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# RAZOR SLASHED PRICES: THE APPLICABILITY OF PATENT EXHAUSTION TO SALES FOR BELOW COST

DANIEL HUTTLE<sup>†</sup>

## INTRODUCTION

Around the time of their eighteenth birthday, many young adults are hoping to receive a car to use for the remainder of high school into college or their careers. However, young men often receive an unsolicited surprise gift of a new Gillette razor in the mail around this time. While the benefit of a free razor to the recipient is obvious, the direct benefit to the manufacturer is less so. Besides the value as a marketing tool, the company can use this promotion as a way to not only recoup the costs of the freely given razor, but also profit in the long-term. This can be achieved in the medium to long-term through the sale of the compatible blade cartridges at a much higher price than they cost to produce.

This strategy of selling goods or services is known as the “metered” pricing model.<sup>1</sup> This is also referred to as the “Razors-and-Blades” model which is sometimes incorrectly attributed to King C. Gillette.<sup>2</sup> The concept is that by selling an initial good or service for a very low price, the universe of customers willing to purchase the product increases.<sup>3</sup> Any losses incurred from the

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<sup>1</sup> Ricard Gil & Wesley R. Hartmann, *Empirical Analysis of Metering Price Discrimination: Evidence from Concession Sales at Movie Theaters*, 28 *MARKETING SCI.* 1046, 1046 (2009).

<sup>2</sup> Randal C. Picker, *The Razors-and-Blades Myth(s)*, 78 *U. CHI. L. REV.* 225, 227 (2011) (“The first [myth] is that Gillette invented razors-and-blades and gave away or sold low-priced handles to sell high-priced blades.”).

<sup>3</sup> See Gil & Hartmann, *supra* note 1.

first transaction can be overcome by selling goods or services needed by the initial product for a much higher price than they cost to produce.<sup>4</sup>

In the original example, Gillette loses money on production and shipping of the razor for free in the hope that the recipient becomes a customer for blades—sold for much higher than the cost to produce—in order to continue using the device. This is a viable strategy assuming that Gillette has a patent on both the razor and the blades, as no one will be able to compete in the blade market for the duration of that patent. However, suppose the blade is not patented, or the patent was later invalidated. In that situation, absent some other patent protection, competition in the market for blades would drive prices down to the cost of production. This would prevent Gillette from recouping its costs under this model, making it an economically unsound course of action.

In *LifeScan Scotland, Ltd. v. Shasta Technologies, LLC*,<sup>5</sup> the Federal Circuit heard, in a matter of first impression, whether a patentee should retain rights to control the use of a good distributed for free in a manner similar to the Gillette example.<sup>6</sup> The suit involved a method patent<sup>7</sup> to test blood glucose levels for diabetics.<sup>8</sup> LifeScan manufactures a product utilizing this method called the “OneTouch Ultra” blood glucose meter.<sup>9</sup> In marketing these meters, forty percent are sold for below cost and sixty percent are distributed for free.<sup>10</sup> The goal of this strategy is to later profit from the sale of compatible test strips, which are required to use the meter.<sup>11</sup> Shasta manufactures a test strip designed to work in the LifeScan meter, which led LifeScan to file a civil suit.<sup>12</sup> LifeScan claimed that Shasta committed

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<sup>4</sup> Picker, *supra* note 2, at 226.

<sup>5</sup> 734 F.3d 1361 (Fed. Cir. 2013).

<sup>6</sup> *Id.* at 1374.

<sup>7</sup> A method patent, also called a process patent, protects “an operation or series of steps leading to a useful result.” DONALD S. CHISUM, 1 CHISUM ON PATENTS § 1.03 (Matthew Bender 2015). The other broad category of utility patents is for specific tangible products including machines, manufactures, and compositions of matter. *Id.* § 1.02.

<sup>8</sup> *LifeScan*, 734 F.3d at 1363–64.

<sup>9</sup> *Id.* at 1364.

<sup>10</sup> *Id.* at 1365.

<sup>11</sup> *Id.*

<sup>12</sup> *Id.*

contributory infringement<sup>13</sup> by selling test strips designed to work with its meters, which embodied their patented method of testing blood glucose.<sup>14</sup>

Despite the lack of profit made on sales of the meters, the Federal Circuit held that the policy of patent exhaustion applies in circumstances where products are given away for free or sold below cost.<sup>15</sup> Patent exhaustion is a common law doctrine which has historically stated that once a patentee has sold a patented good for its full value, he loses the ability to control the use and sale of that particular article on patent grounds.<sup>16</sup> The concept of the doctrine being applied to goods distributed for free—rather than being sold—is a matter of first impression for the Federal Circuit.<sup>17</sup> The court expanded the doctrine to cover all transfers of title, not just sales to purchasers for the full value of the patented article.<sup>18</sup> This holding is binding precedent in all United States District Courts because, unlike most areas of law, the Federal Circuit is designated by statute as the sole court of appeals for patent cases.<sup>19</sup>

This Note addresses whether this expansion of patent exhaustion is necessary or justified. Part I provides a background on the relevant doctrines and concepts implicated by the *LifeScan* decision. This Part begins with a discussion on the history and development of the patent exhaustion doctrine under the common law. This Part also introduces the antitrust concept of tying and how it relates to patent misuse. Part II considers whether patent exhaustion should be applied to both goods distributed for no cost and goods sold below the cost to produce. Part III analyzes the anticompetitive potential of refusing to extend patent exhaustion in both of these situations, and discusses the application of the doctrine of patent misuse in

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<sup>13</sup> “The seller is liable as a contributory infringer if he knows that the component is ‘especially made or especially adapted for use in an infringement of such patent’ and if the component is ‘not a staple article or commodity of commerce suitable for substantial noninfringing use.’” CHISUM, *supra* note 7, § 17.01.

