called "remanufacturers" in the ITC proceeding). Some of the remanufacturers refused discovery entirely or in part, and some presented evidence that the ALJ found incomplete or not credible. The Commission explains: "Since so little was known about the accused infringing processes, the ALJ considered the common steps that each participating respondent admitted during the hearing were part of their processes." The ALJ summarized these common steps as follows:

- removing the cardboard cover;
- opening the LFFP body (usually by cutting at least one weld);
- replacing the winding wheel or modifying the film cartridge to be inserted;
- resetting the film counter;
- replacing the battery in flash LFFPs;
- winding new film out of a canister onto a spool or into a roll;
- resealing the LFFP body using tape and/or glue;
- applying a new cardboard cover.

….

The appellants argue that they are not building new LFFPs, but simply replacing the film in used cameras. They argue that the LFFPs have a useful life longer than the single use proposed by Fuji, that the patent right has been exhausted as to these articles, and that the patentee cannot restrict their right to refit the cameras with new film by the procedures necessary to insert the film and reset the mechanism. Unless these activities are deemed to be permissible, infringement of at least some of the patents in suit is conceded. ….

The Law of Permissible Repair and Prohibited Reconstruction

The distinction between permitted and prohibited activities, with respect to patented items after they have been placed in commerce by the patentee, has been distilled into the terms "repair" and "reconstruction." The purchaser of a patented article has the rights of any owner of personal property, including the right to use it, repair it, modify it, discard it, or resell it, subject only to overriding conditions of the sale. Thus patented articles when sold "become the private individual property of the purchasers, and are no longer specifically protected by the patent laws." *Mitchell v. Hawley,* 83 U.S. (16 Wall.) 544, 548, 21. 322 (1872). The fact that an article is patented gives the purchaser neither more nor less rights of use and disposition. However, the rights of ownership do not include the right to construct an essentially new article on the template of the original, for the right to make the article remains with the patentee.

While the ownership of a patented article does not include the right to make a substantially new article, it does include the right to preserve the useful life of the original article. It is readily apparent that there is a continuum between these concepts; precedent demonstrates that litigated cases rarely reside at the poles wherein "repair" is readily distinguished from "reconstruction." Thus the law has developed in the body of precedent, illustrating the policy underlying the law as it has been applied in diverse factual contexts. *Cf. Goodyear Shoe Mach. Co. v. Jackson,* 112 F. 146, 150 (1st Cir.1901) ("It is impracticable, as well as unwise, to attempt to lay down any rule on this subject, owing to the number and infinite variety of patented inventions.")

The principle of the distinction between permissible and prohibited activities was explained in *Wilson v. Simpson,* 50 U.S. (9 How.) 109, 13. 66 (1850), where the Court distinguished the right of a purchaser of a patented planing machine to replace the machine's cutting-knives when they became dull or broken, from the patentee's sole right to make or renew the entire machine. The Court observed that the knives had to be replaced every 60–90 days whereas the machines would last for several years, explaining, "what harm is done to the patentee in the use of his right of invention, when the repair and replacement of a partial injury are confined to the machine which the purchaser has bought?" *Id.* at 123.

This principle underlies the application of the law. It was elaborated by the Court in *Aro Manufacturing Co. v. Convertible Top Replacement Co.,* 365 U.S. 336, 81 599, 5 L.Ed.2d 592 (1961), where the patented combination was a fabric convertible top and the associated metal support structure. The Court explained that replacement of the worn fabric top constituted permissible repair of the patented combination, and could not be controlled by the patentee. The Court restated the principles that govern the inquiry as applied to replacement of unpatented parts of a patented article:

> The decisions of this Court require the conclusion that reconstruction of a patented entity, comprised of unpatented elements, is limited to such a true reconstruction of the entity as to "in fact make a new article," *United States v. Aluminum Co. of America,* [148 F.2d 416, 425 (2d Cir.1945)], after the entity, viewed as a whole, has become spent. In order to call the monopoly, conferred by the patent grant, into play for a second time, it must, indeed, be a second creation of the patented entity, as, for example, in *American Cotton Tie Co. v. Simmons,* [106 U.S. 89, 1 52 (1882)]. Mere replacement of individual unpatented parts, one at a time, whether of the same part repeatedly or different parts successively, is no more than the lawful right of the owner to repair his property.

365 U.S. at 346, 81 599.

This right of repair, provided that the activity does not "in fact make a new article," accompanies the article to succeeding owners. In *Wilbur–Ellis Co. v. Kuther,* 377 U.S. 422, 84 1561, 12 L.Ed.2d 419, 141 USPQ 703 (1964), the Court dealt with the refurbishing of patented fish-canning machines by a purchaser of used machines. The Court held that the fairly extensive refurbishment by the new owner, including modification and resizing of six separate parts of the machine, although more than customary repair of spent or broken components, was more like repair then reconstruction, for it extended the useful life of the original machine. *See id.* at 425, 141 USPQ at 704–05 ("Petitioners in adapting the old machines to a related use were doing more than repair in the customary sense; but what they did was kin to repair for it bore on the useful capacity of the old combination, on which the royalty had been paid.")

Precedent has classified as repair the disassembly and cleaning of patented articles accompanied by replacement of unpatented parts that had become worn or spent, in order to preserve the utility for which the article was originally intended. In *General Electric Co. v. United States,* 215 Ct. Cl. 636, 572 F.2d 745, 198 USPQ 65 (1978), the court held that the Navy's large scale "overhauling" of patented gun mounts, including disassembly into their component parts and replacement of parts that could not be repaired with parts from other gun mounts or new parts, was permissible repair of the original gun mounts. The court explained that the assembly-line method of reassembly, without regard to where each component had originated, was simply a matter of efficiency and economy, with the same effect as if each gun mount had been refurbished individually by disassembly and reassembly of its original components with replacement of a minor amount of worn elements. *Id.* at 780–86, 198 USPQ at 95–100.

Similarly, in *Dana Corp. v. American Precision Co.,* 827 F.2d 755, 3 USPQ2d 1852 (Fed.Cir.1987), the court held that the "rebuilding" of worn truck clutches, although done on a commercial scale, was permissible repair. The defendants in *Dana Corp.* acquired worn clutches that had been discarded by their original owners, disassembled them, cleaned and sorted the individual parts, replaced worn or defective parts with new or salvaged parts, and reassembled the clutches. Although the patentee stressed that some new parts were used and that the rebuilding was a large scale commercial operation, the activity was held to be repair. The court also observed that in general the new parts were purchased from Dana, the original manufacturer of the patented clutches, and that repair of used clutches was contemplated by the patentee. The court rejected the argument that the complete disassembly and production-line reassembly of the clutches constituted a voluntary destruction followed by a "second creation of the patented entity,"

"Reconstruction," precedent shows, requires a more extensive rebuilding of the patented entity than is exemplified in *Aro Manufacturing, Wilbur–Ellis, General Electric,* and *Dana Corp. See also, e.g., Bottom Line Mgmt., Inc. v. Pan Man, Inc.,* 228 F.3d 1352, (repair of cooking device by reapplying non-stick coating); *Hewlett–Packard Co. v. Repeat–O–Type Stencil Mfg. Corp.,* 123 F.3d 1445, 43 USPQ2d 1650 (Fed.Cir.1997) (modifying unused printer cartridges akin to repair); *Kendall Co. v. Progressive Med. Tech., Inc.,* 85 F.3d 1570, 38 USPQ2d 1917 (Fed.Cir.1996) (replacement of used pressure sleeve in medical device is repair); *Sage Prods., Inc. v. Devon Indus., Inc.,* 45 F.3d 1575, 33 USPQ2d 1765 (Fed.Cir.1995) (replacement of inner container for medical waste is repair); *FMC Corp. v. Up–Right, Inc.,* 21 F.3d 1073, 30 USPQ2d 1361 (Fed.Cir.1994) (replacing worn unpatented picking heads of harvester is repair); *Everpure, Inc. v. Cuno, Inc.,* 875 F.2d 300, 10 USPQ2d 1855 (Fed.Cir.1989) (replacement of entire cartridge containing spent filter is repair); *Porter v. Farmers Supply Serv., Inc.,* 790 F.2d 882, 229 USPQ 814 (Fed.Cir.1986) (replacement of disks in tomato harvester head is repair). In contrast, in *Sandvik Aktiebolag v. E.J. Co.,* 121 F.3d 669, 43 USPQ2d 1620 (Fed.Cir.1997), reconstruction was held to apply when a patented drill bit was "recreated" by construction of an entirely new cutting tip after the existing cutting tip could no longer be resharpened and reused. The court explained that it was not dispositive that the cutting tip was the "novel feature" of the invention, but that prohibited reconstruction occurred because a "new article" was made after the patented article, "viewed as a whole, has become spent."

Underlying the repair/reconstruction dichotomy is the principle of exhaustion of the patent right. The unrestricted sale of a patented article, by or with the authority of the patentee, "exhausts" the patentee's right to control further sale and use of that article by enforcing the patent under which it was first sold. In *United States v. Masonite Corp.,* 316 U.S. 265, 278, 62 1070, 86. 1461 (1942), the Court explained that exhaustion of the patent right depends on "whether or not there has been such a disposition of the article that it may fairly be said that the patentee has received his reward for the use of the article." Thus when a patented device has been lawfully sold in the United States, subsequent purchasers inherit the same immunity under the doctrine of patent exhaustion. However, the prohibition that the product may not be the vehicle for a "second creation of the patented entity" continues to apply, for such re-creation exceeds the rights that accompanied the initial sale. …

Application of the Law

In the Commission's Initial Determination the administrative judge, applying the four factors discussed in *Sandvik Aktiebolag,* 121 F.3d at 673, 43 USPQ2d at 1623, held that the remanufacturers had made a new LFFP after the useful life of the original LFFP had been spent. Thus, the ALJ ruled that the remanufacturers were engaged in prohibited reconstruction. The Commission adopted the ALJ's findings and conclusions that the remanufacturers were not simply repairing an article for which either the producer or the purchaser expected a longer useful life, pointing out that the purchaser discarded the camera after use. The Commission ruled that the respondents were not simply repairing the LFFP in order to achieve its intended life span, but created a new single use camera that would again be discarded by its purchaser after use.

Although the Commission's conclusion is supported by its reasoning and reflects concern for the public interest, for there was evidence of imperfections and failures of some refurbished cameras, precedent requires that these cameras be viewed as repaired, not reconstructed. In *Dana Corp.,* for example, the truck clutches had lived their intended lives as originally produced, yet the court ruled that the "rebuilding" of the used clutches was more akin to repair than to reconstruction. The activities of disassembly and rebuilding of the gun mounts of *General Electric* were similarly extensive, yet were deemed to be repair. *Aro Manufacturing* and the other Supreme Court decisions which underlie precedent require that infringing reconstruction be a "second creation" of the patented article. Although the Commission deemed this requirement met by the "remanufactured" LFFPs, precedent places the acts of inserting new film and film container, resetting the film counter, and resealing the broken case—the principal steps performed by the remanufacturers—as more akin to repair.

The Court has cautioned against reliance on any specific set of "factors" in distinguishing permissible from prohibited activities, stating in *Aro Manufacturing* that "While there is language in some lower court opinions indicating that 'repair' or 'reconstruction' depends on a number of factors, it is significant that each of the three cases of this Court, cited for that proposition, holds that a license to use a patented combination includes the right 'to preserve its fitness for use....' " 365 U.S. at 345, 81 599. Indeed, this criterion is the common thread in precedent, requiring consideration of the remaining useful capacity of the article, and the nature and role of the replaced parts in achieving that useful capacity. The appellants stress that all of the original components of the LFFP except the film and battery have a useful remaining life, and are reused. The appellants state that but for the exposed roll of film and its container, any portion of the case that was broken by the photo processor, and the winding wheel in certain cameras, the refurbished LFFP is substantially the original camera, for which the patent right has been exhausted.

The Commission placed weight on Fuji's intention that the LFFP not be reused. … However, the patentee's unilateral intent, without more, does not bar reuse of the patented article, or convert repair into reconstruction. *See Hewlett–Packard,* 123 F.3d at 1453, 43 USPQ2d at 1658 ("a seller's intent, unless embodied in an enforceable contract, does not create a limitation on the right of a purchaser to use, sell, or modify a patented product so long as a reconstruction of the patented combination is avoided"). …

The appellants state that the film and its removable container are commercial items, and that their replacement in a camera cannot be deemed to be reconstruction. As discussed in *Aro Manufacturing,* the replacement of unpatented parts, having a shorter life than is available from the combination as a whole, is characteristic of repair, not reconstruction. On the totality of the circumstances, the changes made by the remanufacturers all relate to the replacement of the film, the LFFP otherwise remaining as originally sold. …

License

Fuji alternatively contends that the right to repair the patented cameras is impliedly limited by the circumstances of sale, pointing to the instructions and warnings printed on the covers of the LFFPs, and arguing that these constituted a license limited to a single use. *See Mallinckrodt, Inc. v. Medipart, Inc.,* 976 F.2d 700, 709, 24 USPQ2d 1173, 1180 (Fed.Cir.1992) (the conditions of sale of a "single-use" medical device may contractually restrict further use). The administrative law judge found that:

> A Fuji flash QuickSnap single use camera is in a box and each of the box and the outer cardboard cover of the camera has statements instructing the purchaser to not remove the film and return the camera to the photoprocessor and further cautioning the purchaser about the risk of electrical shock if opened by the purchaser.... [The packaging also] instructs the purchaser that the single use camera will not be returned to the purchaser after processing. Similar notations are on [other cameras].

Initial Determination at 141.

A license is governed by the laws of contract. It was undisputed that no express conditions of sale, license terms or restrictions attended the sale of these cameras. There was no express contractual undertaking by the purchaser. The administrative judge observed that any issue of implied contract or license was mooted by the finding of infringement based on reconstruction, and made no findings on the issues of contract or license.

Determinations of express or implied license or contract are matters of law. As stated in *Hewlett–Packard,* "A seller's intent, unless embodied in an enforceable contract, does not create a limitation on the right of a purchaser to use, sell, or modify a patented product as long as a reconstruction of the patented combination is avoided." We do not discern an enforceable restriction on the reuse of these cameras based on the package statements. These statements are instructions and warnings of risk, not mutual promises or a condition placed upon the sale. *See Kendall Co.,* 85 F.3d at 1576, 38 USPQ2d at 1922 (holding that instruction meant to ensure product safety and efficiency did not have contractual significance).

These package instructions are not in the form of a contractual agreement by the purchaser to limit reuse of the cameras. There was no showing of a "meeting of the minds" whereby the purchaser, and those obtaining the purchaser's discarded camera, may be deemed to have breached a contract or violated a license limited to a single use of the camera. *See Hercules, Inc. v. United States,* 516 U.S. 417, 424, 116 981, 134 L.Ed.2d 47 (1996) ("An agreement implied in fact is 'founded upon a meeting of minds, which, although not embodied in an express contract, is inferred, as a fact, from conduct of the parties showing, in the light of the surrounding circumstances, their tacit understanding.' ") We conclude that no license limitation may be implied from the circumstances of sale.

Summary

The Commission's ruling of reconstruction was based on the acknowledged general activities of the remanufacturers, and thus did not require evidence of whether any specific additional procedures were performed, for such evidence would not have affected the Commission's ruling. However, a ruling of repair can not be open-ended, for there is undoubtedly a stage at which permissible repair becomes prohibited reconstruction. We can not exculpate unknown processes from the charge of infringing reconstruction. Thus our reversal of the Commission's decision does not apply to LFFPs from those remanufacturing facilities for which discovery was refused or where the evidence offered was found incomplete or not credible by the ALJ. For those respondents' activities that were shown to be limited to those steps considered by the ALJ, as set forth in the Initial Determination at 108–109, *see supra,* and affirmed by the Commission, we conclude that these activities constitute permissible repair. For those respondents who refused to provide discovery or access, or proffered incomplete or "bench" evidence (a partial display created for litigation purposes), or presented testimony that the ALJ found to be not credible or inadequate, it can not be determined from the record whether their remanufacturing activities are limited to those considered by the ALJ and on which our ruling of permissible repair is based. For those respondents, the record contains insufficient basis on which to reverse the Commission's rulings. …

BOWMAN v MONSANTO

133 S. Ct. 1761 (2013)

Justice KAGAN delivered the opinion of the Court.

