TransCore, LP v. Electronic Transaction Consultants Corp. —

The Federal Circuit Invokes Patent Exhaustion Based on an Unconditional Covenant Not to Sue

Patent exhaustion has received significant attention of late, stemming from the Supreme Court's 2008 *Quanta* decision, which restated the longstanding doctrine that an initial *authorized sale* of a patented item, whether by the patent owner or its licensee, exhausts the patent rights embodied in the sold item. *Quanta Computer, Inc. v. LG Electronics, Inc.*, 128 S. Ct. 2109, 2121 (2008). In *Quanta*, the authorized sales were made pursuant to a license agreement between the patent owner, LG, and its licensee, Intel. In *TransCore, LP v. Electronic Transaction Consultants Corp.*, No. 2008-1430 (Fed. Cir. Apr. 8, 2009), the Federal Circuit addressed the question of whether a covenant not to sue is equivalent to a non-exclusive patent license for purposes of patent exhaustion. Following closely in *Quanta*'s footsteps, the Federal Circuit held that "an unconditional covenant not to sue" *does* authorize sales "by the covenantee for purposes of patent exhaustion."

In 2001, TransCore, a maker of automatic vehicle ID systems with patents covering automated toll collection systems (e.g., E-ZPass), settled a lawsuit with competitor Mark IV Industries ("Mark IV") by entering into an unconditional covenant not to sue Mark IV. Several years later, Electronic Transaction Consultants ("ETC") installed and tested a toll system for the Illinois State Toll Highway Authority that was purchased from Mark IV. TransCore sued ETC in the Northern District of Texas for allegedly infringing patents covered under the TransCore-Mark IV settlement agreement. On summary judgment, the district court dismissed TransCore's patent infringement suit with prejudice, barring the claims based on patent exhaustion, implied license, and legal estoppel. 2008 WL 2152027 (N.D. Tex. May 22, 2008).

On appeal, TransCore argued that its unconditional covenant not to sue Mark IV did not authorize the sale of the patented products because it only provided a promise not to sue, not a license or permission to sell. The Federal Circuit rejected the distinction between a covenant not to sue and a nonexclusive patent license:

> [A] patent does not provide the patentee with an affirmative right to practice the patent but merely the right to exclude. It follows, therefore, that a patentee, by license or otherwise, cannot convey an affirmative right to practice a patented invention by way of making, using, selling, etc.; the patentee can only convey a freedom from suit.

The court explained that the question is not whether an agreement is framed as a "covenant not to sue" or a "license"—what matters is whether the agreement *authorizes sales*. The court concluded that a covenant not to sue "for future infringement," without further restriction, "thus authorizes all acts that would otherwise be infringements: making, using, offering for sale, selling, or importing." The court pointed out that TransCore could have limited this authorization (e.g., to just "making" or "using") but did not in fact do so.

The Federal Circuit's decision relied heavily on *Quanta*, which found patent exhaustion where the licensee had an unrestricted right to make, use, and sell. *Quanta*, 128 S. Ct. at 2121. Notably, the license in *Quanta* was

phrased as a grant of affirmative rights, including the right to sell. The *TransCore* court, however, relying on Supreme Court and Federal Circuit precedent, explained that such a license grant passes no affirmative rights under the patent but is merely a waiver of the right to sue by the patent owner.

In another parallel to *Quanta*, where the Supreme Court discounted an express disclaimer of license rights to third party customers as "irrelevant" to the patent exhaustion analysis, the *TransCore* court also noted that the parties' intent with respect to downstream customers was immaterial to its patent exhaustion analysis:

> 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.

Having concluded that the unconditional covenant not to sue in the settlement agreement unambiguously authorized Mark IV's sales without restriction, and therefore exhausted TransCore's patent rights, the Federal Circuit affirmed the district court's grant of summary judgment and dismissal of TransCore's infringement claims against ETC.

The *TransCore* decision highlights the Federal Circuit's renewed interest in addressing patent exhaustion issues following the Supreme Court's *Quanta* decision. Patent holders and license holders may want to diligently review their existing covenants not to sue for potential exhaustion issues.

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