<sup>14</sup> *LifeScan*, 734 F.3d at 1365.

<sup>15</sup> *Id.* at 1377.

<sup>16</sup> *See infra* Part I.A.

<sup>17</sup> *LifeScan*, 734 F.3d at 1374.

<sup>18</sup> *Id.* at 1377.

<sup>19</sup> 28 U.S.C. § 1295(a)(1) (2012). Patent cases may only be initiated in United States District Courts. 28 U.S.C. § 1338(a) (2012).

such circumstances. Finally, Part IV analyzes a hypothetical situation where the concerns created by the expansion of patent exhaustion are put into sharper focus.

The Note concludes that the Federal Circuit's extension of patent exhaustion is not consistent with United States Supreme Court jurisprudence on the matter. Further, this refocus on transfers of title instead of sales for fair value causes problems to the metered pricing model, which may lead to unintended harms to both consumers and manufacturers of patented goods. Finally, this Note argues that any anticompetitive results that might arise from a failure to expand patent exhaustion in such a way are mitigated by the existing doctrine of patent misuse. To begin, the evolution of both patent exhaustion and patent misuse must be discussed.

## I. BACKGROUND ON THE RELEVANT DOCTRINES AND CONCEPTS

### A. *The Common Law Development of Patent Exhaustion*

Generally speaking, obtaining a patent for an invention “confers the right to exclude others from making, using, or selling the claimed invention in the United States for a term of . . . years.”<sup>20</sup> A patentee may bring a lawsuit against anyone who either directly or indirectly infringes upon any of these rights under the patent.<sup>21</sup>

Under the common law doctrine of patent exhaustion, often referred to as “first sale” doctrine, once a patentee has sold a patented good he has exhausted his ability to control the use, resale, or repair of the particular article.<sup>22</sup> There are two general public policies that justify limiting the general principle of patent law in this way. First is the common law's strong stance against barriers to the free alienation of property.<sup>23</sup> Second is the risk that placing such conditions on trade may implicate antitrust concerns.<sup>24</sup> Since a patent infringement action can be sought against anyone who knowingly contributes to the infringement of

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<sup>20</sup> CHISUM, *supra* note 7, § OV.1.

<sup>21</sup> *Id.*

<sup>22</sup> *Id.* § 16.03(2)(a).

<sup>23</sup> Herbert Hovenkamp, *Post-Sale Restraints and Competitive Harm: The First Sale Doctrine in Perspective*, 66 N.Y.U. ANN. SURV. AM. L. 487, 493 (2011); *see also* Amelia Smith Rinehart, *Contracting Patents: A Modern Patent Exhausting Doctrine*, 23 HARV. J.L. & TECH. 483, 492 (2010).

<sup>24</sup> Rinehart, *supra* note 23.

others—with no limitation from privity of contract—there can be serious anticompetitive consequences if there were no such restriction available.<sup>25</sup>

The Supreme Court's decision in *Bloomer v. McQuewan*<sup>26</sup> is generally regarded as the origin of the patent exhaustion doctrine.<sup>27</sup> Chief Justice Taney framed the rights given by the patent for a planing machine as a monopoly by the patentee, who could share a portion of such monopoly with his licensees.<sup>28</sup> The Court held that a distinction exists between a licensee and one who purchases a good whose only value is in its use from the patentee in a lawful sale.<sup>29</sup> Once such a sale occurs, the patented article “passes outside of [the monopoly], and is no longer under the protection of the act of Congress.”<sup>30</sup>

The Supreme Court refined the concept two decades later in *Adams v. Burke*.<sup>31</sup> This case dealt with a patent for coffin lids where the patentee gave his licensee the right to manufacture, use, and sell these lids in a limited geographic area.<sup>32</sup> The question presented to the Court was whether a purchaser who had bought such a lid from the licensee within his region had the right to use the lid in a burial outside of that region.<sup>33</sup> The Court held that even though the assignee had a limitation on the region in which he was authorized to sell the lids, a purchaser of a patented good whose sole function is its use has the right to use the good regardless of any restrictions on an assignee.<sup>34</sup> The patentee no longer has the right to restrict the use of the good when he has “in the act of sale received all the royalty or consideration” for that good.<sup>35</sup>

Both *Bloomer* and *Adams* were further interpreted by the Supreme Court in *Keeler v. Standard Folding Bed Co.*<sup>36</sup> There, the patentee assigned the right to sell his patented folding beds

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<sup>25</sup> See Hovenkamp, *supra* note 23, at 492.