Under the doctrine of patent exhaustion, the authorized sale of a patented article gives the purchaser, or any subsequent owner, a right to use or resell that article. Such a sale, however, does not allow the purchaser to make new copies of the patented invention. The question in this case is whether a farmer who buys patented seeds may reproduce them through planting and harvesting without the patent holder's permission. We hold that he may not.

I

Respondent Monsanto invented a genetic modification that enables soybean plants to survive exposure to glyphosate, the active ingredient in many herbicides (including Monsanto's own Roundup). Monsanto markets soybean seed containing this altered genetic material as Roundup Ready seed. Farmers planting that seed can use a glyphosate-based herbicide to kill weeds without damaging their crops. Two patents issued to Monsanto cover various aspects of its Roundup Ready technology, including a seed incorporating the genetic alteration.

Monsanto sells, and allows other companies to sell, Roundup Ready soybean seeds to growers who assent to a special licensing agreement. That agreement permits a grower to plant the purchased seeds in one (and only one) season. He can then consume the resulting crop or sell it as a commodity, usually to a grain elevator or agricultural processor. But under the agreement, the farmer may not save any of the harvested soybeans for replanting, nor may he supply them to anyone else for that purpose. These restrictions reflect the ease of producing new generations of Roundup Ready seed. Because glyphosate resistance comes from the seed's genetic material, that trait is passed on from the planted seed to the harvested soybeans: Indeed, a single Roundup Ready seed can grow a plant containing dozens of genetically identical beans, each of which, if replanted, can grow another such plant—and so on and so on. See App. 100a. The agreement's terms prevent the farmer from co-opting that process to produce his own Roundup Ready seeds, forcing him instead to buy from Monsanto each season.

Petitioner Vernon Bowman is a farmer in Indiana who, it is fair to say, appreciates Roundup Ready soybean seed. He purchased Roundup Ready each year, from a company affiliated with Monsanto, for his first crop of the season. In accord with the agreement just described, he used all of that seed for planting, and sold his entire crop to a grain elevator (which typically would resell it to an agricultural processor for human or animal consumption).

Bowman, however, devised a less orthodox approach for his second crop of each season. Because he thought such late-season planting "risky," he did not want to pay the premium price that Monsanto charges for Roundup Ready seed. He therefore went to a grain elevator; purchased "commodity soybeans" intended for human or animal consumption; and planted them in his fields.[1] Those soybeans came from prior harvests of other local farmers. And because most of those farmers also used Roundup Ready seed, Bowman could anticipate that many of the purchased soybeans would contain Monsanto's patented technology. When he applied a glyphosate-based herbicide to his fields, he confirmed that this was so; a significant proportion of the new plants survived the treatment, and produced in their turn a new crop of soybeans with the Roundup Ready trait. Bowman saved seed from that crop to use in his late-season planting the next year—and then the next, and the next, until he had harvested eight crops in that way. Each year, that is, he planted saved seed from the year before (sometimes adding more soybeans bought from the grain elevator), sprayed his fields with glyphosate to kill weeds (and any non-resistant plants), and produced a new crop of glyphosate-resistant—*i.e.,* Roundup Ready—soybeans.

After discovering this practice, Monsanto sued Bowman for infringing its patents on Roundup Ready seed. Bowman raised patent exhaustion as a defense, arguing that Monsanto could not control his use of the soybeans because they were the subject of a prior authorized sale (from local farmers to the grain elevator). The District Court rejected that argument, and awarded damages to Monsanto of $84,456. The Federal Circuit affirmed. It reasoned that patent exhaustion did not protect Bowman because he had "created a newly infringing article." 657 F.3d, at 1348. The "right to use" a patented article following an authorized sale, the court explained, "does not include the right to construct an essentially new article on the template of the original, for the right to make the article remains with the patentee." *Ibid.* (brackets and internal quotation marks omitted). Accordingly, Bowman could not " 'replicate' Monsanto's patented technology by planting it in the ground to create newly infringing genetic material, seeds, and plants." *Ibid.*

II

The doctrine of patent exhaustion limits a patentee's right to control what others can do with an article embodying or containing an invention. Under the doctrine, "the initial authorized sale of a patented item terminates all patent rights to that item." And by "exhaust[ing] the [patentee's] monopoly" in that item, the sale confers on the purchaser, or any subsequent owner, "the right to use [or] sell" the thing as he sees fit. We have explained the basis for the doctrine as follows: "[T]he purpose of the patent law is fulfilled with respect to any particular article when the patentee has received his reward ... by the sale of the article"; once that "purpose is realized the patent law affords no basis for restraining the use and enjoyment of the thing sold."

Consistent with that rationale, the doctrine restricts a patentee's rights only as to the "particular article" sold, it leaves untouched the patentee's ability to prevent a buyer from making new copies of the patented item. "[T]he purchaser of the [patented] machine ... does not acquire any right to construct another machine either for his own use or to be vended to another." *Mitchell v. Hawley,* 16 Wall. 544, 548, 21. 322 (1873); see *Wilbur–Ellis Co. v. Kuther,* 377 U.S. 422, 424, 84 1561, 12 L.Ed.2d 419 (1964) (holding that a purchaser's "reconstruction" of a patented machine "would impinge on the patentee's right *'to exclude others from making'* ... the article" (quoting 35 U.S.C. § 154 (1964 ed.))). Rather, "a second creation" of the patented item "call[s] the monopoly, conferred by the patent grant, into play for a second time." *Aro Mfg. Co. v.*

Convertible Top Replacement Co., 365 U.S. 336, 346, 81 599, 5 L.Ed.2d 592 (1961). That is because the patent holder has "received his reward" only for the actual article sold, and not for subsequent recreations of it. *Univis,* 316 U.S., at 251, 62 1088. If the purchaser of that article could make and sell endless copies, the patent would effectively protect the invention for just a single sale. Bowman himself disputes none of this analysis as a general matter: He forthrightly acknowledges the "well settled" principle "that the exhaustion doctrine does not extend to the right to 'make' a new product." Brief for Petitioner 37 (citing *Aro,* 365 U.S., at 346, 81 599).

Unfortunately for Bowman, that principle decides this case against him. Under the patent exhaustion doctrine, Bowman could resell the patented soybeans he purchased from the grain elevator; so too he could consume the beans himself or feed them to his animals. Monsanto, although the patent holder, would have no business interfering in those uses of Roundup Ready beans. But the exhaustion doctrine does not enable Bowman to make *additional* patented soybeans without Monsanto's permission (either express or implied). And that is precisely what Bowman did. He took the soybeans he purchased home; planted them in his fields at the time he thought best; applied glyphosate to kill weeds (as well as any soy plants lacking the Roundup Ready trait); and finally harvested more (many more) beans than he started with. That is how "to 'make' a new product," to use Bowman's words, when the original product is a seed. Brief for Petitioner 37; see Webster's Third New International Dictionary 1363 (1961) ("make" means "cause to exist, occur, or appear," or more specifically, "plant and raise (a crop)"). Because Bowman thus reproduced Monsanto's patented invention, the exhaustion doctrine does not protect him.

Were the matter otherwise, Monsanto's patent would provide scant benefit. After inventing the Roundup Ready trait, Monsanto would, to be sure, "receiv[e] [its] reward" for the first seeds it sells. But in short order, other seed companies could reproduce the product and market it to growers, thus depriving Monsanto of its monopoly. And farmers themselves need only buy the seed once, whether from Monsanto, a competitor, or (as here) a grain elevator. The grower could multiply his initial purchase, and then multiply that new creation, *ad infinitum*—each time profiting from the patented seed without compensating its inventor. Bowman's late-season plantings offer a prime illustration. After buying beans for a single harvest, Bowman saved enough seed each year to reduce or eliminate the need for additional purchases. Monsanto still held its patent, but received no gain from Bowman's annual production and sale of Roundup Ready soybeans. The exhaustion doctrine is limited to the "particular item" sold to avoid just such a mismatch between invention and reward. …

Bowman principally argues that exhaustion should apply here because seeds are meant to be planted. The exhaustion doctrine, he reminds us, typically prevents a patentee from controlling the use of a patented product following an authorized sale. And in planting Roundup Ready seeds, Bowman continues, he is merely using them in the normal way farmers do. Bowman thus concludes that allowing Monsanto to interfere with that use would "creat[e] an impermissible exception to the exhaustion doctrine" for patented seeds and other "self-replicating technologies."

But it is really Bowman who is asking for an unprecedented exception—to what he concedes is the "well settled" rule that "the exhaustion doctrine does not extend to the right to 'make' a new product." See *supra,* at 1766. Reproducing a patented article no doubt "uses" it after a fashion. But as already explained, we have always drawn the boundaries of the exhaustion doctrine to exclude that activity, so that the patentee retains an undiminished right to prohibit others from making the thing his patent protects. That is because, once again, if simple copying were a protected use, a patent would plummet in value after the first sale of the first item containing the invention. The undiluted patent monopoly, it might be said, would extend not for 20 years (as the Patent Act promises), but for only one transaction. And that would result in less incentive for innovation than Congress wanted. Hence our repeated insistence that exhaustion applies only to the particular item sold, and not to reproductions.

Nor do we think that rule will prevent farmers from making appropriate use of the Roundup Ready seed they buy. Bowman himself stands in a peculiarly poor position to assert such a claim. As noted earlier, the commodity soybeans he purchased were intended not for planting, but for consumption. Indeed, Bowman conceded in deposition testimony that he knew of no other farmer who employed beans bought from a grain elevator to grow a new crop. See App. 84a. So a non-replicating use of the commodity beans at issue here was not just available, but standard fare. And in the more ordinary case, when a farmer purchases Roundup Ready seed *qua* seed—that is, seed intended to grow a crop—he will be able to plant it. Monsanto, to be sure, conditions the farmer's ability to reproduce Roundup Ready; but it does not—could not realistically—preclude all planting. No sane farmer, after all, would buy the product without some ability to grow soybeans from it. And so Monsanto, predictably enough, sells Roundup Ready seed to farmers with a license to use it to make a crop. Applying our usual rule in this context therefore will allow farmers to benefit from Roundup Ready, even as it rewards Monsanto for its innovation.

Still, Bowman has another seeds-are-special argument: that soybeans naturally "self-replicate or 'sprout' unless stored in a controlled manner," and thus "it was the planted soybean, not Bowman" himself, that made replicas of Monsanto's patented invention. But we think that blame-the-bean defense tough to credit. Bowman was not a passive observer of his soybeans' multiplication; or put another way, the seeds he purchased (miraculous though they might be in other respects) did not spontaneously create eight successive soybean crops. As we have explained, Bowman devised and executed a novel way to harvest crops from Roundup Ready seeds without paying the usual premium. He purchased beans from a grain elevator anticipating that many would be Roundup Ready; applied a glyphosate-based herbicide in a way that culled any plants without the patented trait; and saved beans from the rest for the next season. He then planted those Roundup Ready beans at a chosen time; tended and treated them, including by exploiting their patented glyphosate-resistance; and harvested many more seeds, which he either marketed or saved to begin the next cycle. In all this, the bean surely figured. But it was Bowman, and not the bean, who controlled the reproduction (unto the eighth generation) of Monsanto's patented invention.

Our holding today is limited—addressing the situation before us, rather than every one involving a self-replicating product. We recognize that such inventions are becoming ever more prevalent, complex, and diverse. In another case, the article's self-replication might occur outside the purchaser's control. Or it might be a necessary but incidental step in using the item for another purpose. Cf. 17 U.S.C. § 117(a)(1) ("[I]t is not [a copyright] infringement for the owner of a copy of a computer program to make ... another copy or adaptation of that computer program provide[d] that such a new copy or adaptation is created as an essential step in the utilization of the computer program"). We need not address here whether or how the doctrine of patent exhaustion would apply in such circumstances. In the case at hand, Bowman planted Monsanto's patented soybeans solely to make and market replicas of them, thus depriving the company of the reward patent law provides for the sale of each article. Patent exhaustion provides no haven for that conduct. We accordingly affirm the judgment of the Court of Appeals for the Federal Circuit.

It is so ordered.

QUANTA COMPUTER, INC. v. LG ELECTRONICS
553 U.S. 617 (2008)

Justice THOMAS delivered the opinion of the Court.

For over 150 years this Court has applied the doctrine of patent exhaustion to limit the patent rights that survive the initial authorized sale of a patented item. In this case, we decide whether patent exhaustion applies to the sale of components of a patented system that must be combined with additional components in order to practice the patented methods. The Court of Appeals for the Federal Circuit held that the doctrine does not apply to method patents at all and, in the alternative, that it does not apply here because the sales were not authorized by the license agreement. We disagree on both scores. Because the exhaustion doctrine applies to method patents, and because the license authorizes the sale of components that substantially embody the patents in suit, the sale exhausted the patents.

I

Respondent LG Electronics, Inc. (LGE), purchased a portfolio of computer technology patents in 1999, including the three patents at issue here: U.S. Patent Nos. 4,939,641 ('641); 5,379,379 ('379); and 5,077,733 ('733) (collectively LGE Patents). The main functions of a computer system are carried out on a microprocessor, or central processing unit, which interprets program instructions, processes data, and controls other devices in the system. A set of wires, or bus, connects the microprocessor to a chipset, which transfers data between the microprocessor and other devices, including the keyboard, mouse, monitor, hard drive, memory, and disk drives.

The data processed by the computer are stored principally in random access memory, also called main memory. Webster's New World Dictionary of Computer Terms 334, 451 (8th ed.2000). Frequently accessed data are generally stored in cache memory, which permits faster access than main memory and is often located on the microprocessor itself. *Id.,* at 84. When copies of data are stored in both the cache and main memory, problems may arise when one copy is changed but the other still contains the original "stale" version of the data. J. Handy, Cache Memory Book 124 (2d ed.1993). The '641 patent addresses this problem. It discloses a system for ensuring that the most current data are retrieved from main memory by monitoring data requests and updating main memory from the cache when stale data are requested. *LG Electronics, Inc. v. Bizcom Electronics, Inc.,* 453 F.3d 1364, 1377 (C.A.Fed.2006).

The '379 patent relates to the coordination of requests to read from, and write to, main memory. *Id.,* at 1378. Processing these requests in chronological order can slow down a system because read requests are faster to execute than write requests. Processing all read requests first ensures speedy access, but may result in the retrieval of outdated data if a read request for a certain piece of data is processed before an outstanding write request for the same data. The '379 patent discloses an efficient method of organizing read and write requests while maintaining accuracy by allowing the computer to execute only read requests until it needs data for which there is an outstanding write request. *LG Electronics, Inc. v. Asustek Computer, Inc.,* No. C 01–02187 CW et al., Order Construing Disputed Terms and Phrases, p. 42 (ND Cal., Aug. 20, 2002). Upon receiving such a read request, the computer executes pending write requests first and only then returns to the read requests so that the most up-to-date data are retrieved. *Ibid.*

The '733 patent addresses the problem of managing the data traffic on a bus connecting two computer components, so that no one device monopolizes the bus. It allows multiple devices to share the bus, giving heavy users greater access. This patent describes methods that establish a rotating priority system under which each device alternately has priority access to the bus for a preset number of cycles and heavier users can maintain priority for more cycles without "hogging" the device indefinitely. *Id.,* at 37–38.

LGE licensed a patent portfolio, including the LGE Patents, to Intel Corporation (Intel). The cross-licensing agreement (License Agreement) permits Intel to manufacture and sell microprocessors and chipsets that use the LGE Patents (the Intel Products). The License Agreement authorizes Intel to " 'make, use, sell (directly or indirectly), offer to sell, import or otherwise dispose of' " its own products practicing the LGE Patents. Notwithstanding this broad language, the License Agreement contains some limitations. Relevant here, it stipulates that 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.' "

The License Agreement purports not to alter the usual rules of patent exhaustion, however, providing that, " '[n]otwithstanding 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.' " Brief for Petitioners 8 (quoting App. 164).

In a separate agreement (Master Agreement), Intel agreed to give written notice to its own customers informing them that, while it had obtained a broad license " 'ensur[ing] that any Intel product that you purchase is licensed by LGE and thus does not infringe any patent held by LGE,' " the license " 'does not extend, expressly or by implication, to any product that you make by combining an Intel product with any non-Intel product.' " The Master Agreement also provides that " 'a breach of this Agreement shall have no effect on and shall not be grounds for termination of the Patent License.' "

Petitioners, including Quanta Computer (collectively Quanta), are a group of computer manufacturers. Quanta purchased microprocessors and chipsets from Intel and received the notice required by the Master Agreement. Nonetheless, Quanta manufactured computers using Intel parts in combination with non-Intel memory and buses in ways that practice the LGE Patents. Quanta does not modify the Intel components and follows Intel's specifications to incorporate the parts into its own systems.

