BRYAN CAVE
A Broader Perspective
Bulletin

Intellectual Property Client Service

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TransCore Decision

The Federal Circuit Court of Appeals has held that TransCore LP's blanket covenant not to sue a manufacturer under specified patents unconditionally authorized the manufacturer's sales of the allegedly infringing product and thereby barred TransCore's later infringement claims against a downstream user engaged in installing and testing the product after the manufacturer had sold the product to a customer. *TransCore, LP v. Electronic Transaction Consultants Corp.*, No. 2008-1430 (Fed. Cir. Apr. 8, 2009). The *TransCore* decision relies on a recent Supreme Court decision concerning the patent exhaustion doctrine to hold that an unrestricted covenant not to sue authorizes sales that exhaust a patent holder's rights, and extends that decision, raising new issues to consider when drafting both licenses and settlement agreements.

The *TransCore* Decision

TransCore LP manufactures automated toll collection systems, like E-ZPass, and holds patents for the related technologies. The *TransCore* decision arose out of TransCore's patent infringement suit against Electronic Transaction Consultants Corp. ("ETC"), a company that installed and tested toll collection systems purchased by the Illinois State Toll Highway Authority ("ISTHA") from TransCore's competitor, Mark IV Industries.

ETC moved for summary judgment, arguing that TransCore had exhausted its patent rights in the systems because Mark IV's sales to ISTHA were authorized by a prior settlement agreement between TransCore and Mark IV in which Mark IV paid $4.5 million in exchange for a release of TransCore's claims for past infringement and an unconditional covenant not to sue for future infringement under specified patents. The patent exhaustion doctrine "provides that the initial authorized sale of a patented item terminates all patent rights to that item." *Quanta Computer, Inc. v. LG Electronics, Inc.*, 128 S. Ct. 2109, 2115 (2008). The doctrine prevents patent holders from expanding the scope of their patent monopoly to include a right to control the post-sale use of their patents.

The district court in *TransCore* granted summary judgment in ETC's favor. The Federal Circuit affirmed and held that the unconditional covenant not to sue, executed long before *Quanta*, authorized sales that triggered the patent exhaustion doctrine in the same way as a license. The court reasoned that a patent grants the right to exclude rather than an affirmative right to practice the patent, so a license is in essence merely an agreement not to sue the licensee for practicing the patent. Whether through a

license or a covenant not to sue, "the patentee can only convey a freedom from suit." Both types of agreement, the court found, are "authorizations" to practice the patent.

The Federal Circuit then relied on *Quanta* to determine that TransCore's and Mark IV's intent as to infringement by third parties was irrelevant: "The only issue relevant to patent exhaustion is whether Mark IV's sales were authorized, not whether TransCore and Mark IV intended, expressly or impliedly, for the covenant to extend to Mark IV's customers."

The Federal Circuit further held that there was a legal estoppel arising from the covenant not to sue that prevented TransCore from suing for infringement of a patent whose application was pending at the time of the settlement but which issued subsequent to the settlement agreement, even though the covenant expressly stated that it "shall not apply to any other patents issued as of the effective date of this Agreement or to be issued in the future." The court concluded that Mark IV had an implied license to the later-issued patent by virtue of the fact that the later-issued patent was necessary to practice one of the patents identified in the covenant. And because this implied license was "necessarily co-extensive" with the rights in the covenant, Mark IV's sales were authorized under the later-issued patent and TransCore's rights in that patent were exhausted by those sales.

TransCore's Significance

TransCore expands upon *Quanta* by holding that covenants not to sue operate in the same way as licenses to authorize sales to third parties and thereby trigger the patent exhaustion doctrine. This is not particularly remarkable, since the principles used to reach this result were well-settled.

What is remarkable is *TransCore's* holding as to legal estoppel with respect to a later-issued patent. By extending the legal estoppel theory to subsequently issued patents, deciding this issue as a matter of law on summary judgment, and marginalizing the express limit on the scope of TransCore's covenant not to sue, the Federal Circuit further expanded the scope of the covenant not to sue in a way that may make it difficult for patent owners to narrowly define covenants and licenses or preserve rights to subsequently-issued patents. It remains to be seen whether the courts will apply this aspect of *TransCore* narrowly, perhaps limiting it to pending applications.

TransCore also underscores the importance of carefully drafting the terms of both licenses and settlement agreements. For example, the case might well have come out differently if TransCore's covenant not to sue Mark IV had been conditional in a way that directly restricted Mark IV's authority to sell products. The Federal Circuit expressly noted that the TransCore "did not, as it could have, limit this authorization [that is, the scope of what Mark IV could do freely under the covenant not to sue] to, for example, 'making' or 'using' [and not selling]." And TransCore, like LG Electronics in *Quanta*, did not write into the provision authorizing sales an express condition that sales could only be made for certain third-party uses or that sales could only be made to purchasers who agreed to restrictions.

Contrary to some published accounts, *TransCore* should not invalidate any currently existing licenses or covenants not to sue. But, licenses, releases and covenants not to sue created before *Quanta* and *TransCore* are likely to have much broader effect than was originally anticipated.

As patent holders become more sensitive to the fact that authorized sales can exhaust their patent rights and bar suits against third parties, patent holders may seek higher royalties and damage awards. While neither *Quanta* nor *TransCore* specifically addresses the issue of damage awards, commentators have noted that under the reasoning of these cases the patent exhaustion doctrine could be applied to non-voluntary agreements enforced by courts as well as negotiated agreements between parties.

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