<sup>26</sup> 55 U.S. 539 (1852).

<sup>27</sup> Alfred C. Server & William J. Casey, *Contract-Based Post-Sale Restrictions on Patented Products Following Quanta*, 64 HASTINGS L.J. 561, 564 (2013).

<sup>28</sup> *Bloomer*, 55 U.S. at 549.

<sup>29</sup> *Id.*

<sup>30</sup> *Id.*

<sup>31</sup> 84 U.S. 453 (1873).

<sup>32</sup> *Id.* at 456.

<sup>33</sup> *See id.* at 457.

<sup>34</sup> *Id.* at 456–57.

<sup>35</sup> *Id.* at 456.

<sup>36</sup> 157 U.S. 659 (1895).

within Michigan to an assignee.<sup>37</sup> This assignee sold to defendants a carload of the patented beds, which defendants later took to Massachusetts to resell for their own profit.<sup>38</sup> In reversing the decisions of the lower courts, the Supreme Court held that a purchaser who purchases patented goods from someone authorized to sell such goods gains an “absolute property” right in the goods purchased, “unrestricted in time or place.”<sup>39</sup> This included freedom from restrictions on both use and sale.<sup>40</sup> The Court also explicitly stated that the patentee’s rights are not deprived “because no article can be unfettered from the claim of his monopoly without paying its tribute.”<sup>41</sup>

This justification for the limitation on the patentee’s rights continued into the twentieth century. In *United States v. Univis Lens Co.*,<sup>42</sup> the purpose of the limited monopoly granted by patent law was said to enable the inventor “to secure the financial rewards for his invention.”<sup>43</sup> The Court held that “the purpose of the patent law is fulfilled with respect to any particular article when the patentee has received his reward for the use of his invention by the sale of the article.” Therefore, there is no patent law basis for further restraining the use of that particular article.<sup>44</sup> Even in its most recent case on exhaustion, the Supreme Court still framed the discussion in terms of sale.<sup>45</sup> The Federal Circuit, save its decision in *LifeScan*, has also consistently framed its discussions on exhaustion in this way.<sup>46</sup>

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<sup>37</sup> *Standard Folding Bed Co. v. Keeler*, 37 F. 693, 693–94 (C.C.D. Mass. 1889), *rev’d*, 157 U.S. 659 (1895).

<sup>38</sup> *Id.* at 694.

<sup>39</sup> *Keeler*, 157 U.S. at 666.

<sup>40</sup> *Id.* at 664.

<sup>41</sup> *Id.* at 666–67.

<sup>42</sup> 316 U.S. 241 (1942).

<sup>43</sup> *Id.* at 250.

<sup>44</sup> *Id.* at 251.

<sup>45</sup> *See Quanta Computer, Inc. v. LG Elecs., Inc.*, 553 U.S. 617, 638 (2008) (“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.”).

<sup>46</sup> *See, e.g., B. Braun Med., Inc. v. Abbott Labs.*, 124 F.3d 1419, 1426 (Fed. Cir. 1997) (“The theory behind [patent exhaustion] is that in such a transaction, the patentee has bargained for, and received, an amount equal to the full value of the goods.”).

*B. Patent Misuse in the Context of Antitrust Tying*

Patent misuse<sup>47</sup> arose under common law as a defense to patent infringement when the patentee engaged in conduct which constitutes “misuse” of the patent.<sup>48</sup> To succeed on this defense, the patentee must have “impermissibly broadened the ‘physical or temporal scope’ of the patent grant with anticompetitive effect.”<sup>49</sup>

The doctrine of patent misuse was first adopted by the Supreme Court in *Motion Picture Patents Co. v. Universal Film Manufacturing Co.*<sup>50</sup> This case involved a patented motion picture projector which came affixed with a notice limiting its use to only films which were authorized by the patent holder.<sup>51</sup> The Supreme Court struck down this restriction as invalid because the film itself was not part of the patented invention of the projector.<sup>52</sup> In the eyes of the Court, to not strike down such a provision would give “such a potential power for evil” that would be “gravely injurious” to the public interest.<sup>53</sup> To broaden the patent right in such a way would be an unacceptable result, completely outside “the scope and purpose of our patent laws.”<sup>54</sup>

The restriction imposed in *Motion Picture Patents Co.* is an example of a “tying” arrangement. Tying is a term of art in antitrust law describing an agreement to sell one product—the tying product—on the condition that the purchaser also buys a different product—the tied product.<sup>55</sup> Until a 1988 amendment to the patent infringement statute, the act of tying a patented good to the sale of an unpatented staple product constituted per se patent misuse.<sup>56</sup> “[A] staple article is one that has substantial non-infringing uses. A non-staple article is one which is specially

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<sup>47</sup> For the purposes of this Note, the discussion of patent misuse is limited to its application to the antitrust concept of tying. Patent misuse is a broad concept which applies to many other types of activities which are not relevant to the discussion here.

<sup>48</sup> CHISUM, *supra* note 7, § 19.04.