LGE filed a complaint against Quanta, asserting that the combination of the Intel Products with non-Intel memory and buses infringed the LGE Patents. The District Court granted summary judgment to Quanta, holding that, for purposes of the patent exhaustion doctrine, the license LGE granted to Intel resulted in forfeiture of any potential infringement actions against legitimate purchasers of the Intel Products. *LG Electronics, Inc. v. Asustek Computer, Inc.,* 65 USPQ 2d 1589, 1593, 1600 (N.D.Cal.2002). The court found that, although the Intel Products do not fully practice any of the patents at issue, they have no reasonable noninfringing use and therefore their authorized sale exhausted patent rights in the completed computers under *United States v. Univis Lens Co.,* 316 U.S. 241, 62 1088, 86. 1408 (1942). *Asustek, supra,* at 1598–1600. In a subsequent order limiting its summary judgment ruling, the court held that patent exhaustion applies only to apparatus or composition-of-matter claims that describe a physical object, and does not apply to process, or method, claims that describe operations to make or use a product. *LG Electronics, Inc. v. Asustek Computer, Inc.,* 248 F.Supp.2d 912, 918 (N.D.Cal.2003). Because each of the LGE Patents includes method claims, exhaustion did not apply.

The Court of Appeals for the Federal Circuit affirmed in part and reversed in part. It agreed that the doctrine of patent exhaustion does not apply to method claims. In the alternative, it concluded that exhaustion did not apply because LGE did not license Intel to sell the Intel Products to Quanta for use in combination with non-Intel products.

We granted certiorari.

II

The longstanding doctrine of patent exhaustion provides that the initial authorized sale of a patented item terminates all patent rights to that item. …

III

A

LGE argues that the exhaustion doctrine is inapplicable here because it does not apply to method claims, which are contained in each of the LGE Patents. LGE reasons that, because method patents are linked not to a tangible article but to a process, they can never be exhausted through a sale. Rather, practicing the patent—which occurs upon each use of an article embodying a method patent—is permissible only to the extent rights are transferred in an assignment contract. Quanta, in turn, argues that there is no reason to preclude exhaustion of method claims, and points out that both this Court and the Federal Circuit have applied exhaustion to method claims. It argues that any other rule would allow patent holders to avoid exhaustion entirely by inserting method claims in their patent specifications.

Quanta has the better of this argument. Nothing in this Court's approach to patent exhaustion supports LGE's argument that method patents cannot be exhausted. It is true that a patented method may not be sold in the same way as an article or device, but methods nonetheless may be "embodied" in a product, the sale of which exhausts patent rights. Our precedents do not differentiate transactions involving embodiments of patented methods or processes from those involving patented apparatuses or materials. To the contrary, this Court has repeatedly held that method patents were exhausted by the sale of an item that embodied the method. … These cases rest on solid footing. Eliminating exhaustion for method patents would seriously undermine the exhaustion doctrine. Patentees seeking to avoid patent exhaustion could simply draft their patent claims to describe a method rather than an apparatus. Apparatus and method claims "may approach each other so nearly that it will be difficult to distinguish the process from the function of the apparatus." By characterizing their claims as method instead of apparatus claims, or including a method claim for the machine's patented method of performing its task, a patent drafter could shield practically any patented item from exhaustion.

This case illustrates the danger of allowing such an end-run around exhaustion. On LGE's theory, although Intel is authorized to sell a completed computer system that practices the LGE Patents, any downstream purchasers of the system could nonetheless be liable for patent infringement. Such a result would violate the longstanding principle that, when a patented item is "once lawfully made and sold, there is no restriction on [its] *use* to be implied for the benefit of the patentee." We therefore reject LGE's argument that method claims, as a category, are never exhaustible.

B

We next consider the extent to which a product must embody a patent in order to trigger exhaustion. Quanta argues that, although sales of an incomplete article do not necessarily exhaust the patent in that article, the sale of the microprocessors and chipsets exhausted LGE's patents in the same way the sale of the lens blanks exhausted the patents in *Univis*. Just as the lens blanks in *Univis* did not fully practice the patents at issue because they had not been ground into finished lenses, Quanta observes, the Intel Products cannot practice the LGE Patents—or indeed, function at all—until they are combined with memory and buses in a computer system. … We agree with Quanta that *Univis* governs this case. As the Court there explained, exhaustion was triggered by the sale of the lens blanks because their only reasonable and intended use was to practice the patent and because they "embodie[d] essential features of [the] patented invention." Each of those attributes is shared by the microprocessors and chipsets Intel sold to Quanta under the License Agreement.

First, *Univis* held that "the authorized sale of an article which is capable of use only in practicing the patent is a relinquishment of the patent monopoly with respect to the article sold." Here, LGE has suggested no reasonable use for the Intel Products other than incorporating them into computer systems that practice the LGE Patents.[6] Nor can we discern one: A microprocessor or chipset cannot function until it is connected to buses and memory. And here, as in *Univis,* the 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.

Second, the lens blanks in *Univis* "embodie[d] essential features of [the] patented invention." … Like the Univis lens blanks, the Intel Products constitute a material part of the patented invention and all but completely practice the patent. Here, as in *Univis,* the incomplete article substantially embodies the patent because the 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. …

C

Having concluded that the Intel Products embodied the patents, we next consider whether their sale to Quanta exhausted LGE's patent rights. Exhaustion is triggered only by a sale authorized by the patent holder. *Univis,* 316 U.S., at 249, 62 1088.

LGE argues that there was no authorized sale here because the License Agreement does not permit Intel to sell its products for use in combination with non-Intel products to practice the LGE Patents. It cites *General Talking Pictures Corp. v. Western Elec. Co.,* 304 U.S. 175, 58 849, 82. 1273 (1938), and *General Talking Pictures Corp. v. Western Elec. Co.,* 305 U.S. 124, 59 116, 83. 81 (1938), in which the manufacturer sold patented amplifiers for commercial use, thereby breaching a license that limited the buyer to selling the amplifiers for private and home use. The Court held that exhaustion did not apply because the manufacturer had no authority to sell the amplifiers for commercial use, and the manufacturer "could not convey to petitioner what both knew it was not authorized to sell." *General Talking Pictures, supra,* at 181, 58 849. LGE argues that the same principle applies here: Intel could not convey to Quanta what both knew it was not authorized to sell, *i.e.,* the right to practice the patents with non-Intel parts.

LGE overlooks important aspects of the structure of the Intel–LGE transaction. Nothing in the License Agreement restricts Intel's right to sell its microprocessors and chipsets to purchasers who intend to combine them with non-Intel parts. It broadly permits Intel to " 'make, use, [or] sell' " products free of LGE's patent claims. Brief for Petitioners 8 (quoting App. 154). To be sure, LGE did require Intel to give notice to its customers, including Quanta, that LGE had not licensed those customers to practice its patents. But neither party contends that Intel breached the agreement in that respect. In any event, the provision requiring notice to Quanta appeared only in the Master Agreement, and LGE does not suggest that a breach of that agreement would constitute a breach of the License Agreement. Hence, Intel's authority to sell its products embodying the LGE Patents was not conditioned on the notice or on Quanta's decision to abide by LGE's directions in that notice.

LGE points out that the License Agreement specifically disclaimed any license to third parties to practice the patents by combining licensed products with other components. But the question whether third parties received implied licenses is irrelevant because Quanta asserts its right to practice the patents based not on implied license but on exhaustion. And exhaustion turns only on Intel's own license to sell products practicing the LGE Patents.

Alternatively, LGE invokes the principle that patent exhaustion does not apply to postsale restrictions on "making" an article. But this is simply a rephrasing of its argument that combining the Intel Products with other components adds more than standard finishing to complete a patented article. As explained above, making a product that substantially embodies a patent is, for exhaustion purposes, no different from making the patented article itself. In other words, no further "making" results from the addition of standard parts—here, the buses and memory—to a product that already substantially embodies the patent.

The License Agreement authorized Intel to sell products that practiced the LGE Patents. No conditions limited Intel's authority to sell products substantially embodying the patents. Because Intel was authorized to sell its products to Quanta, the doctrine of patent exhaustion prevents LGE from further asserting its patent rights with respect to the patents substantially embodied by those products.[7]

IV

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. Here, LGE licensed Intel to practice any of its patents and to sell products practicing those patents. Intel's microprocessors and chipsets substantially embodied the LGE Patents because they had no reasonable noninfringing use and included all the inventive aspects of the patented methods. Nothing in the License Agreement limited Intel's ability to sell its products practicing the LGE Patents. Intel's authorized sale to Quanta thus took its products outside the scope of the patent monopoly, and as a result, LGE can no longer assert its patent rights against Quanta. Accordingly, the judgment of the Court of Appeals is reversed.

It is so ordered.

IV. DURATION OF ROYALTY

Page 541. Add the following after the Brulotte *case:*

KIMBLE v. MARVEL ENTERTAINMENT, LLC

2015 U.S. LEXIS 4067 (June 22, 2015)

OPINION

KAGAN, J., joined by Scalia, Kennedy, Ginsberg, Breyer, and Sotomayor

In *Brulotte v. Thys Co.,* 379 U.S. 29, 85 176, 13 L.Ed.2d 99 (1964), this Court held that a patent holder cannot charge royalties for the use of his invention after its patent term has expired. The sole question presented here is whether we should overrule *Brulotte*. Adhering to principles of *stare decisis,* we decline to do so. Critics of the *Brulotte* rule must seek relief not from this Court but from Congress.

I

In 1990, petitioner Stephen Kimble obtained a patent on a toy that allows children (and young-at-heart adults) to role-play as "a spider person" by shooting webs—really, pressurized foam string—"from the palm of [the] hand." … Respondent Marvel Entertainment, LLC (Marvel) makes and markets products featuring Spider–Man, among other comic-book characters. Seeking to sell or license his patent, Kimble met with the president of Marvel's corporate predecessor to discuss his idea for web-slinging fun. Soon afterward, but without remunerating Kimble, that company began marketing the "Web Blaster"—a toy that, like Kimble's patented invention, enables would-be action heroes to mimic Spider–Man through the use of a polyester glove and a canister of foam.

Kimble sued Marvel in 1997 alleging, among other things, patent infringement. The parties ultimately settled that litigation. Their agreement provided that Marvel would purchase Kimble's patent in exchange for a lump sum (of about a half-million dollars) and a 3% royalty on Marvel's future sales of the Web Blaster and similar products. The parties set no end date for royalties, apparently contemplating that they would continue for as long as kids want to imitate Spider–Man (by doing whatever a spider can).

And then Marvel stumbled across *Brulotte,* the case at the heart of this dispute. In negotiating the settlement, neither side was aware of *Brulotte*. But Marvel must have been pleased to learn of it. *Brulotte* had read the patent laws to prevent a patentee from receiving royalties for sales made after his patent's expiration. So the decision's effect was to sunset the settlement's royalty clause. On making that discovery, Marvel sought a declaratory judgment in federal district court confirming that the company could cease paying royalties come 2010—the end of Kimble's patent term. The court approved that relief, holding that *Brulotte* made "the royalty provision ... unenforceable after the expiration of the Kimble patent." The Court of Appeals for the Ninth Circuit affirmed, though making clear that it was none too happy about doing so. "[T]he *Brulotte* rule," the court complained, "is counterintuitive and its rationale is arguably unconvincing."

We granted certiorari, to decide whether, as some courts and commentators have suggested, we should overrule *Brulotte* For reasons of *stare decisis,* we demur.

II

Patents endow their holders with certain superpowers, but only for a limited time. In crafting the patent laws, Congress struck a balance between fostering innovation and ensuring public access to discoveries. While a patent lasts, the patentee possesses exclusive rights to the patented article—rights he may sell or license for royalty payments if he so chooses. But a patent typically expires 20 years from the day the application for it was filed. See § 154(a)(2). And when the patent expires, the patentee's prerogatives expire too, and the right to make or use the article, free from all restriction, passes to the public.

This Court has carefully guarded that cut-off date, just as it has the patent laws' subject-matter limits: In case after case, the Court has construed those laws to preclude measures that restrict free access to formerly patented, as well as unpatentable, inventions. In one line of cases, we have struck down state statutes with that consequence. See, *e.g., Bonito Boats, Inc. v. Thunder Craft Boats, Inc.,* 489 U.S. 141, 152, 167–168, 109 971, 103 L.Ed.2d 118 (1989); *Compco Corp. v. Day–Brite Lighting, Inc.,* 376 U.S. 234, 237–238, 84 779, 11 L.Ed.2d 669 (1964). By virtue of federal law, we reasoned, "an article on which the patent has expired," like an unpatentable article, "is in the public domain and may be made and sold by whoever chooses to do so." *Sears,* 376 U.S., at 231, 84 784. In a related line of decisions, we have deemed unenforceable private contract provisions limiting free use of such inventions. In *Scott Paper Co. v. Marcalus Mfg. Co.,* 326 U.S. 249, 66 101, 90. 47 (1945), for example, we determined that a manufacturer could not agree to refrain from challenging a patent's validity. Allowing even a single company to restrict its use of an expired or invalid patent, we explained, "would deprive ... the consuming public of the advantage to be derived" from free exploitation of the discovery. And to permit such a result, whether or not authorized "by express contract," would impermissibly undermine the patent laws. *Id.,* at 255–256, 66 101; see also, *e.g., Edward Katzinger Co. v. Chicago Metallic Mfg. Co.,* 329 U.S. 394, 400–401, 67 416, 91. 374 (1947) (ruling that *Scott Paper* applies to licensees); *Lear, Inc. v. Adkins,* 395 U.S. 653, 668–675, 89 1902, 23 L.Ed.2d 610 (1969) (refusing to enforce a contract requiring a licensee to pay royalties while contesting a patent's validity).

Brulotte was brewed in the same barrel. There, an inventor licensed his patented hop-picking machine to farmers in exchange for royalties from hop crops harvested both before and after his patents' expiration dates. The Court (by an 8–1 vote) held the agreement unenforceable—"unlawful *per se* "—to the extent it provided for the payment of royalties "accru[ing] after the last of the patents incorporated into the machines had expired." To arrive at that conclusion, the Court began with the statutory provision setting the length of a patent term. (quoting the then-current version of § 154). Emphasizing that a patented invention "become[s] public property once [that term] expires," the Court then quoted from *Scott Paper* : Any attempt to limit a licensee's post-expiration use of the invention, "whatever the legal device employed, runs counter to the policy and purpose of the patent laws." In the *Brulotte* Court's view, contracts to pay royalties for such use continue "the patent monopoly beyond the [patent] period," even though only as to the licensee affected. And in so doing, those agreements conflict with patent law's policy of establishing a "post-expiration ... public domain" in which every person can make free use of a formerly patented product.

The *Brulotte* rule, like others making contract provisions unenforceable, prevents some parties from entering into deals they desire. As compared to lump-sum fees, royalty plans both draw out payments over time and tie those payments, in each month or year covered, to a product's commercial success. And sometimes, for some parties, the longer the arrangement lasts, the better—not just up to but beyond a patent term's end. A more extended payment period, coupled (as it presumably would be) with a lower rate, may bring the price the patent holder seeks within the range of a cash-strapped licensee. (Anyone who has bought a product on installment can relate.). Or such an extended term may better allocate the risks and rewards associated with commercializing inventions—most notably, when years of development work stand between licensing a patent and bringing a product to market. See, *e.g.,* 3 R. Milgrim & E. Bensen, Milgrim on Licensing § 18.05, p. 18–9 (2013). As to either goal, *Brulotte* may pose an obstacle.

Yet parties can often find ways around *Brulotte,* enabling them to achieve those same ends. To start, *Brulotte* allows a licensee to defer payments for pre-expiration use of a patent into the post-expiration period; all the decision bars are royalties for using an invention after it has moved into the public domain. A licensee could agree, for example, to pay the licensor a sum equal to 10% of sales during the 20–year patent term, but to amortize that amount over 40 years. That arrangement would at least bring down early outlays, even if it would not do everything the parties might want to allocate risk over a long timeframe. And parties have still more options when a licensing agreement covers either multiple patents or additional non-patent rights. Under *Brulotte,* royalties may run until the latest-running patent covered in the parties' agreement expires. Too, post-expiration royalties are allowable so long as tied to a non-patent right—even when closely related to a patent. That means, for example, that a license involving both a patent and a trade secret can set a 5% royalty during the patent period (as compensation for the two combined) and a 4% royalty afterward (as payment for the trade secret alone). Finally and most broadly, *Brulotte* poses no bar to business arrangements other than royalties—all kinds of joint ventures, for example—that enable parties to share the risks and rewards of commercializing an invention.

Contending that such alternatives are not enough, Kimble asks us to abandon *Brulotte* in favor of "flexible, case-by-case analysis" of post-expiration royalty clauses "under the rule of reason." Used in antitrust law, the rule of reason requires courts to evaluate a practice's effect on competition by "taking into account a variety of factors, including specific information about the relevant business, its condition before and after the [practice] was imposed, and the [practice's] history, nature, and effect." *State Oil Co. v. Khan,* 522 U.S. 3, 10, 118 275, 139 L.Ed.2d 199 (1997). Of primary importance in this context, Kimble posits, is whether a patent holder has power in the relevant market and so might be able to curtail competition. See Brief for Petitioners 47–48; *Illinois Tool Works Inc. v. Independent Ink, Inc.,* 547 U.S. 28, 44, 126 1281, 164 L.Ed.2d 26 (2006) ("[A] patent does not necessarily confer market power"). Resolving that issue, Kimble notes, entails "a full-fledged economic inquiry into the definition of the market, barriers to entry, and the like."

III

Overruling precedent is never a small matter. *Stare decisis*—in English, the idea that today's Court should stand by yesterday's decisions—is "a foundation stone of the rule of law." Application of that doctrine, although "not an inexorable command," is the "preferred course because it promotes the evenhanded, predictable, and consistent development of legal principles, fosters reliance on judicial decisions, and contributes to the actual and perceived integrity of the judicial process." It also reduces incentives for challenging settled precedents, saving parties and courts the expense of endless relitigation.

Respecting *stare decisis* means sticking to some wrong decisions. The doctrine rests on the idea, as Justice Brandeis famously wrote, that it is usually "more important that the applicable rule of law be settled than that it be settled right." *Burnet v. Coronado Oil & Gas Co.,* 285 U.S. 393, 406, 52 443, 76. 815 (1932) (dissenting opinion). Indeed, *stare decisis* has consequence only to the extent it sustains incorrect decisions; correct judgments have no need for that principle to prop them up. Accordingly, an argument that we got something wrong—even a good argument to that effect—cannot by itself justify scrapping settled precedent. Or otherwise said, it is not alone sufficient that we would decide a case differently now than we did then. To reverse course, we require as well what we have termed a "special justification"—over and above the belief "that the precedent was wrongly decided." *Halliburton Co. v. Erica P. John Fund, Inc.,* 134 2398, 2407, 189 L.Ed.2d 339 (2014).

What is more, *stare decisis* carries enhanced force when a decision, like *Brulotte,* interprets a statute. Then, unlike in a constitutional case, critics of our ruling can take their objections across the street, and Congress can correct any mistake it sees. That is true, contrary to the dissent's view, regardless whether our decision focused only on statutory text or also relied, as *Brulotte* did, on the policies and purposes animating the law. Indeed, we apply statutory *stare decisis* even when a decision has announced a "judicially created doctrine" designed to implement a federal statute. All our interpretive decisions, in whatever way reasoned, effectively become part of the statutory scheme, subject (just like the rest) to congressional change. Absent special justification, they are balls tossed into Congress's court, for acceptance or not as that branch elects.

And Congress has spurned multiple opportunities to reverse *Brulotte*—openings as frequent and clear as this Court ever sees. *Brulotte* has governed licensing agreements for more than half a century. During that time, Congress has repeatedly amended the patent laws, including the specific provision (35 U.S.C. § 154) on which *Brulotte* rested. … *Brulotte* survived every such change. Indeed, Congress has rebuffed bills that would have replaced *Brulotte* 's *per se* rule with the same antitrust-style analysis Kimble now urges. … Congress's continual reworking of the patent laws—but never of the *Brulotte* rule—further supports leaving the decision in place.

Nor yet are we done, for the subject matter of *Brulotte* adds to the case for adhering to precedent. *Brulotte* lies at the intersection of two areas of law: property (patents) and contracts (licensing agreements). And we have often recognized that in just those contexts—"cases involving property and contract rights"—considerations favoring *stare decisis* are "at their acme." That is because parties are especially likely to rely on such precedents when ordering their affairs. To be sure, Marvel and Kimble disagree about whether *Brulotte* has actually generated reliance. Marvel says yes: Some parties, it claims, do not specify an end date for royalties in their licensing agreements, instead relying on *Brulotte* as a default rule. … Overturning *Brulotte* would thus upset expectations, most so when long-dormant licenses for long-expired patents spring back to life. Not true, says Kimble: Unfair surprise is unlikely, because no "meaningful number of [such] license agreements ... actually exist." Reply Brief 18. To be honest, we do not know (nor, we suspect, do Marvel and Kimble). But even uncertainty on this score cuts in Marvel's direction. So long as we see a reasonable possibility that parties have structured their business transactions in light of *Brulotte,* we have one more reason to let it stand.

As against this superpowered form of *stare decisis,* we would need a superspecial justification to warrant reversing *Brulotte*. But the kinds of reasons we have most often held sufficient in the past do not help Kimble here. If anything, they reinforce our unwillingness to do what he asks.

First, *Brulotte* 's statutory and doctrinal underpinnings have not eroded over time. When we reverse our statutory interpretations, we most often point to subsequent legal developments—"either the growth of judicial doctrine or further action taken by Congress"—that have removed the basis for a decision. But the core feature of the patent laws on which *Brulotte* relied remains just the same: Section 154 now, as then, draws a sharp line cutting off patent rights after a set number of years. And this Court has continued to draw from that legislative choice a broad policy favoring unrestricted use of an invention after its patent's expiration. *Scott Paper*—the decision on which *Brulotte* primarily relied—remains good law. So too do this Court's other decisions refusing to enforce either state laws or private contracts constraining individuals' free use of formerly patented (or unpatentable) discoveries. *Brulotte,* then, is not the kind of doctrinal dinosaur or legal last-man-standing for which we sometimes depart from *stare decisis*. To the contrary, the decision's close relation to a whole web of precedents means that reversing it could threaten others. If *Brulotte* is outdated, then (for example) is *Scott Paper* too? We would prefer not to unsettle stable law.

And second, nothing about *Brulotte* has proved unworkable. … A court need only ask whether a licensing agreement provides royalties for post-expiration use of a patent. If not, no problem; if so, no dice. *Brulotte* 's ease of use appears in still sharper relief when compared to Kimble's proposed alternative. Recall that he wants courts to employ antitrust law's rule of reason to identify and invalidate those post-expiration royalty clauses with anti-competitive consequences. See *supra,* at ——– – ——. But whatever its merits may be for deciding antitrust claims, that "elaborate inquiry" produces notoriously high litigation costs and unpredictable results. For that reason, trading in *Brulotte* for the rule of reason would make the law less, not more, workable than it is now. Once again, then, the case for sticking with long-settled precedent grows stronger: Even the most usual reasons for abandoning *stare decisis* cut the other way here.

IV

Lacking recourse to those traditional justifications for overruling a prior decision, Kimble offers two different ones. He claims first that *Brulotte* rests on a mistaken view of the competitive effects of post-expiration royalties. He contends next that *Brulotte* suppresses technological innovation and so harms the nation's economy. We consider the two claims in turn, but our answers to both are much the same: Kimble's reasoning may give Congress cause to upset *Brulotte,* but does not warrant this Court's doing so.

A

According to Kimble, we should overrule *Brulotte* because it hinged on an error about economics: It assumed that post-patent royalty "arrangements are invariably anticompetitive." That is not true, Kimble notes; indeed, such agreements more often increase than inhibit competition, both before and after the patent expires. As noted earlier, a longer payment period will typically go hand-in-hand with a lower royalty rate. During the patent term, those reduced rates may lead to lower consumer prices, making the patented technology more competitive with alternatives; too, the lesser rates may enable more companies to afford a license, fostering competition among the patent's own users. And after the patent's expiration, Kimble continues, further benefits follow: Absent high barriers to entry (a material caveat, as even he would agree, the licensee's continuing obligation to pay royalties encourages new companies to begin making the product, figuring that they can quickly attract customers by undercutting the licensee on price. In light of those realities, Kimble concludes, "the *Brulotte per se* rule makes little sense."

We do not join issue with Kimble's economics—only with what follows from it. A broad scholarly consensus supports Kimble's view of the competitive effects of post-expiration royalties, and we see no error in that shared analysis. Still, we must decide what that means for *Brulotte*. Kimble, of course, says it means the decision must go. Positing that *Brulotte* turned on the belief that post-expiration royalties are always anticompetitive, he invokes decisions in which this Court abandoned antitrust precedents premised on similarly shaky economic reasoning. But to agree with Kimble's conclusion, we must resolve two questions in his favor. First, even assuming Kimble accurately characterizes *Brulotte* 's basis, does the decision's economic mistake suffice to overcome *stare decisis* ? Second and more fundamentally, was *Brulotte* actually founded, as Kimble contends, on an analysis of competitive effects?

If *Brulotte* were an antitrust rather than a patent case, we might answer both questions as Kimble would like. This Court has viewed *stare decisis* as having less-than-usual force in cases involving the Sherman Act. See, *e.g., Khan,* 522 U.S., at 20–21, 118 275. Congress, we have explained, intended that law's reference to "restraint of trade" to have "changing content," and authorized courts to oversee the term's "dynamic potential." We have therefore felt relatively free to revise our legal analysis as economic understanding evolves and (just as Kimble notes) to reverse antitrust precedents that misperceived a practice's competitive consequences. Moreover, because the question in those cases was whether the challenged activity restrained trade, the Court's rulings necessarily turned on its understanding of economics. Accordingly, to overturn the decisions in light of sounder economic reasoning was to take them "on [their] own terms."

But *Brulotte* is a patent rather than an antitrust case, and our answers to both questions instead go against Kimble. To begin, even assuming that *Brulotte* relied on an economic misjudgment, Congress is the right entity to fix it. By contrast with the Sherman Act, the patent laws do not turn over exceptional law-shaping authority to the courts. Accordingly, statutory *stare decisis*—in which this Court interprets and Congress decides whether to amend—retains its usual strong force. And as we have shown, that doctrine does not ordinarily bend to "wrong on the merits"-type arguments; it instead assumes Congress will correct whatever mistakes we commit. See *supra,* at ——– – ——. Nor does Kimble offer any reason to think his own "the Court erred" claim is special. Indeed, he does not even point to anything that has changed since *Brulotte*—no new empirical studies or advances in economic theory. Compare, *e.g., Halliburton,* 573 U.S., at ——, 134, at 2409–2411 (considering, though finding insufficient, recent economic research). On his argument, the *Brulotte* Court knew all it needed to know to determine that post-patent royalties are not usually anticompetitive; it just made the wrong call. See Brief for Petitioners 36–40. That claim, even if itself dead-right, fails to clear *stare decisis* 's high bar.

And in any event, *Brulotte* did not hinge on the mistake Kimble identifies. Although some of its language invoked economic concepts, the Court did not rely on the notion that post-patent royalties harm competition. Nor is that surprising. The patent laws—unlike the Sherman Act—do not aim to maximize competition (to a large extent, the opposite). And the patent term—unlike the "restraint of trade" standard—provides an all-encompassing bright-line rule, rather than calling for practice-specific analysis. So in deciding whether post-expiration royalties comport with patent law, *Brulotte* did not undertake to assess that practice's likely competitive effects. Instead, it applied a categorical principle that all patents, and all benefits from them, must end when their terms expire. See *Brulotte,* 379 U.S., at 30–32. Or more specifically put, the Court held, as it had in *Scott Paper,* that Congress had made a judgment: that the day after a patent lapses, the formerly protected invention must be available to all for free. And further: that post-expiration restraints on even a single licensee's access to the invention clash with that principle. See *Brulotte,* 379 U.S., at 31–32, 85 176 (a licensee's obligation to pay post-patent royalties conflicts with the "free market visualized for the post-expiration period" and so "runs counter to the policy and purpose of the patent laws". That patent (not antitrust) policy gave rise to the Court's conclusion that post-patent royalty contracts are unenforceable—utterly "regardless of a demonstrable effect on competition."

Kimble's real complaint may go to the merits of such a patent policy—what he terms its "formalis[m]," its "rigid[ity]", and its detachment from "economic reality." But that is just a different version of the argument that *Brulotte* is wrong. And it is, if anything, a version less capable than the last of trumping statutory *stare decisis*. For the choice of what patent policy should be lies first and foremost with Congress. So if Kimble thinks patent law's insistence on unrestricted access to formerly patented inventions leaves too little room for pro-competitive post-expiration royalties, then Congress, not this Court, is his proper audience.

B

Kimble also seeks support from the wellspring of all patent policy: the goal of promoting innovation. *Brulotte,* he contends, "discourages technological innovation and does significant damage to the American economy." Brief for Petitioners 29. Recall that would-be licensors and licensees may benefit from post-patent royalty arrangements because they allow for a longer payment period and a more precise allocation of risk. See *supra,* at ——. If the parties' ideal licensing agreement is barred, Kimble reasons, they may reach no agreement at all. See Brief for Petitioners 32. And that possibility may discourage invention in the first instance. The bottom line, Kimble concludes, is that some "breakthrough technologies will never see the light of day."

Maybe. Or, then again, maybe not. While we recognize that post-patent royalties are sometimes not anticompetitive, we just cannot say whether barring them imposes any meaningful drag on innovation. As we have explained, *Brulotte* leaves open various ways—involving both licensing and other business arrangements—to accomplish payment deferral and risk-spreading alike. Those alternatives may not offer the parties the precise set of benefits and obligations they would prefer. But they might still suffice to bring patent holders and product developers together and ensure that inventions get to the public. Neither Kimble nor his *amici* have offered any empirical evidence connecting *Brulotte* to decreased innovation; they essentially ask us to take their word for the problem. And the United States, which acts as both a licensor and a licensee of patented inventions while also implementing patent policy, vigorously disputes that *Brulotte* has caused any "significant real-world economic harm." Truth be told, if forced to decide that issue, we would not know where or how to start.

Which is one good reason why that is not our job. Claims that a statutory precedent has "serious and harmful consequences" for innovation are (to repeat this opinion's refrain) "more appropriately addressed to Congress." That branch, far more than this one, has the capacity to assess Kimble's charge that *Brulotte* suppresses technological progress. And if it concludes that *Brulotte* works such harm, Congress has the prerogative to determine the exact right response—choosing the policy fix, among many conceivable ones, that will optimally serve the public interest. As we have noted, Congress legislates actively with respect to patents, considering concerns of just the kind Kimble raises. In adhering to our precedent as against such complaints, we promote the rule-of-law values to which courts must attend while leaving matters of public policy to Congress.

V

What we can decide, we can undecide. But *stare decisis* teaches that we should exercise that authority sparingly. Finding many reasons for staying the *stare decisis* course and no "special justification" for departing from it, we decline Kimble's invitation to overrule *Brulotte*.

For the reasons stated, the judgment of the Court of Appeals is affirmed.

Justice ALITO, with whom THE CHIEF JUSTICE and Justice THOMAS join, dissenting.

The Court employs *stare decisis,* normally a tool of restraint, to reaffirm a clear case of judicial overreach. Our decision in *Brulotte v. Thys Co.,* 379 U.S. 29, 85 176, 13 L.Ed.2d 99 (1964), held that parties cannot enter into a patent licensing agreement that provides for royalty payments to continue after the term of the patent expires. That decision was not based on anything that can plausibly be regarded as an interpretation of the terms of the Patent Act. It was based instead on an economic theory—and one that has been debunked. The decision interferes with the ability of parties to negotiate licensing agreements that reflect the true value of a patent, and it disrupts contractual expectations. *Stare decisis* does not require us to retain this baseless and damaging precedent.