<sup>49</sup> *Windsurfing Int'l, Inc. v. AMF, Inc.*, 782 F.2d 995, 1001 (Fed. Cir. 1986) (quoting *Blonder-Tongue Labs., Inc. v. Univ. of Ill. Found.*, 402 U.S. 313, 343 (1971)).

<sup>50</sup> 243 U.S. 502 (1917).

<sup>51</sup> *Id.* at 505–06.

<sup>52</sup> *Id.* at 518.

<sup>53</sup> *Id.* at 519.

<sup>54</sup> *Id.*

<sup>55</sup> *N. Pac. Ry. Co. v. United States*, 356 U.S. 1, 5–6 (1958).

<sup>56</sup> Kenneth J. Burchfiel, *Patent Misuse and Antitrust Reform: “Blessed Be the Tie?”* 4 HARV. J.L. & TECH. 1, 1–2 (1991).

made or adapted for use in infringement of a patent and which has no substantial non-infringing uses.”<sup>57</sup> The rationale behind the judicially created per se rule against tying was grounded in an attempt to restrict patentees from using their rights to gain an unfair advantage in the marketplace of goods beyond the scope of the patent.<sup>58</sup>

The Patent Misuse Reform Act of 1988 added, in relevant part:

No patent owner otherwise entitled to relief for infringement or contributory infringement of a patent shall be denied relief or deemed guilty of misuse or illegal extension of the patent right by reason of his having . . . conditioned the license of any rights to the patent or the sale of the patented product on the acquisition of a license to rights in another patent or purchase of a separate product, unless, in view of the circumstances, the patent owner has market power in the relevant market for the patent or patented product on which the license or sale is conditioned.<sup>59</sup>

This action by Congress limited the original rule against tying to only apply if the patentee has “market power” in the market of the tying product.<sup>60</sup> When determining the existence of market power, the existence of the patent is relevant to the analysis but is generally not in itself sufficient to presume that market power exists.<sup>61</sup> “Market power is determined by whether the seller has the power ‘to raise prices, or impose other burdensome terms such as a tie-in, with respect to any appreciable number of buyers within the market.’ ”<sup>62</sup>

Another area where tying arrangements have historically constituted patent misuse is in the context of contributory infringement actions.<sup>63</sup> This situation often arises when a third party manufactures component parts designed specifically for use in a patented device or machine.<sup>64</sup> The specific design of these

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<sup>57</sup> THOMAS V. VAKERICS, ANTITRUST BASICS § 11.02 (2015).

<sup>58</sup> C.R. Bard, Inc. v. M3 Sys., Inc., 157 F.3d 1340, 1372 (Fed. Cir. 1998).

<sup>59</sup> 35 U.S.C. § 271(d) (2012).

<sup>60</sup> HERBERT HOVENKAMP ET AL., IP AND ANTITRUST: AN ANALYSIS OF ANTITRUST PRINCIPLES APPLIED TO INTELLECTUAL PROPERTY LAW § 3.3a1 (CCH Inc., 2014).

<sup>61</sup> HERBERT HOVENKAMP ET AL., IP AND ANTITRUST: AN ANALYSIS OF ANTITRUST PRINCIPLES APPLIED TO INTELLECTUAL PROPERTY LAW § 3.2 (CCH Inc., 2010).

<sup>62</sup> Burchfiel, *supra* note 56, at 28 (quoting Fortner Enters. v. U.S. Steel Corp., 394 U.S. 495, 504 (1969)).

<sup>63</sup> HOVENKAMP ET AL., *supra* note 60, § 3.3a2.

<sup>64</sup> *Id.*

parts to work with the patented machine, as opposed to a part common to an entire class of devices, makes the part a nonstaple good.<sup>65</sup> The Supreme Court has held that a patentee misused his patent by attempting to control third-party sales of component parts, even nonstaple goods, for use in the patented device.<sup>66</sup>

Additions made in the 1952 Patent Act<sup>67</sup> served to reverse these decisions and restrict the boundaries of patent misuse.<sup>68</sup> This amendment allows a patentee “to require its licensees to purchase non-staple goods only from it, and to sue makers of those non-staple goods for contributory infringement, without liability for misuse.”<sup>69</sup> Further, the patentee is permitted to enforce his rights against contributory infringers without concern that such an action would be a misuse of his patent right.<sup>70</sup>

With this introduction to the long histories of both patent exhaustion and patent misuse, the applicability of these doctrines to the *LifeScan* case can now be discussed. First, the Federal Circuit’s holding that patent exhaustion applies to all transfers of title needs to be examined.

## II. PATENT EXHAUSTION SHOULD NOT APPLY TO GOODS SOLD BELOW COST

There are two major concerns arising from the Federal Circuit holding that goods distributed for free or sold below cost are subject to patent exhaustion as authorized transfers of title.<sup>71</sup> First, this expansion of patent exhaustion doctrine is not consistent with the Supreme Court’s jurisprudence on the doctrine.<sup>72</sup> Second, such a harsh rule may present unanticipated negative effects on both consumers and patentees.<sup>73</sup> These two issues demonstrate that such an expansion might not be a

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<sup>65</sup> *Id.*

<sup>66</sup> *Id.*; see also *Mercoid Corp. v. Mid-Continent Inv. Co.*, 320 U.S. 661 (1944); *Mercoid Corp. v. Minneapolis-Honeywell Regulator Co.*, 320 U.S. 680 (1944).