I

A

The Patent Act provides that a patent grants certain exclusive rights to the patentee and "his heirs or assigns" for a term of 20 years. The Act says nothing whatsoever about post-expiration royalties. In *Brulotte,* however, the Court held that such royalties are *per se* unlawful. The Court made little pretense of finding support for this holding in the language of the Act. Instead, the Court reasoned that allowing post-expiration royalties would subject "the free market visualized for the post-expiration period ... to monopoly influences that have no proper place there." Invoking antitrust concepts, the decision suggested that such arrangements are "an effort to enlarge the monopoly of the patent by t[y]ing the sale or use of the patented article to the purchase or use of unpatented ones."

Whatever the merits of this economic argument, it does not represent a serious attempt to interpret the Patent Act. A licensing agreement that provides for the payment of royalties after a patent's term expires does not enlarge the patentee's monopoly or extend the term of the patent. It simply gives the licensor a contractual right. Thus, nothing in the text of the Act even arguably forbids licensing agreements that provide for post-expiration royalties.

Brulotte was thus a bald act of policymaking. It was not simply a case of incorrect statutory interpretation. It was not really statutory interpretation at all.

B

Not only was *Brulotte* based on policymaking, it was based on a policy that is difficult to defend. Indeed, in the intervening 50 years, its reasoning has been soundly refuted. …

Brulotte misperceived the purpose and effect of post-expiration royalties. The decision rested on the view that post-expiration royalties extend the patent term by means of an anti-competitive tying arrangement. As the Court understood such an arrangement, the patent holder leverages its monopoly power during the patent term to require payments after the term ends, when the invention would otherwise be available for free public use. But agreements to pay licensing fees after a patent expires do not "enlarge the monopoly of the patent." Instead, "[o]nce the patent term expires, the power to exclude is gone," and all that is left "is a problem about optimal contract design." Easterbrook, Contract and Copyright, 42 Hous. L. Rev. 953, 955 (2005).

The economics are simple: Extending a royalty term allows the parties to spread the licensing fees over a longer period of time, which naturally has the effect of reducing the fees during the patent term. Restricting royalty payments to the patent term, as *Brulotte* requires, compresses payment into a shorter period of higher fees. The Patent Act does not prefer one approach over the other.

…

NOTES

1. The Justice Kagan's majority opinion comments: "*Brulotte,* then, is not the kind of doctrinal dinosaur or legal last-man-standing for which we sometimes depart from *stare decisis*." Considering modern antitrust law which moves away from the type of per se rule used in *Brulotte*, and other developments, do you agree with the Court's observation?

2. Justice Kagan characterizes *Brulotte* as a statutory interpretation case, while Justice Scalia disagrees. What part of the Patent Act was being interpreted in *Brulotte*? With which Justice do you agree? Should the difference in viewpoint affect the outcome in *Kimble*?

3. In the case, the license carried a royalty rate of "3% of 'net product sales' " past the expiration of the patent. There was uncertainty about to what extent the deal hinged on the patent license or was a hybrid license involving an idea disclosure and a patent. What if a license primarily involved an idea or trade secret disclosure and incidentally a patent license of a method that might be used to implement the idea or secret process, but was not essential to it? In Kimble, assuming idea or trade secret elements were involved, what result if the license adjusted to royalties to 2.5% of net product sales when the patent expired?

4. The Court of Appeals in Kimble, as had most commentators and courts, had agreed with the following comments of the Seventh Circuit.

> The Supreme Court's majority opinion [in *Brulotte*] reasoned that by extracting a promise to continue paying royalties after expiration of the patent, the patentee extends the patent beyond the term fixed in the patent statute and therefore in violation of the law. That is not true. After the patent expires, anyone can make the patented process or product without being guilty of patent infringement. The patent can no longer be used to exclude anybody from such production. Expiration thus accomplishes what it is supposed to accomplish. For a licensee in accordance with a provision in the license agreement to go on paying royalties after the patent expires does not extend the duration of the patent either technically or practically, because ... if the licensee agrees to continue paying royalties after the patent expires the royalty rate will be lower. The duration of the patent fixes the limit of the patentee's power to extract royalties; it is a detail whether he extracts them at a higher rate over a shorter period of time or a lower rate over a longer period of time.

Scheiber v. Dolby Labs., Inc., 293 F.3d 1014, 1017 (7th Cir.2002). What was the response of Justice Kagan to this argument?

IV. DISTINGUISHING CONTRACT AND PROPERT REMEDIES

Page 580. Delete the Bassett *case.*

V. DAMAGES

Page 588. Add the following before the Universal Gym Case*:*

Although there is obviously far more to know, here are selections from the intellectual property law damages rules:

Patent Law § 284. Damages

Upon finding for the claimant the court shall award the claimant damages adequate to compensate for the infringement, but in no event less than a reasonable royalty for the use made of the invention by the infringer, together with interest and costs as fixed by the court.

When the damages are not found by a jury, the court shall assess them. In either event the court may increase the damages up to three times the amount found or assessed. Increased damages under this paragraph shall not apply to provisional rights under section 154(d).

The court may receive expert testimony as an aid to the determination of damages or of what royalty would be reasonable under the circumstances.

Copyright Law Damages: 17 USC § 504. Remedies for infringement: Damages and profits

(a) In General.—Except as otherwise provided by this title, an infringer of copyright is liable for either—

(1) the copyright owner's actual damages <u>and</u> any additional profits of the infringer, as provided by subsection (b); or

(2) statutory damages, as provided by subsection (c).

(b) Actual Damages and Profits.—The copyright owner is entitled to recover the actual damages suffered by him or her as a result of the infringement, and any profits of the infringer that are attributable to the infringement and are not taken into account in computing the actual damages. In establishing the infringer's profits, the copyright owner is required to present proof only of the infringer's gross revenue, and the infringer is required to prove his or her deductible expenses and the elements of profit attributable to factors other than the copyrighted work.

(c) Statutory Damages.—

(1) Except as provided by clause (2) of this subsection, the copyright owner may elect, at any time before final judgment is rendered, to recover, instead of actual damages and profits, an award of statutory damages for all infringements involved in the action, with respect to any one work, for which any one infringer is liable individually, or for which any two or more infringers are liable jointly and severally, in a sum of not less than $750 or more than $30,000 as the court considers just. For the purposes of this subsection, all

the parts of a compilation or derivative work constitute one work.

(2) In a case where the copyright owner sustains the burden of proving, and the court finds, that infringement was committed willfully, the court in its discretion may increase the award of statutory damages to a sum of not more than $150,000. In a case where the infringer sustains the burden of proving, and the court finds, that such infringer was not aware and had no reason to believe that his or her acts constituted an infringement of copyright, the court in its discretion may reduce the award of statutory damages to a sum of not less than $200. The court shall remit statutory damages in any case where an infringer believed and had reasonable grounds for believing that his or her use of the copyrighted work was a fair use under section 107, if the infringer was: (i) an employee or agent of a nonprofit educational institution, library, or archives acting within the scope of his or her employment who, or such institution, library, or archives itself, which infringed by reproducing the work in copies or phonorecords; or (ii) a public broadcasting entity which or a person who, as a regular part of the nonprofit activities of a public broadcasting entity (as defined in subsection (g) of section 118) infringed by performing a published nondramatic literary work or by reproducing a transmission program embodying a performance of such a work.

Page 604. Insert after Problem 12.8:

PARAMOUNT PICTURES CORP. v. METRO PROGRAM NETWORK
962 F.2d 775 (8th Cir. 1992)

MAGILL, Circuit Judge.

Metro Program Network, Inc., and Gerald Fitzgerald, president of Metro, appeal from the district court's order finding them liable for copyright infringement and the breach of contract state law claim. Appellants claim that the award for breach of contract damages was excessive, and make the somewhat novel argument that the award of both breach of contract and copyright infringement damages constituted an impermissible award of double damages under 17 U.S.C. § 504. We affirm.

I.

Metro operates commercial television station KOCR-TV in Cedar Rapids, Iowa. Fitzgerald is the president, general manager, secretary, registered agent and sole shareholder of Metro. During January 1988, Fitzgerald signed eight interim license agreements with Paramount to broadcast episodes of "Happy Days," "Mork and Mindy," "Taxi," and packages of motion pictures or movies of the week entitled "Preview II," "Preview III," "Portfolio IX," "Portfolio X," and "Portfolio Special Edition II." Paramount accepted Metro's offers to license these products by letters dated January 28 and March 1. Under the interim agreements, Metro was to pay Paramount 10% of the license fees on January 14, and the remainder in thirty-six equal monthly installments. Each of the agreements contained the following language: "The license arrangement is subject to those additional provisions as are contained in Paramount's Standard Series Contract and Paramount's Standard Terms and Conditions, copies of which are available on request, and will be fully set forth in a formal written contract." The district court found that the Standard Terms and Conditions were properly considered part of the contracts even though appellants had not seen or read them and did not know what they contained when appellants signed the contracts.

Fitzgerald tendered a check to Paramount dated January 14 in the amount of $26,000. This check was dishonored on March 19 because Metro's account was closed. No other payment was made by Metro under the contracts. Prior to March 19, Paramount had delivered the episodes of "Happy Days," "Mork and Mindy," and "Taxi" to Metro and Metro began to broadcast them. In addition, Paramount delivered two movies. Metro broadcasted these movies. On May 6, having not received any payments, Paramount sent Metro a letter terminating the contracts pursuant to the default provision of the Standard Terms and

Conditions[4] and reserving their rights to collect the sums due under the contracts. On May 20, Paramount sent a second letter, saying that it had been informed that Metro was broadcasting Paramount products "in direct contravention of the Notice of Termination of KOCR's telecast rights" and that the unauthorized broadcast of those products constituted a willful infringement of Paramount's copyrights. Paramount demanded that Metro immediately cease any further broadcasts of Paramount products and return any and all products Metro might have in its possession.

Subsequently, Metro broadcast [several of the programs numerous times].

Paramount filed suit, alleging breach of contract and copyright infringement. The case was tried without a jury. The district court found that Metro and Fitzgerald were liable to Paramount for breach of contract in the amount of $217,760, the full contract price. It also found that Metro and Fitzgerald were liable for copyright infringement in the amount of $23,500. On appeal, appellants make two arguments. First, they argue that the breach of contract damages are excessive. Second, they argue that the award of both breach of contract damages and copyright infringement damages is an impermissible award of double damages to Paramount. We affirm the district court.

II.

We review the district court's findings of fact under the clearly erroneous standard, and conclusions of law de novo.

A. Breach of Contract Damages

Appellants admit that they breached the contracts with Paramount. They argue, however, that the district court erred in finding that they are liable for the full value of all the contracts. They contend that, because Paramount did not deliver all of the movies under the five movie contracts, they cannot be liable for the full amount.

Under Iowa law, when a contract is breached, the nonbreaching party is entitled to recover the contract price less the amount it would have cost the nonbreaching party to perform. In this case, the cost of performance has not been shown by either party. There are, however, no apparent costs, other than overhead,[5] that Paramount would have incurred if the contract had been performed. The nonbreaching party's overhead costs are counted as a part of the cost of performance only if the overhead costs would have increased due to performance of the contract. The breaching party bears the burden of proving the nonbreaching party's overhead costs would have increased had the contract been performed. Appellants have not shown that those costs would have increased. Therefore, we cannot say that the district court's finding that the appellants are liable for the full contract price was clearly erroneous.

Appellants' argument appears to claim that the acceleration clause, in conjunction with the termination of the contracts, is essentially a liquidated damages clause that, under the circumstances of this case, is really a penalty. Under Iowa law, "[a] party who contends that a liquidation clause is in reality a penalty has the burden to plead that fact and prove the actual damages in the trial court." While this may have been a viable argument at trial, especially in reference to the contracts where there was no performance by either party, appellants did not present this issue to the trial court. We are not required to address arguments that were not presented below. Appellants have waived this issue.

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[4] [FN5] This provision provides in pertinent part:

> If Licensee shall default in the payment of any sums payable in accordance with the terms of this Agreement and such default shall continue for a period of ten (10) days, ... any and all installments or sums payable under this Agreement remaining unpaid shall immediately become due and payable to Paramount, regardless of the due date thereof, and, in addition ... Paramount shall have the right to (i) terminate each and all of the rights of Licensee under this Agreement ... and/or (ii) suspend the further delivery of prints until such defaults shall have ceased and shall have been remedied, and/or (iii) seize, wherever found, any print of any licensed picture delivered to Licensee hereunder.

[5] [FN7] Expenses that are necessarily incurred, such as utilities, wages and taxes, but that can vary in amount.

B. Double Damages

Appellants also claim that the district court erred in granting appellees both breach of contract damages and copyright infringement damages because this constitutes an impermissible award of double damages under 17 U.S.C. § 504 (1988).

Under the Copyright Act of 1976, 17 U.S.C. § 101 *et seq.,* a copyright owner can only recover once for each infringement. 17 U.S.C. § 504. The copyright owner suing an infringer is entitled to *either* actual damages under § 504(b) *or* statutory damages under § 504(c). *Id.* In this case, Paramount opted for statutory damages for the infringement. The district court found that appellants had broadcast forty-seven episodes of the three sitcoms owned by Paramount after May 20. The court awarded them $500 per infringement, totalling $23,500 in statutory copyright infringement damages. Appellants claim that the breach of contract damages are really an award of actual damages under § 504(b) because the claimed infringements occurred during the time the licenses would have been in effect if they had not been terminated and, therefore, appellees are not entitled to both awards. We must therefore look to see if the district court's award of breach of contract damages is, substantively, an award of actual damages for copyright infringement. We find that the breach of contract damages award is not an award of actual damages for copyright infringement under § 504(b).

The breach of contract claim asserted by Paramount relates solely to events that occurred before May 6. The district court recognized this, and relied strictly on contract law and on the events that took place before May 6 in analyzing this claim. Because appellants did not pay Paramount any of the money owed under the license agreements, they were in default, or breach, of the contracts. Under the bankruptcy and default clause in the Standard Terms and Conditions, this occurred within ten days of the first missed payment, due January 14. Thus, at the time Paramount terminated the contracts on May 6, appellants had clearly breached the contracts and Paramount was entitled to damages for that breach. Appellants were liable for these damages even if they had not broadcast any Paramount products after the contracts were terminated.

In contrast, the copyright infringement claim relates to events that occurred after May 6. Once Paramount exercised its contractual right to terminate the licenses on May 6, appellants no longer had any right to broadcast Paramount products. The district court recognized this temporal distinction between Paramount's two claims by relying on facts and events occurring after May 20[6] to make its determination on the copyright infringement claim.

Because the damage awards for breach of contract and copyright infringement were for completely separate injuries, the district court correctly awarded both breach of contract damages and copyright infringement damages to appellees. *See Joseph J. Legat Architects, P.C. v. United States Dev. Corp.,* No. 84-C-8803, 1991 WL 38714, 1991 U.S. Dist. LEXIS 3358 (N.D. Ill. Mar. 20, 1991) (damages for copyright infringement not synonymous with damages for breach of contract; claims seek to redress two distinctly different injuries where breach of contract claim seeks to enforce rights under contract to receive monies due for preparation and use of plans while copyright claim seeks to recover for use of plans in way that exceeded rights under the contract).

PROBLEM 12.6a

You represent "Author" who has reached a deal to license rights in a book manuscript she wrote about a famous U.S politician. The politician was assassinated two weeks ago. She had been working on the book for two years. The deal calls for a $10,000 royalty advance and royalties of 20% for each copy sold. The publisher agrees to print and begin selling the book within 60 days of receipt of the manuscript and to use best efforts to promote sales of the book.. Author has written three prior biographies that have had almost no commercial success (she has never received more than 5,000 in royalties for any book). She wants a clause that guaranties her that, if Publisher finds a better known author, she will still earn around $300,000

[6] [FN11] The licenses were terminated by letter on May 6. Paramount, however, gave appellants, who claimed they never saw this letter, the benefit of the doubt and only claimed infringement damages from the date of the second notice of termination on May 20.

and have control of her book. In fact, she has heard that Publisher has contacted on of their Best Sellers about quickly writing a book on this politician.

Consider how to draft a clause under each of the following assumptions:

a. You are in the jurisdiction that has the Paramont case. A court reviewing your contract will take the other cases we have read into consideration.

b. You are in the jurisdiction that has the MCA case. A court reviewing your contract will take the other cases we have read into consideration.

Chapter 13

SELECTED ANTITRUST ISSUES

II. STATUTORY APPROACHES

Page 618. Insert the following above the title to Section III:

TESTS/APPROACHES

A per se rule assumes that a given arrangement or practice is illegal, per se.

Such a conclusion is an exception to the analysis applicable in most antitrust claims, described as a "rule of reason" analysis. The origins of the terminology relate back to the fact that, while the Sherman Act proscribes any restraint on competition, courts early recognized that this language must be applied with a rule of reason that understands that not all restraints on competition are illegal. The rule (actually, it is an analytical style) was described in the following terms:

> Under this rule, the fact finder weighs all of the circumstances of a case in deciding whether a restrictive practice should be prohibited as imposing an unreasonable restraint upon competition.

A rule-of-reason analysis thus entails a balancing test. One first determines if anticompetitive effects are created or potentially created by the allegedly illegal practice. If so, questions arise about whether these effects are outweighed by efficiency or other pro-competitive effects, including in licensing, fostering the affirmative goals of the underlying property rights.

The rule-of-reason and per se approaches actually describe different points on a same continuum. That continuum reflects the extent to which a given practice clearly does or does not violate competition law standards and, thus, relates to the extent to which close analysis of the individual context is required. At one end, the practices are so clearly legal that they require little if any scrutiny even if they succeed in elevating the actor's market position. At the other end, some practices are so clearly anticompetitive or convey a risk of such effects that they require little or no analysis to determine that they should not be permitted. Between the two extremes are many varieties and shapes of risk and analysis, all characterized as invoking the rule of reason.

III. TYING ARRANGEMENTS

Page 639. Add the following after Note 2:

3. In *State Oil Co. v. Khan*, 522 U.S. 3 (1997), the Supreme Court reversed preexisting precedent and held that vertical restraints on maximum resale price of a product should be examined under a rule of reason, rather than as a per se violation. The Court's decision observed maximum resale price controls on a particular product line do not restrain interbrand competition.

In 2007, the Supreme Court visited the same issue with respect to minimum price restraints. It reached the same conclusion. In *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, 551 U.S. 877 (2007), the court rejected decades of case law and held that minimum price restraints are not per se invalid under antitrust law, but must be treated under a rule of reason. Depending on the particular context and the terms of the restraint, such practice may or may not be procompetitive.

Page 668. Add the follow new Section VIII at the end of the chapter:

VIII. REVERSE PAYMENT SETTLEMENTS

FEDERAL TRADE COMMISSION v. ACTAVIS, INC.

133 S. Ct. 2223 (2013)

BREYER, J., delivered the opinion of the Court, in which KENNEDY, GINSBURG, SOTOMAYOR, and KAGAN, JJ., joined. ROBERTS, C.J., filed a dissenting opinion, in which SCALIA and THOMAS, JJ., joined. ALITO, J., took no part in the consideration or decision of the case.

Company A sues Company B for patent infringement. The two companies settle under terms that require (1) Company B, the claimed infringer, not to produce the patented product until the patent's term expires, and (2) Company A, the patentee, to pay B many millions of dollars. Because the settlement requires the patentee to pay the alleged infringer, rather than the other way around, this kind of settlement agreement is often called a "reverse payment" settlement agreement. And the basic question here is whether such an agreement can sometimes unreasonably diminish competition in violation of the antitrust laws. See, *e.g.,* 15 U.S.C. § 1 (Sherman Act prohibition of "restraint[s] of trade or commerce").

In this case, the Eleventh Circuit dismissed a Federal Trade Commission (FTC) complaint claiming that a particular reverse payment settlement agreement violated the antitrust laws. In doing so, the Circuit stated that a reverse payment settlement agreement generally is "immune from antitrust attack so long as its anticompetitive effects fall within the scope of the exclusionary potential of the patent." *FTC v. Watson Pharmaceuticals, Inc.*, 677 F.3d 1298, 1312 (2012). And since the alleged infringer's promise not to enter the patentee's market expired before the patent's term ended, the Circuit found the agreement legal and dismissed the FTC complaint. *Id.,* at 1315. In our view, however, reverse payment settlements such as the agreement alleged in the complaint before us can sometimes violate the antitrust laws. We consequently hold that the Eleventh Circuit should have allowed the FTC's lawsuit to proceed.

I

A

Apparently most if not all reverse payment settlement agreements arise in the context of pharmaceutical drug regulation, and specifically in the context of suits brought under statutory provisions allowing a generic drug manufacturer (seeking speedy marketing approval) to challenge the validity of a patent owned by an already-approved brand-name drug owner. See Brief for Petitioner 29; 12 P. Areeda & H. Hovenkamp, Antitrust Law ¶ 2046, p. 338 (3d ed. 2012) (hereinafter Areeda); Hovenkamp, Sensible Antitrust Rules for Pharmaceutical Competition, 39 U.S.F. L. Rev. 11, 24 (2004). We consequently describe four key features of the relevant drug-regulatory framework established by the Drug Price Competition and Patent Term Restoration Act of 1984, 98 Stat. 1585, as amended. That Act is commonly known as the Hatch–Waxman Act.

First, a drug manufacturer, wishing to market a new prescription drug, must submit a New Drug Application to the federal Food and Drug Administration (FDA) and undergo a long, comprehensive, and costly testing process, after which, if successful, the manufacturer will receive marketing approval from the FDA. …

Second, once the FDA has approved a brand-name drug for marketing, a manufacturer of a generic drug can obtain similar marketing approval through use of abbreviated procedures. The Hatch–Waxman Act permits a generic manufacturer to file an Abbreviated New Drug Application specifying that the generic has the "same active ingredients as," and is "biologically equivalent" to, the already-approved brand-name drug. *Caraco Pharmaceutical Laboratories, Ltd. v. Novo Nordisk A/S,* 566 U.S. ——, ——, 132 1670, 1676, 182 L.Ed.2d 678 (2012) (citing 21 U.S.C. §§ 355(j)(2)(A)(ii), (iv)). In this way the generic manufacturer can obtain approval while avoiding the "costly and time-consuming studies" needed to obtain approval "for a pioneer drug." …

Third, the Hatch–Waxman Act sets forth special procedures for identifying, and resolving, related patent disputes. It requires the pioneer brand-name manufacturer to list in its New Drug Application the "number and the expiration date" of any relevant patent. See 21 U.S.C. § 355(b)(1). And it requires the generic manufacturer in its Abbreviated New Drug Application to "assure the FDA" that the generic "will not infringe" the brand-name's patents.

The generic can provide this assurance in one of several ways. See 21 U.S.C. § 355(j)(2)(A)(vii). It can certify that the brand-name manufacturer has not listed any relevant patents. It can certify that any relevant patents have expired. It can request approval to market beginning when any still-in-force patents expire. Or, it can certify that any listed, relevant patent "is invalid or will not be infringed by the manufacture, use, or sale" of the drug described in the Abbreviated New Drug Application. Taking this last-mentioned route (called the "paragraph IV" route), automatically counts as patent infringement, and often "means provoking litigation." If the brand-name patentee brings an infringement suit within 45 days, the FDA then must withhold approving the generic, usually for a 30–month period, while the parties litigate patent validity (or infringement) in court….

Fourth, Hatch–Waxman provides a special incentive for a generic to be the first to file an Abbreviated New Drug Application taking the paragraph IV route. That applicant will enjoy a period of 180 days of exclusivity (from the first commercial marketing of its drug). During that period of exclusivity no other generic can compete with the brand-name drug. If the first-to-file generic manufacturer can overcome any patent obstacle and bring the generic to market, this 180–day period of exclusivity can prove valuable, possibly "worth several hundred million dollars." Hemphill, Paying for Delay: Pharmaceutical Patent Settlement as a Regulatory Design Problem, 81 N.Y.U.. 1553, 1579 (2006). Indeed, the Generic Pharmaceutical Association said in 2006 that the " 'vast majority of potential profits for a generic drug manufacturer materialize during the 180–day exclusivity period.' " The 180–day exclusivity period, however, can belong only to the first generic to file….

B

1

In 1999, Solvay Pharmaceuticals, a respondent here, filed a New Drug Application for a brand-name drug called AndroGel. The FDA approved the application in 2000. In 2003, Solvay obtained a relevant patent and disclosed that fact to the FDA, as Hatch–Waxman requires.

Later the same year another respondent, Actavis, Inc. (then known as Watson Pharmaceuticals), filed an Abbreviated New Drug Application for a generic drug modeled after AndroGel. Subsequently, Paddock Laboratories, also a respondent, separately filed an Abbreviated New Drug Application for its own generic product. Both Actavis and Paddock certified under paragraph IV that Solvay's listed patent was invalid and their drugs did not infringe it. A fourth manufacturer, Par Pharmaceutical, likewise a respondent, did not file an application of its own but joined forces with Paddock, agreeing to share the patent litigation costs in return for a share of profits if Paddock obtained approval for its generic drug.

Solvay initiated paragraph IV patent litigation against Actavis and Paddock. Thirty months later the FDA approved Actavis' first-to-file generic product, but, in 2006, the patent-litigation parties all settled. Under the terms of the settlement Actavis agreed that it would not bring its generic to market until August 31, 2015, 65 months before Solvay's patent expired (unless someone else marketed a generic sooner). Actavis also agreed to promote AndroGel to urologists. The other generic manufacturers made roughly similar promises. And Solvay agreed to pay millions of dollars to each generic—$12 million in total to Paddock; $60 million in total to Par; and an estimated $19–$30 million annually, for nine years, to Actavis. The companies described these payments as compensation for other services the generics promised to perform, but the FTC contends the other services had little value. According to the FTC the true point of the payments was to compensate the generics for agreeing not to compete against AndroGel until 2015.

2

On January 29, 2009, the FTC filed this lawsuit against all the settling parties, namely, Solvay, Actavis, Paddock, and Par. The FTC's complaint (as since amended) alleged that respondents violated § 5 of the Federal Trade Commission Act, 15 U.S.C. § 45, by unlawfully agreeing "to share in Solvay's monopoly profits, abandon their patent challenges, and refrain from launching their low-cost generic products to compete with AndroGel for nine years." … The District Court held that these allegations did not set forth an antitrust law violation. It accordingly dismissed the FTC's complaint. The FTC appealed.

The Court of Appeals for the Eleventh Circuit affirmed the District Court. It wrote that "absent sham litigation or fraud in obtaining the patent, a reverse payment settlement is immune from antitrust attack so long as its anticompetitive effects fall within the scope of the exclusionary potential of the patent." …

The FTC sought certiorari. Because different courts have reached different conclusions about the application of the antitrust laws to Hatch–Waxman–related patent settlements, we granted the FTC's petition. …

II

A

Solvay's patent, if valid and infringed, might have permitted it to charge drug prices sufficient to recoup the reverse settlement payments it agreed to make to its potential generic competitors. And we are willing to take this fact as evidence that the agreement's "anticompetitive effects fall within the scope of the exclusionary potential of the patent." But we do not agree that that fact, or characterization, can immunize the agreement from antitrust attack.

For one thing, to refer, as the Circuit referred, simply to what the holder of a valid patent could do does not by itself answer the antitrust question. The patent here may or may not be valid, and may or may not be infringed. "[A] *valid* patent excludes all except its owner from the use of the protected process or product," *United States v. Line Material Co.,* 333 U.S. 287, 308, 68 550, 92. 701 (1948) (emphasis added). And that exclusion may permit the patent owner to charge a higher-than-competitive price for the patented product. But an *invalidated* patent carries with it no such right. And even a valid patent confers no right to exclude products or processes that do not actually infringe. The paragraph IV litigation in this case put the patent's validity at issue, as well as its actual preclusive scope. The parties' settlement ended that litigation. The FTC alleges that in substance, the plaintiff agreed to pay the defendants many millions of dollars to stay out of its market, even though the defendants did not have any claim that the plaintiff was liable to them for damages. That form of settlement is unusual. And, for reasons discussed in Part II–B, *infra,* there is reason for concern that settlements taking this form tend to have significant adverse effects on competition.

Given these factors, it would be incongruous to determine antitrust legality by measuring the settlement's anticompetitive effects solely against patent law policy, rather than by measuring them against procompetitive antitrust policies as well. And indeed, contrary to the Circuit's view that the only pertinent question is whether "the settlement agreement ... fall[s] within" the legitimate "scope" of the patent's "exclusionary potential," this Court has indicated that patent and antitrust policies are both relevant in determining the "scope of the patent monopoly"—and consequently antitrust law immunity—that is conferred by a patent.

Thus, the Court in *Line Material* explained that "the improper use of [a patent] monopoly," is "invalid" under the antitrust laws and resolved the antitrust question in that case by seeking an accommodation "between the lawful restraint on trade of the patent monopoly and the illegal restraint prohibited broadly by the Sherman Act." To strike that balance, the Court asked questions such as whether "the patent statute specifically gives a right" to restrain competition in the manner challenged; and whether "competition is impeded to a greater degree" by the restraint at issue than other restraints previously approved as reasonable. *Id.,* at 311, 68 550. See also *United States v. United States Gypsum Co.,* 333 U.S. 364, 390–391, 68 525, 92. 746 (1948) (courts must "balance the privileges of [the patent holder] and its licensees under the patent grants with the prohibitions of the Sherman Act against combinations and attempts to monopolize"); *Walker Process Equipment, Inc. v. Food Machinery & Chemical Corp.,* 382 U.S. 172, 174, 86 347, 15 L.Ed.2d 247 (1965) ("[E]nforcement of a patent procured by fraud" may violate the Sherman Act). In short, rather than measure the length or amount of a restriction solely against the length of the patent's term or its earning potential, as the Court of Appeals apparently did here, this Court answered the antitrust question by considering traditional antitrust factors such as likely anticompetitive effects, redeeming virtues, market power, and potentially offsetting legal considerations present in the circumstances, such as here those related to patents. See Part II–B, *infra.* Whether a particular restraint lies "beyond the limits of the patent monopoly" is a *conclusion* that flows from that analysis and not, as THE CHIEF JUSTICE suggests, its starting point.

For another thing, this Court's precedents make clear that patent-related settlement agreements can sometimes violate the antitrust laws. In *United States v. Singer Mfg. Co.,* 374 U.S. 174, 83 1773, 10 L.Ed.2d 823 (1963), for example, two sewing machine companies possessed competing patent claims; a third company sought a patent under circumstances where doing so might lead to the disclosure of information that would invalidate the other two firms' patents. All three firms settled their patent-related disagreements while assigning the broadest claims to the firm best able to enforce the patent against yet other potential competitors. The Court did not examine whether, on the assumption that all three patents were valid, patent law would have allowed the patents' holders to do the same. Rather, emphasizing that the Sherman Act "imposes strict limitations on the concerted activities in which patent owners may lawfully engage," it held that the agreements, although settling patent disputes, violated the antitrust laws. And that, in important part, was because "the public interest in granting patent monopolies" exists only to the extent that "the public is given a novel and useful invention" in "consideration for its grant." See also *United States v. New Wrinkle, Inc.,* 342 U.S. 371, 378, 72 350, 96. 417 (1952) (applying antitrust scrutiny to patent settlement); *Standard Oil Co. (Indiana) v. United States,* 283 U.S. 163, 51 421, 75. 926 (1931) (same).

Similarly, both within the settlement context and without, the Court has struck down overly restrictive patent licensing agreements—irrespective of whether those agreements produced supra-patent-permitted revenues. We concede that in *United States v. General Elec. Co.,* 272 U.S. 476, 489, 47 192, 71. 362 (1926), the Court permitted a single patentee to grant to a single licensee a license containing a minimum resale price requirement. But in *Line Material, supra,* at 308, 310–311, 68 550, the Court held that the antitrust laws forbid a group of patentees, each owning one or more patents, to cross-license each other, and, in doing so, to insist that each licensee maintain retail prices set collectively by the patent holders. The Court was willing to presume that the single-patentee practice approved in *General Electric* was a "reasonable restraint" that "accords with the patent monopoly granted by the patent law," 333 U.S., at 312, 68 550, but declined to extend that conclusion to multiple-patentee agreements: "As the Sherman Act prohibits agreements to fix prices, any arrangement between patentees runs afoul of that prohibition and is outside the patent monopoly." *Ibid.* In *New Wrinkle,* 342 U.S., at 378, 72 350, the Court held roughly the same, this time in respect to a similar arrangement in settlement of a litigation between two patentees, each of which contended that its own patent gave it the exclusive right to control production. That one or the other company (we may presume) was right about its patent did not lead the Court to confer antitrust immunity. Far from it, the agreement was found to violate the Sherman Act. *Id.,* at 380, 72 350.