<sup>67</sup> 35 U.S.C. § 271(d)(1)–(3) (2012).

<sup>68</sup> HOVENKAMP ET AL., *supra* note 60, § 3.3a2.

<sup>69</sup> *Id.*; see also *Dawson Chem. Co. v. Rohm & Haas Co.*, 448 U.S. 176, 201 (1980) (rejecting a patent misuse defense for a third-party seller of an unpatented, nonstaple chemical whose sole use is in the patentee’s method for treating weeds).

<sup>70</sup> 35 U.S.C. § 271(d)(3) (2012).

<sup>71</sup> *LifeScan Scot., Ltd. v. Shasta Techs., LLC*, 734 F.3d 1361, 1377 (Fed. Cir. 2013).

<sup>72</sup> See *infra* Part II.A.

<sup>73</sup> See *infra* Part II.B.

prudent course to take, especially in light of the availability of existing patent misuse doctrine to prevent anticompetitive acts that may result from failing to expand patent exhaustion.<sup>74</sup>

A. *The Federal Circuit's Expansion of Patent Exhaustion Is Not Consistent with the Prior Precedent of the Supreme Court*

When discussing transactions that trigger an exhaustion of a patentee's rights, the Supreme Court and Federal Circuit have consistently framed the requirements as an authorized sale to a purchaser for fair value or consideration.<sup>75</sup> The Federal Circuit's decision in *LifeScan* adds two additional categories of transactions to the definition: goods distributed for free and goods sold for below the cost of production.<sup>76</sup> To expand the scope of exhaustive transactions to anyone in which title is transferred redefines the entire concept of such a transaction. While the category of goods distributed for free has a stronger argument that patent exhaustion should not apply, both categories ultimately lack consistency with the historical development of the doctrine.<sup>77</sup>

The first requirement to trigger exhaustion of the patent right—that a “sale”<sup>78</sup> occurs—is not met for goods distributed for free. This requirement is so fundamental to a qualifying transaction that patent exhaustion is also known as the doctrine of “first sale.”<sup>79</sup> By plain meaning of the word sale, one does not consider a freely given good to have been sold. This is true even by the legal definition of the word, meaning “[t]he transfer of property or title for a price.”<sup>80</sup>

It is possible that the reason the Supreme Court used the term “sale” is that the Court never had the opportunity to hear a patent exhaustion dispute regarding transfers of title in a

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<sup>74</sup> See *infra* Part III.

<sup>75</sup> See *supra* Part I.A.

<sup>76</sup> Freely distributed meters constituted sixty percent of all transfers of title in that case, while the remaining forty percent were sold below the cost to produce. Both categories of transaction were held to exhaust the patentee's rights. *LifeScan*, 734 F.3d at 1365, 1377.

<sup>77</sup> It was for this reason that the true focus of analysis for the Federal Circuit in *LifeScan* was on the freely distributed meters.

<sup>78</sup> See, e.g., *Quanta Computer, Inc. v. LG Elecs., Inc.*, 553 U.S. 617, 625, (2008); *United States v. Univis Lens Co.*, 316 U.S. 241, 250 (1942); *Adams v. Burke*, 84 U.S. 453, 456 (1873).

<sup>79</sup> CHISUM, *supra* note 7, § 16.03(2)(a).

<sup>80</sup> BLACK'S LAW DICTIONARY 1537 (10th ed. 2014) (definition of “sale”).

patented article without cost. While that may explain why the Court has not expanded the definition of patent exhaustion, it does not change the fact that the Court's 150 years of jurisprudence on the matter has consistently required a sale to occur. This means that any decision that alters that definition by a lower court—even one with so unique a position as the Federal Circuit<sup>81</sup>—should be heavily scrutinized.

A similar result is reached when discussing the second requirement, that the recipient be a “purchaser.”<sup>82</sup> Under the same plain meaning consideration, it is not common usage to refer to the recipient of a free good as a purchaser. The legal definition agrees, describing a purchaser as “[s]omeone who obtains property for money or other valuable consideration; a buyer.”<sup>83</sup> In light of both plain meaning and the legal definition, it is difficult to justify calling the recipient of a freely distributed good a purchaser. Once again, the Supreme Court would be in the best position to decide whether to extend its standard for exhaustive transactions to not require a purchaser.

In contrast to goods distributed for free, the concepts of sale and purchaser do fit a transaction where the good was sold for below cost. Such an exchange involves a vendor that sells the good for a price in money, despite that price being less than the cost the vendor incurred to produce that good. By paying a price in money for the property, the recipient is also within the definition of a purchaser. However, in both freely distributed and below cost transactions, the third requirement is problematic.