Finally in *Standard Oil Co. (Indiana),* the Court upheld cross-licensing agreements among patentees that settled actual and impending patent litigation, 283 U.S., at 168, 51 421, which agreements set royalty rates to be charged third parties for a license to practice all the patents at issue (and which divided resulting revenues). But, in doing so, Justice Brandeis, writing for the Court, warned that such an arrangement would have violated the Sherman Act had the patent holders thereby "dominate[d]" the industry and "curtail[ed] the manufacture and supply of an unpatented product." *Id.,* at 174, 51 421. These cases do not simply ask whether a hypothetically valid patent's holder would be able to charge, *e.g.,* the high prices that the challenged patent-related term allowed. Rather, they seek to accommodate patent and antitrust policies, finding challenged terms and conditions unlawful unless patent law policy offsets the antitrust law policy strongly favoring competition.

Thus, contrary to the dissent's suggestion, there is nothing novel about our approach. What *does* appear novel are the dissent's suggestions that a patent holder may simply "pa[y] a competitor to respect its patent" and quit its patent invalidity or noninfringement claim without any antitrust scrutiny whatever, and that "such settlements ... are a well-known feature of intellectual property litigation,". Closer examination casts doubt on these claims. The dissent does not identify any patent statute that it understands to grant such a right to a patentee, whether expressly or by fair implication. It would be difficult to reconcile the proposed right with the patent-related policy of eliminating unwarranted patent grants so the public will not "continually be required to pay tribute to would-be monopolists without need or justification." *Lear, Inc. v. Adkins,* 395 U.S. 653, 670, 89 1902, 23 L.Ed.2d 610 (1969). And the authorities cited for this proposition (none from this Court, and none an antitrust case) are not on point. Some of them say that when Company A sues Company B for patent infringement and demands, say, $100 million in damages, it is not uncommon for B (the defendant) to pay A (the plaintiff) some amount less than the full demand as part of the settlement—$40 million, for example. See Schildkraut, Patent–Splitting Settlements and the Reverse Payment Fallacy, 71 Antitrust L.J. 1033, 1046 (2004) (suggesting that this hypothetical settlement includes "an implicit net payment" from A to B of $60 million—*i.e.,* the amount of the settlement discount). The cited authorities also indicate that if B has a counterclaim for damages against A, the original infringement plaintiff, A might end up paying B to settle B's counterclaim. Cf. *Metro–Goldwyn Mayer, Inc. v. 007 Safety Prods., Inc.,* 183 F.3d 10, 13 (C.A.1 1999) (describing trademark dispute and settlement). Insofar as the dissent urges that settlements taking these commonplace forms have not been thought for that reason alone subject to antitrust liability, we agree, and do not intend to alter that understanding. But the dissent appears also to suggest that reverse payment settlements—*e.g.,* in which A, the plaintiff, pays money to defendant B purely so B will give up the patent fight—should be viewed for antitrust purposes in the same light as these familiar settlement forms. See *post,* at 2242 – 2243. We cannot agree. In the traditional examples cited above, a party with a claim (or counterclaim) for damages receives a sum equal to or less than the value of its claim. In reverse payment settlements, in contrast, a party with no claim for damages (something that is usually true of a paragraph IV litigation defendant) walks away with money simply so it will stay away from the patentee's market. That, we think, is something quite different. Cf. *Verizon Communications, Inc. v. Law Offices of Curtis V. Trinko, LLP,* 540 U.S. 398, 408, 124 872, 157 L.Ed.2d 823 (2004) ("[C]ollusion" is "the supreme evil of antitrust").

Finally, the Hatch–Waxman Act itself does not embody a statutory policy that supports the Eleventh Circuit's view. Rather, the general procompetitive thrust of the statute, its specific provisions facilitating challenges to a patent's validity, see Part I–A, *supra,* and its later-added provisions requiring parties to a patent dispute triggered by a paragraph IV filing to report settlement terms to the FTC and the Antitrust Division of the Department of Justice, all suggest the contrary. See §§ 1112–1113, 117 Stat. 2461–2462. Those interested in legislative history may also wish to examine the statements of individual Members of Congress condemning reverse payment settlements in advance of the 2003 amendments. See, *e.g.,* 148 Cong. Rec. 14437 (2002) (remarks of Sen. Hatch) ("It was and is very clear that the [Hatch–Waxman Act] was not designed to allow deals between brand and generic companies to delay competition"); 146 Cong. Rec. 18774 (2000) (remarks of Rep. Waxman) (introducing bill to deter companies from "strik[ing] collusive agreements to trade multimillion dollar payoffs by the brand company for delays in the introduction of lower cost, generic alternatives").

B

The Eleventh Circuit's conclusion finds some degree of support in a general legal policy favoring the settlement of disputes. See also *Schering–Plough Corp. v. FTC,* 402 F.3d 1056, 1074–1075 (C.A.11 2005) (same); *In re Tamoxifen Citrate,* 466 F.3d, at 202 (noting public's " 'strong interest in settlement' " of complex and expensive cases). The Circuit's related underlying practical concern consists of its fear that antitrust scrutiny of a reverse payment agreement would require the parties to litigate the validity of the patent in order to demonstrate what would have happened to competition in the absence of the settlement. Any such litigation will prove time consuming, complex, and expensive. The antitrust game, the Circuit may believe, would not be worth that litigation candle.

We recognize the value of settlements and the patent litigation problem. But we nonetheless conclude that this patent-related factor should not determine the result here. Rather, five sets of considerations lead us to conclude that the FTC should have been given the opportunity to prove its antitrust claim.

First, the specific restraint at issue has the "potential for genuine adverse effects on competition." The payment in effect amounts to a purchase by the patentee of the exclusive right to sell its product, a right it already claims but would lose if the patent litigation were to continue and the patent were held invalid or not infringed by the generic product. Suppose, for example, that the exclusive right to sell produces $50 million in supracompetitive profits per year for the patentee. And suppose further that the patent has 10 more years to run. Continued litigation, if it results in patent invalidation or a finding of noninfringement, could cost the patentee $500 million in lost revenues, a sum that then would flow in large part to consumers in the form of lower prices.

We concede that settlement on terms permitting the patent challenger to enter the market before the patent expires would also bring about competition, again to the consumer's benefit. But settlement on the terms said by the FTC to be at issue here—payment in return for staying out of the market—simply keeps prices at patentee-set levels, potentially producing the full patent-related $500 million monopoly return while dividing that return between the challenged patentee and the patent challenger. The patentee and the challenger gain; the consumer loses. Indeed, there are indications that patentees sometimes pay a generic challenger a sum even larger than what the generic would gain in profits if it won the paragraph IV litigation and entered the market. The rationale behind a payment of this size cannot in every case be supported by traditional settlement considerations. The payment may instead provide strong evidence that the patentee seeks to induce the generic challenger to abandon its claim with a share of its monopoly profits that would otherwise be lost in the competitive market.

But, one might ask, as a practical matter would the parties be able to enter into such an anticompetitive agreement? Would not a high reverse payment signal to other potential challengers that the patentee lacks confidence in its patent, thereby provoking additional challenges, perhaps too many for the patentee to "buy off?" Two special features of Hatch–Waxman mean that the answer to this question is "not necessarily so." First, under Hatch–Waxman only the first challenger gains the special advantage of 180 days of an exclusive right to sell a generic version of the brand-name product. See Part I–A, *supra*. And as noted, that right has proved valuable—indeed, it can be worth several hundred million dollars. Subsequent challengers cannot secure that exclusivity period, and thus stand to win significantly less than the first if they bring a successful paragraph IV challenge. That is, if subsequent litigation results in invalidation of the patent, or a ruling that the patent is not infringed, that litigation victory will free not just the challenger to compete, but all other potential competitors too (once they obtain FDA approval). The potential reward available to a subsequent challenger being significantly less, the patentee's payment to the initial challenger (in return for not pressing the patent challenge) will not necessarily provoke subsequent challenges. Second, a generic that files a paragraph IV after learning that the first filer has settled will (if sued by the brand-name) have to wait out a stay period of (roughly) 30 months before the FDA may approve its application, just as the first filer did. See 21 U.S.C. § 355(j)(5)(B)(iii). These features together mean that a reverse payment settlement with the first filer (or, as in this case, *all* of the initial filers) "removes from consideration the most motivated challenger, and the one closest to introducing competition." Hemphill, *supra,* at 1586. The dissent may doubt these provisions matter, *post,* at 2234 – 2236, but scholars in the field tell us that "where only one party owns a patent, it is virtually unheard of outside of pharmaceuticals for that party to pay an accused infringer to settle the lawsuit." 1 H. Hovenkamp, M. Janis, M. Lemley, & C. Leslie, IP and Antitrust § 15.3, p. 15–45, n. 161 (2d ed. Supp. 2011). It may well be that Hatch–Waxman's unique regulatory framework, including the special advantage that the 180–day exclusivity period gives to first filers, does much to explain why in this context, but not others, the patentee's ordinary incentives to resist paying off challengers (*i.e.,* the fear of provoking myriad other challengers) appear to be more frequently overcome. See 12 Areeda ¶ 2046, at 341 (3d ed. 2010) (noting that these provisions, no doubt unintentionally, have created special incentives for collusion).

Second, these anticompetitive consequences will at least sometimes prove unjustified. As the FTC admits, offsetting or redeeming virtues are sometimes present. The reverse payment, for example, may amount to no more than a rough approximation of the litigation expenses saved through the settlement. That payment may reflect compensation for other services that the generic has promised to perform—such as distributing the patented item or helping to develop a market for that item. There may be other justifications. Where a reverse payment reflects traditional settlement considerations, such as avoided litigation costs or fair value for services, there is not the same concern that a patentee is using its monopoly profits to avoid the risk of patent invalidation or a finding of noninfringement. In such cases, the parties may have provided for a reverse payment without having sought or brought about the anticompetitive consequences we mentioned above. But that possibility does not justify dismissing the FTC's complaint. An antitrust defendant may show in the antitrust proceeding that legitimate justifications are present, thereby explaining the presence of the challenged term and showing the lawfulness of that term under the rule of reason.

Third, where a reverse payment threatens to work unjustified anticompetitive harm, the patentee likely possesses the power to bring that harm about in practice. At least, the "size of the payment from a branded drug manufacturer to a prospective generic is itself a strong indicator of power"—namely, the power to charge prices higher than the competitive level. An important patent itself helps to assure such power. Neither is a firm without that power likely to pay "large sums" to induce "others to stay out of its market." In any event, the Commission has referred to studies showing that reverse payment agreements are associated with the presence of higher-than-competitive profits—a strong indication of market power.

Fourth, an antitrust action is likely to prove more feasible administratively than the Eleventh Circuit believed. The Circuit's holding does avoid the need to litigate the patent's validity (and also, any question of infringement). But to do so, it throws the baby out with the bath water, and there is no need to take that drastic step. That is because it is normally not necessary to litigate patent validity to answer the antitrust question (unless, perhaps, to determine whether the patent litigation is a sham, see An unexplained large reverse payment itself would normally suggest that the patentee has serious doubts about the patent's survival. And that fact, in turn, suggests that the payment's objective is to maintain supracompetitive prices to be shared among the patentee and the challenger rather than face what might have been a competitive market—the very anticompetitive consequence that underlies the claim of antitrust unlawfulness. The owner of a particularly valuable patent might contend, of course, that even a small risk of invalidity justifies a large payment. But, be that as it may, the payment (if otherwise unexplained) likely seeks to prevent the risk of competition. And, as we have said, that consequence constitutes the relevant anticompetitive harm. In a word, the size of the unexplained reverse payment can provide a workable surrogate for a patent's weakness, all without forcing a court to conduct a detailed exploration of the validity of the patent itself.

Fifth, the fact that a large, unjustified reverse payment risks antitrust liability does not prevent litigating parties from settling their lawsuit. They may, as in other industries, settle in other ways, for example, by allowing the generic manufacturer to enter the patentee's market prior to the patent's expiration, without the patentee paying the challenger to stay out prior to that point. Although the parties may have reasons to prefer settlements that include reverse payments, the relevant antitrust question is: What are those reasons? If the basic reason is a desire to maintain and to share patent-generated monopoly profits, then, in the absence of some other justification, the antitrust laws are likely to forbid the arrangement.

In sum, a reverse payment, where large and unjustified, can bring with it the risk of significant anticompetitive effects; one who makes such a payment may be unable to explain and to justify it; such a firm or individual may well possess market power derived from the patent; a court, by examining the size of the payment, may well be able to assess its likely anticompetitive effects along with its potential justifications without litigating the validity of the patent; and parties may well find ways to settle patent disputes without the use of reverse payments. In our view, these considerations, taken together, outweigh the single strong consideration—the desirability of settlements—that led the Eleventh Circuit to provide near-automatic antitrust immunity to reverse payment settlements.

III

The FTC urges us to hold that reverse payment settlement agreements are presumptively unlawful and that courts reviewing such agreements should proceed via a "quick look" approach, rather than applying a "rule of reason." See *California Dental,* 526 U.S., at 775, n. 12, 119 1604 ("Quick-look analysis in effect" shifts to "a defendant the burden to show empirical evidence of procompetitive effects"); 7 Areeda ¶ 1508, at 435–440 (3d ed. 2010). We decline to do so. In *California Dental,* we held (unanimously) that abandonment of the "rule of reason" in favor of presumptive rules (or a "quick-look" approach) is appropriate only where "an observer with even a rudimentary understanding of economics could conclude that the arrangements in question would have an anticompetitive effect on customers and markets." 526 U.S., at 770, 119 1604; *id.,* at 781, 119 1604 (BREYER, J., concurring in part and dissenting in part). We do not believe that reverse payment settlements, in the context we here discuss, meet this criterion.

That is because the likelihood of a reverse payment bringing about anticompetitive effects depends upon its size, its scale in relation to the payor's anticipated future litigation costs, its independence from other services for which it might represent payment, and the lack of any other convincing justification. The existence and degree of any anticompetitive consequence may also vary as among industries. These complexities lead us to conclude that the FTC must prove its case as in other rule-of-reason cases.

…

It is so ordered.

Justice ALITO took no part in the consideration or decision of this case.

Chief Justice ROBERTS, with whom Justice SCALIA and Justice THOMAS join, dissenting.

…

Solvay Pharmaceuticals holds a patent. It sued two generic drug manufacturers that it alleged were infringing that patent. Those companies counterclaimed, contending the patent was invalid and that, in any event, their products did not infringe. The parties litigated for three years before settling on these terms: Solvay agreed to pay the generics millions of dollars and to allow them into the market five years before the patent was set to expire; in exchange, the generics agreed to provide certain services (help with marketing and manufacturing) and to honor Solvay's patent. The Federal Trade Commission alleges that such a settlement violates the antitrust laws. The question is how to assess that claim.

A patent carves out an exception to the applicability of antitrust laws. The correct approach should therefore be to ask whether the settlement gives Solvay monopoly power beyond what the patent already gave it. The Court, however, departs from this approach, and would instead use antitrust law's amorphous rule of reason to inquire into the anticompetitive effects of such settlements. This novel approach is without support in any statute, and will discourage the settlement of patent litigation. I respectfully dissent.

I

The point of antitrust law is to encourage competitive markets to promote consumer welfare. The point of patent law is to grant limited monopolies as a way of encouraging innovation. Thus, a patent grants "the right to exclude others from profiting by the patented invention." *Dawson Chemical Co. v. Rohm & Haas Co.,* 448 U.S. 176, 215, 100 2601, 65 L.Ed.2d 696 (1980). In doing so it provides an exception to antitrust law, and the scope of the patent—*i.e.*, the rights conferred by the patent—forms the zone within which the patent holder may operate without facing antitrust liability.

…

We have never held that it violates antitrust law for a competitor to refrain from challenging a patent. And by extension, we have long recognized that the settlement of patent litigation does not by itself violate the antitrust laws. *Standard Oil Co. (Indiana) v. United States,* 283 U.S. 163, 171, 51 421, 75. 926 (1931) ("Where there are legitimately conflicting claims or threatened interferences, a settlement by agreement, rather than litigation, is not precluded by the [Sherman] Act"). Like most litigation, patent litigation is settled all the time, and such settlements—which can include agreements that clearly violate antitrust law, such as licenses that fix prices, or agreements among competitors to divide territory—do not ordinarily subject the litigants to antitrust liability. See 1 H. Hovenkamp, M. Janis, M. Lemley, & C. Leslie, IP and Antitrust § 7.3, pp. 7–13 to 7–15 (2d ed. 2003) (hereinafter Hovenkamp).

The key, of course, is that the patent holder—when doing anything, including settling—must act within the scope of the patent. If its actions go beyond the monopoly powers conferred by the patent, we have held that such actions are subject to antitrust scrutiny. If its actions are within the scope of the patent, they are not subject to antitrust scrutiny, with two exceptions concededly not applicable here: (1) when the parties settle sham litigation; and (2) when the litigation involves a patent obtained through fraud on the Patent and Trademark Office. …

NOTES

1. *Actavis* has generated significant reported litigation with mixed results, but seemingly little tendency to extend its rationale to other settlements. See, e.g., In re Loestrin 24 Fe Antitrust Litigation, 45 F. Supp. 3d 180 (D. R.I. 2014); Intellectual Ventures I LLC v. Capital One Financial Corp., 2013 U.S. Dist. LEXIS 177836 (E.D. Va. 2013).

2. To what extent was the Court's decision influence by the mere size of the payment? What could justify such a large payment? What would justify a smaller one? Typical settlements reflect the cost of litigation and the risk of loss. Does the Court take both elements into account?

Chapter 14

LIMITING DOCTRINES DERIVED FROM PROPERTY LAW

II. POLICY PREEMPTION AND CONTRACT CHOICE

Page 686. Add the following above the title to Section III:

FOREST PARK PICTURES v. UNIVERSAL TELEVISION
683 F.3d 424 (2d Cir. 2012)

OPINION

This dispute over the concept for a television show presents the question of the extent to which the Copyright Act, 17 U.S.C. § 101 *et seq.,* preempts contract claims involving copyrightable property. Plaintiffs–Appellants Forest Park Pictures, Hayden Christensen, and Tove Christensen (collectively, "Forest Park") developed an idea for a television series and created a writing that embodied it, known in the industry as a "series treatment." Forest Park submitted its idea, first by mail and then in person, to Defendant–Appellee USA Network, a division of Universal Television Network, Inc. ("USA Network"). Forest Park alleges an implied promise by USA Network to pay reasonable compensation if the idea were used. The District Court for the Southern District of New York (Colleen McMahon, *Judge*) held that the Copyright Act preempted a breach of contract claim … We reach a different conclusion.

BACKGROUND

Facts

Because Forest Park appeals from an order dismissing the complaint on the pleadings, we accept as true the facts alleged in the Third Amended Complaint ("Complaint"). In 2005, Forest Park formulated a concept for a television show called "Housecall," in which a doctor, after being expelled from the medical community for treating patients who could not pay, moved to Malibu, California, and became a "concierge" doctor to the rich and famous. Forest Park created a written series treatment for the idea, including character biographies, themes, and storylines. It mailed this written material to Alex Sepiol, who worked for USA Network.

After sending the written materials, Forest Park requested a meeting between its representatives and Sepiol. Sepiol scheduled the meeting "for the express purpose of hearing Plaintiffs pitch" their show. Complaint ¶ 12. At the time, Sepiol and USA Network knew "that writer-creat[o]rs pitch creative ideas to prospective purchasers with the object of selling those ideas for compensation" and "that it was standard in the entertainment industry for ideas to be pitched with the expectation of compensation in the event of use." *Id.* ¶ 9. And, at the meeting, "[i]t was understood that Plaintiffs were pitching those ideas with the object of persuading USA Network to purchase those ideas for commercial development." *Id.* ¶ 13. Sepiol said that prior to hearing the idea for "Housecall," he had never heard of "concierge" doctors, or doctors who make house calls for wealthy patients, and "thought it was a fascinating concept for a television show." *Id.* ¶ 15. Over the course of the following week, Sepiol and Forest Park exchanged further communications; however, discussions soon ceased and no further contact between the parties ensued.

A little less than four years later, USA Network produced and aired a television show called "Royal Pains," in which a doctor, after being expelled from the medical community for treating patients who could not pay, became a concierge doctor to the rich and famous in the Hamptons. Forest Park had no prior knowledge of "Royal Pains," did not consent to its production, and received no compensation from USA Network for the use of its idea for the show.

DISCUSSION

This appeal presents two questions: first, whether Forest Park's breach of implied contract claim is preempted by the Copyright Act; and second, if such a claim is not preempted, whether Forest Park adequately pleaded a claim under state law. We hold that Forest Park's claim is not preempted and that the Complaint pleads an enforceable contract under state law that survives a motion to dismiss.

I. Preemption

We first turn to USA Network's argument that Forest Park's claim is preempted. Section 301 of the Copyright Act expressly preempts a state law claim only if (i) the work at issue "come[s] within the subject matter of copyright" and (ii) the right being asserted is "equivalent to any of the exclusive rights within the general scope of copyright."

A. Subject Matter Requirement

In order to be preempted, a claim must involve a work "within the subject matter of copyright." Copyright protection exists for "original works of authorship fixed in any tangible medium of expression," but does not extend to an "idea, ... regardless of the form in which it is described, explained, illustrated, or embodied." 17 U.S.C. § 102(a), (b). We have held, however, that works may fall within the subject matter of copyright, and thus be subject to preemption, even if they contain material that is uncopyrightable under section 102. In *Harper & Row,* for example, the work at issue, President Ford's memoirs, contained uncopyrightable facts. 723 F.2d at 200. Nevertheless, we held that the factual content of the book did not remove the work as a whole (indisputably a literary work of authorship, *see* § 102(a)(1)) from the subject matter of copyright. we held that a novel fell within "the broad ambit of the subject matter categories" listed in section 102(a) despite containing uncopyrightable ideas. *Id.* at 306. The scope of copyright for preemption purposes, then, extends beyond the scope of available copyright protection.

The reason for our broad interpretation of the scope of copyright preemption is that Congress, in enacting section 301, created a regime in which some types of works are copyrightable and others fall into the public domain. *See NBA,* 105 F.3d at 849. In preempting certain state causes of action, Congress deprived the states of the power to "vest exclusive rights in material that Congress intended to be in the public domain." *Id.; see also Harper & Row,* 723 F.2d at 200 (recognizing that it would "run directly afoul of one of the Act's central purposes" to allow the states to expand copyright protection to works Congress deemed uncopyrightable). Section 301's preemption scheme functions properly only if the " 'subject matter of copyright' includes all works of a *type* covered by sections 102 and 103, even if federal law does not afford protection to them."

The work at issue in this case is Forest Park's idea for "Housecall," manifested in the series treatment (comprising character biographies, themes, and storylines). This treatment and associated written materials are "works of authorship that are fixed in a tangible medium." 17 U.S.C. § 301(a). Although Forest Park's Complaint does not allege that USA Network took its actual scripts or biographies, the subject matter requirement is met because the Complaint alleges that USA Network used the ideas embodied in those written works. That the work contains within it some uncopyrightable ideas does not remove it from the subject matter of copyright. Moreover, because the ideas that are the subject of the claim were fixed in writing—whether or not the writing itself is at issue—the claim is within the subject matter of copyright. *See NBA,* 105 F.3d at 849; *see also Montz v. Pilgrim Films & Television, Inc.,* 649 F.3d 975, 979 (9th Cir.2011) (en banc) (holding that an idea for a television show, once fixed in a tangible medium, fell within the subject matter of copyright); *Wrench LLC v. Taco Bell Corp.,* 256 F.3d 446, 455 (6th Cir.2001) (holding that an idea for a character, conveyed in storyboards, scripts, and drawings, was within the subject matter of copyright). Therefore, the first requirement for preemption is met.

B. Equivalency Requirement

In order to establish preemption, USA Network must also demonstrate that the Complaint seeks to vindicate a "legal or equitable right[ ] that [is] equivalent to any of the exclusive rights within the general scope of copyright as specified by section 106." 17 U.S.C. § 301(a). Section 106 gives copyright owners the exclusive rights, among other things, to reproduce a copyrighted work, to prepare derivative works, to distribute copies of the work to the public, and to display the work publicly. 17 U.S.C. § 106. A state law right is equivalent to one of the exclusive rights of copyright if it "may be abridged by an act which, in and of itself, would infringe one of the exclusive rights." *Harper & Row,* 723 F.2d at 200. "But if an extra element is required instead of or in addition to the acts of reproduction, performance, distribution or display, in order to constitute a state-created cause of action," there is no preemption.

Applying this "extra element" test, we have held numerous categories of claims to be not preempted, including trade secret claims, in which the plaintiff must show the defendant breached a duty of trust through improper disclosure of confidential material, certain "hot news" misappropriation claims, because the plaintiff must show time-sensitive factual information, free-riding by the defendant, and a threat to the very existence of the plaintiff's product, and breach of confidential relationship, in which the plaintiff must show an obligation not to disclose ideas revealed in confidence, *Smith v. Weinstein,* 578. 1297, 1307 (S.D.N.Y.1984), *aff'd without opinion,* 738 F.2d 419 (2d Cir.1984). *See also Harper & Row,* 723 F.2d at 201 (in dictum, suggesting that conversion based on physical possession and control of a copyrighted work may not be preempted because such a tort involves "acts ... qualitatively different from those proscribed by copyright law"). By contrast, we have found a state law claim preempted when the extra element changes the scope but not the fundamental nature of the right. *See, e.g., Briarpatch,* 373 F.3d at 306–07 (holding an unjust enrichment claim preempted because, although plaintiff must prove "enrichment," the essential nature of the claim remained the unauthorized use of a work); *Fin. Info., Inc. v. Moody's Investors Serv., Inc.,* 808 F.2d 204, 208 (2d Cir.1986) (holding that a misappropriation claim was preempted because the element of commercial immorality did not change qualitative nature of the right); *Harper & Row,* 723 F.2d at 201 (holding that a claim of conversion based on unauthorized publication of a work was preempted because it is "coextensive with an exclusive right already safeguarded by the Act").

In this case, the issue is whether a particular breach of contract claim survives preemption. More specifically, Forest Park alleges that it entered into an implied-in-fact agreement with USA Network that required USA Network to pay Forest Park for the use of its idea. *See* Complaint ¶¶ 24–26. There are several qualitative differences between such a contract claim and a copyright violation claim. First, the Copyright Act does not provide an express right for the copyright owner to receive payment for the use of a work. It simply gives the copyright owner the right to prevent distribution, copying, or the creation of derivative works (though, of course, the copyright owner may cede or all part of these rights for payment). *See* 17 U.S.C. § 106. Second, a plaintiff suing for failure to pay under a contract must prove extra elements beyond use or copying, including mutual assent and valid consideration. Third, a breach of contract claim asserts rights only against the contractual counterparty, not the public at large. As the Seventh Circuit explained in *ProCD,* "A copyright is a right against the world. Contracts, by contrast, generally affect only their parties; strangers may do as they please, so contracts do not create 'exclusive rights.' " 86 F.3d at 1454.

A number of our sister circuits have accordingly concluded that at least some contract claims involving the subject matter of copyright do not contest rights that are the equivalent of rights under the Copyright Act, and thus are not preempted. *See Montz,* 649 F.3d at 980–81 (implied-in-fact contract); *Utopia Provider Sys., Inc. v. Pro–Med Clinical Sys., L.L.C.,* 596 F.3d 1313, 1326–27 (11th Cir.2010) (express contract); *Bowers v. Baystate Techs., Inc.,* 320 F.3d 1317, 1324–26 (Fed.Cir.2003) (applying First Circuit law to an express contract in a software license); *Wrench,* 256 F.3d at 456 (implied-in-fact contract); *ProCD,* 86 F.3d at 1454–55(express contract in a software license); *Nat'l Car Rental Sys., Inc. v. Computer Assocs. Int'l, Inc.,* 991 F.2d 426, 431 (8th Cir.1993) (express licensing agreement); *Taquino v. Teledyne Monarch Rubber,* 893 F.2d 1488, 1490, 1501 (5th Cir.1990) (express contract); *Acorn Structures, Inc. v. Swantz,* 846 F.2d 923, 926 (4th Cir.1988) (per curiam) (express contract); *see also* 4 Nimmer § 19D.03 [C][2] ("As a general rule, contract claims require proof of a significant 'extra element': the existence of an actual agreement between plaintiff and defendant involving a promise to pay for use of disclosed ideas. That conclusion is the same, regardless of whether the particular claim at issue is labeled express contract [or] implied-in-fact contract...." (footnotes omitted)). Of course, preemption cannot be avoided simply by labeling a claim "breach of contract." A plaintiff must actually allege the elements of an enforceable contract (whether express or implied-in-fact), including offer, acceptance, and consideration, in addition to adequately alleging the defendant's breach of the contract.

As long as the elements of a contract are properly pleaded, there is no difference for preemption purposes between an express contract and an implied-in-fact contract. *See, e.g., Leibowitz v. Cornell Univ.,* 584 F.3d 487, 507 (2d Cir.2009) (under New York law, proof of an implied-in-fact contract requires proof of the same elements as an express contract); *Warner Bros. Int'l Television Distribution v. Golden Channels & Co.,* 522 F.3d 1060, 1069 (9th Cir.2008) (same under California law). There is, however, a significant difference for preemption purposes between contracts implied-in-fact and contracts implied-in-law. Theories of implied-in-law contract, quasi-contract, or unjust enrichment differ significantly from breach of contract because the plaintiff need not allege the existence of an actual agreement between the parties. *See* 1–1 Corbin on Contracts § 1.20 ("A contract 'implied in law' is a fictitious contract.... A contract 'implied in fact' is a true contract that arises from the tacit agreement of the parties."). Under these quasi-contractual theories, the plaintiff need only prove that the defendant was unjustly enriched through the use of her idea or work. Such a claim is not materially different from a claim for copyright infringement that requires a plaintiff to prove that the defendant used, reproduced, copied, or displayed a copyrighted work. *See Briarpatch,* 373 F.3d at 306 (finding no extra element in an unjust enrichment claim); *see also Wrench,* 256 F.3d at 459 (noting that there is "a crucial difference" between implied-in-fact contracts and implied-in-law contracts because the latter "depend[ ] on nothing more than the unauthorized use of the work"); 4 Nimmer §§ 19D.03[B][6], [7] (unjust enrichment and quasi-contract preempted).

In this case, we need not address whether preemption is precluded whenever there is a contract claim, or only when the contract claim includes a promise to pay. *Compare Montz,* 649 F.3d at 980–81 (holding that the element of mutual assent in a contract claim can by itself provide the "extra element"), *with Wrench,* 256 F.3d at 457–58 (holding that the promise of payment in a contract claim provides the "extra element"). *See also* 4 Nimmer § 19D.03[C][2] (suggesting that a contract that "does not purport to give [the plaintiff] any protection beyond that provided ... by copyright law itself" would be preempted). Here the Complaint specifically alleges that the contract includes by implication a promise to pay for the use of Forest Park's idea. *See* Complaint ¶ 11 (alleging that it was understood when Forest Park met with Sepiol they were "pitching ... ideas with the object of persuading USA Network to *purchase* those ideas for commercial development") (emphasis added); *id.* ¶ 25 ("USA Network voluntarily accepted Plaintiffs' ideas knowing full well that Plaintiffs had submitted those ideas in confidence and for economic gain, and with *the clear expectation of payment* in the event those ideas were utilized by USA Network....") (emphasis added). The alleged contract does not simply require USA Network to honor Forest Park's exclusive rights under the Copyright Act (assuming the material at issue to be copyrightable); it requires USA Network to pay for the use of Forest Park's ideas. A claim for breach of a contract including a promise to pay is qualitatively different from a suit to vindicate a right included in the Copyright Act and is not subject to preemption.[1]

II. Breach of Contract

…

Forest Park alleges that it agreed with USA Network to be paid the industry standard for its idea, which is enough under California law to survive a motion to dismiss. At trial, Forest Park will have to prove that such an industry standard price exists and that both parties implicitly agreed to it. That Forest Park might fail to prove its claim, however, does not render the contract unenforceable as a matter of law at the pleading stage. Because Forest Park has alleged an enforceable implied-in-fact contract including a promise of payment for the disclosure of its idea, its claim is not preempted by the Copyright Act and therefore the district court erred in dismissing the Complaint.

CONCLUSION

For the foregoing reasons, we VACATE the district court's judgment dismissing Forest Park's complaint and REMAND for further proceedings.