Unlike “sale” and “purchaser,” the third requirement for an exhaustive transaction is less clearly defined than the other two. The Supreme Court has referred to this in earlier cases as when “the patentee . . . received all the royalty or consideration”<sup>84</sup> or “a valuable consideration.”<sup>85</sup> The Federal Circuit itself has interpreted this as meaning “the patentee has bargained for, and

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<sup>81</sup> The Federal Circuit is the sole court of appeals for patent cases arising from any United States District Court. 28 U.S.C. § 1295(a)(1) (2012).

<sup>82</sup> *See, e.g., Keeler v. Standard Folding Bed Co.*, 157 U.S. 659, 664 (1895); *Adams*, 84 U.S. at 456; *B. Braun Med., Inc. v. Abbott Labs.*, 124 F.3d 1419, 1426 (Fed. Cir. 1997).

<sup>83</sup> BLACK'S LAW DICTIONARY 1430 (10th ed. 2014) (definition of “purchaser”).

<sup>84</sup> *Adams*, 84 U.S. at 456.

<sup>85</sup> *Keeler*, 157 U.S. at 661.

received, an amount equal to the full value of the goods.”<sup>86</sup> The rationale for this requirement is that patent exhaustion limits the right of the patentee to control a sold patented article because the patentee has received his reward under patent law for the article sold.<sup>87</sup>

To hone in on what full value means in light of this rationale, it is important to consider the overarching goals of intellectual property law and patent law. The predominant theory justifying intellectual property protection is utilitarian in nature.<sup>88</sup> In the open market, the only reason an inventor would invest the time and money necessary to develop a new invention is if the profits to be made exceed those initial costs.<sup>89</sup> However, once the idea behind the invention is discovered, competition will drive costs down to their marginal cost, preventing the inventor from recouping the costs of developing the invention.<sup>90</sup> Intellectual property law lessens this outcome, encouraging others to invent new products by giving them the tools to prevent others from copying them, which increases the chances of both recouping costs and profiting on the initial investment.<sup>91</sup> Since increasing the likelihood of an inventor recouping research and development time as well as eventually profiting are the aims of the system of intellectual property laws, patent exhaustion doctrine should be consistent with those goals.

The next step is to see if application of patent exhaustion when a good is sold below cost sacrifices this goal on individual articles in order to promote the free alienation of property. To determine if this “full value” of the goods has been received by the patentee, two timeframes need to be examined. First, the value received at the time of the transaction must be determined. In addition to that, any value that may be acquired posttransaction as a result of the transaction must also be considered.

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<sup>86</sup> *B. Braun Med., Inc.*, 124 F.3d at 1426.

<sup>87</sup> *United States v. Univis Lens Co.*, 316 U.S. 241, 251 (1942).

<sup>88</sup> ROBERT P. MERGES ET AL., *INTELLECTUAL PROPERTY IN THE NEW TECHNOLOGICAL AGE* 11 (6th ed. 2012).

<sup>89</sup> *Id.* at 12.

<sup>90</sup> Ariel Katz, *Making Sense of Nonsense: Intellectual Property, Antitrust, and Market Power*, 49 ARIZ. L. REV. 837, 841 (2007).

<sup>91</sup> *Id.*

At the time of the transaction—whether it concerns a good distributed for free or one sold for below cost—it cannot be said that the full value of the article has been received absent some consideration of future profits. If the article was distributed for free, no monetary value was gained at the time of transaction. This cannot be said to have granted the full value of the article without going into needlessly subjective analysis over the good feelings received by the patentee.<sup>92</sup> The same can be said for the value if the good is sold for below cost. If the price paid for the article is less than its cost to produce it, for each transaction the patentee would be losing the difference between the two prices. If, at least at the time of transaction, each sale causes the patentee to lose more and more money, the goal of increasing likelihood of profitability can hardly be said to have been met at this point.<sup>93</sup>

If the full value of the patented article has not been received at the time of the transaction, there must be some posttransaction reward that justifies applying patent exhaustion. Looking to the introductory example of giving away razors to make profit on the blades, that would constitute such a scenario in theory, as the blades are sold at a higher profit margin than the razors. However, there is a potential problem with this method in practice. Assuming a competitor enters the market for the profitable blades, the price of the blades would be reduced via competition towards the marginal cost to produce them, which would destroy the ability of the seller to both recoup his investment and eventually profit.<sup>94</sup> This would lead the seller to default back to selling the initial good at a much higher price instead, which, as discussed later in this Note, causes potential problems for both the seller and prospective buyers.<sup>95</sup>

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<sup>92</sup> *Cf.* Kirksey v. Kirksey, 8 Ala. 131 (1845) (holding that under contract law, a promise to a close family member that would make the promisor feel better does not constitute consideration).

<sup>93</sup> Katz, *supra* note 90.

<sup>94</sup> *See id.*

<sup>95</sup> *See infra* Part II.B.

To prevent this outcome, the seller would need some way to block competitors out of the market.<sup>96</sup> If both the razor and the blades were patented, the patentee would be able to use his right to exclude others from selling the patented good to prevent the competitor from entering the market for the term of the patent.<sup>97</sup> However, the situation changes if only the original, below-cost good is patented, while the profitable good is not. These were the circumstances surrounding *LifeScan*, where the blood glucose meter was found to embody the method patent but the profitable test strips did not.<sup>98</sup>

In the situation where the profitable good is not patented, whether the full value of the good is received to justify patent exhaustion depends, ironically, on whether patent exhaustion is applied. If patent exhaustion does not apply—assuming the patent is not being misused<sup>99</sup>—the patentee can file suit against the competitor for contributory infringement of its patent for selling the profitable good to be used with the patented good.<sup>100</sup> This would lead the patentee to getting the full value of the good. However, if patent exhaustion does apply, the original concern of a competitor driving down prices to their marginal costs occurs, preventing the full value of the patented good from being realized postsale.<sup>101</sup>

There is a real consistency problem when comparing the history of Supreme Court jurisprudence on patent exhaustion with the proposed expansion by the Federal Circuit. For goods distributed for free, there is no sale, purchaser, or full value received for the article if exhaustion is applied. While there is a sale and a purchaser for goods sold for below their costs to produce, such a sale would not give the full value of the article if

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<sup>96</sup> Picker, *supra* note 2, at 226. Professor Picker also mentions loyalty as a way to profit off the sale of the blades; however, the focus of this Note is limited to whether the value of the goods can be attained without some level of patent protection due to exhaustion.

<sup>97</sup> CHISUM, *supra* note 7, § OV.1 (“A patent confers the right to exclude others from making, using, or selling the claimed invention in the United States for a [specified] term . . .”).

<sup>98</sup> *LifeScan Scot., Ltd. v. Shasta Techs., LLC*, 734 F.3d 1361, 1371 (Fed. Cir. 2013).

<sup>99</sup> See *infra* Part III.

<sup>100</sup> Hovenkamp, *supra* note 23, at 492 (“By contrast [to contracts, which are limited by privity], infringement actions can run against all who infringe an IP right, and even those who knowingly contribute to the infringements of others.”).

<sup>101</sup> See *supra* notes 94–95 and accompanying text.

exhaustion was applied to limit posttransaction value received. If after applying exhaustion the requirements of the doctrine are not met, its application cannot be justified in these types of circumstances.

*B. The Expansion of Patent Exhaustion Has Likely Negative Effects for the Marketplace*

In addition to the inconsistencies with the history of patent exhaustion jurisprudence, the *LifeScan* decision will likely have unintended consequences for the market. The Federal Circuit stresses that the patentee has a choice for how to secure the reward for his invention.<sup>102</sup> As a result, the patentee cannot use the failure to gain a reward resulting from the choice to distribute a good for free to circumvent patent exhaustion.<sup>103</sup> However, in expanding exhaustion in such a way in order to prevent public harm by patentees asserting control over the purchaser's use of the product, there is the risk of potential harms to both patentee and the end consumer.

The most obvious harm by expanding patent exhaustion is to the patentee. The problem is that the patentee is deprived of his rights in the patent monopoly of the article without receiving the full value of the article.<sup>104</sup> While the Federal Circuit argues this is the patentee's choice,<sup>105</sup> there are legitimate business reasons to go about such transactions that can have benefits to both the patentee and the consumers in the market.

To properly analyze this situation, the concept of metered pricing must be examined. The metered pricing model works by selling an initial good or service below market price, usually at or below the cost to produce or provide the good or service, while a secondary good or service that is required to use or enhances the use of the original product is sold for a premium.<sup>106</sup> The most commonly cited example is razors and razor blades, where the razors are given away or sold very cheaply in order to create a market for razor blades, which are required to use the razor, need to be periodically replaced, and are sold at a large profit

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<sup>102</sup> *LifeScan*, 734 F.3d at 1375.

<sup>103</sup> *Id.*

<sup>104</sup> *See supra* Part II.A.

<sup>105</sup> *LifeScan*, 734 F.3d at 1375.

<sup>106</sup> *See Gil & Hartmann, supra* note 1.

margin.<sup>107</sup> The costs that are incurred by distributing the razors so cheaply are recouped and then exceeded by subsequent sales of the blades.<sup>108</sup> Modern examples using this sales model include printers with ink, e-book readers with e-books, video game consoles with games, and movie tickets with concessions.<sup>109</sup>

This concept of metered selling has the ability to increase efficiency for the seller.<sup>110</sup> Take the example of movie tickets and high concession prices.<sup>111</sup> Due to the high prices, only a subset of consumers will purchase concessions, but each of those sales will be highly profitable.<sup>112</sup> Absent these highly profitable concession sales, the movie theatre would likely need to raise ticket prices in order to maintain the same profits.<sup>113</sup> This would cause some customers to be “priced out of the market,” leading to less total volume of customers. By lowering the up-front cost, more total customers will purchase tickets, with higher profits extracted from the subset of customers that purchase the higher priced concessions.<sup>114</sup>

By applying patent exhaustion to goods distributed for free or sold below cost as a per se rule, the model breaks down. Absent some level of patent protection, the patentee will be unable to prevent competition from lowering the price of the secondary product to the cost of production.<sup>115</sup> This consequence disincentivizes the patentee from using a business model that can simultaneously promote efficiency by increasing the total universe of available customers for the seller and increasing access to the good for buyers<sup>116</sup> and increase the likelihood of the patentee profiting from his invention.

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<sup>107</sup> Picker, *supra* note 2, at 226.

<sup>108</sup> *Id.*

<sup>109</sup> *Id.*; see also Gil & Hartmann, *supra* note 1, at 1046–47.

<sup>110</sup> Gil & Hartmann, *supra* note 1.

<sup>111</sup> *Id.* (using a similar scenario to explain the concept).

<sup>112</sup> See *id.*

<sup>113</sup> *Id.*

<sup>114</sup> See George Anders, *Inside Amazon's Idea Machine: How Bezos Decodes Customers*, FORBES, Apr. 23, 2012, available at <http://www.forbes.com/sites/georgeanders/2012/04/04/inside-amazon/> (“Amazon’s selling price [for the Kindle Fire tablet] of \$199 [does not] appear to cover costs. [Founder and CEO Jeff] Bezos [is not] perturbed. . . . If it induces owners to buy more from Amazon, the costs of spreading these tablets globally will be well worth it.”).

<sup>115</sup> Picker, *supra* note 2, at 226.

<sup>116</sup> Gil & Hartmann, *supra* note 1, at 1046–47.

If the metered pricing model is disincentivized as a result of such an expansion in patent exhaustion, patentees are not the only group who would be harmed. Consumers in the market would also face indirect harm as a result. One of the advantages of metered pricing to consumers is that the initial cost of the initial good or service involved is lower.<sup>117</sup> This reduced up-front cost has the ability to “open access of a good to customers that would otherwise be priced out of the market.”<sup>118</sup>

Going back to the movie theatre example, if concessions were unable to be priced at a premium, in order for the theatre to maintain the previous profit margins the price of tickets would have to be increased to even higher than they are today.<sup>119</sup> This increase would lead to fewer customers buying tickets for movies, which would in turn lead to fewer customers purchasing the concessions as well.<sup>120</sup> This outcome is not beneficial for consumers either, as they will likely see fewer movies as a result, and when they do go to the movies, they will need to pay a higher price for their ticket.

The same result would occur in other examples: more expensive printers with low priced ink, marked up e-book readers with cheaper e-books, and exorbitantly priced video game consoles with more affordable games. This sort of result may benefit some high frequency users, but the average user of any of these products would be less likely to pay the up-front costs due to being priced out of the market.

Patent exhaustion does not fit well when applied to goods distributed for free or sold below cost. There are consistency problems with the Supreme Court’s jurisprudence, as well as unintended harms for both buyers and sellers in the marketplace. At its core, patent exhaustion is the balance of several principles. On one side is the promotion of invention by increasing the ability of an inventor to profit from his invention via the limited monopoly over it.<sup>121</sup> On the other side are two principles. The first is the general public interest in the free alienation of property.<sup>122</sup> While reducing the burdens on innocent

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<sup>117</sup> *Id.*

<sup>118</sup> *Id.* at 1046.

<sup>119</sup> *See id.*

<sup>120</sup> *See id.*

<sup>121</sup> Rinehart, *supra* note 23, at 490.

<sup>122</sup> *Id.* at 492.

purchasers is important,<sup>123</sup> doing so at the cost of losing public access to the new technology due to higher prices makes it less so.

In order to justify an expansion of the doctrine, it would need to be in furtherance of the second competing goal, reducing the anticompetitive effects of postsale restrictions.<sup>124</sup> However, the existing doctrine of patent misuse is more closely tailored to fulfill this need in circumstances where a patented good is sold below cost with the goal of profiting from a related unpatented good.<sup>125</sup> The existence of a body of law which better fits the circumstances raised in the Federal Circuit's decision to expand patent exhaustion demonstrates how unnecessary this expansion is.

### III. PATENT MISUSE WILL BETTER LIMIT THE POTENTIAL NEGATIVE CONSEQUENCES OF FAILING TO APPLY PATENT EXHAUSTION TO GOODS SOLD BELOW COST

In its *LifeScan* decision, the Federal Circuit expressed concerns about the potential impact on market competition resulting from a failure to expand patent exhaustion to goods distributed for free.<sup>126</sup> Permitting LifeScan to conduct business in this way “would be akin to allowing a tying arrangement” that would prevent purchasers from using competing test strips.<sup>127</sup> The court cites to *Motion Picture Patents Co. v. Universal Film Manufacturing Co.*<sup>128</sup> to bolster its concerns.<sup>129</sup>

While the concern that LifeScan would leverage its patent on the meter to gain an unfair advantage in the test strip market is certainly legitimate, this neither requires nor justifies an expansion of patent exhaustion. Instead, this issue points towards an existing solution that originated in *Motion Picture Patents Co.* itself: the doctrine of patent misuse. There are two

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<sup>123</sup> *Id.*

<sup>124</sup> *Id.*

<sup>125</sup> *See infra* Part III.

<sup>126</sup> *LifeScan Scot., Ltd. v. Shasta Techs., LLC*, 734 F.3d 1361, 1373 (Fed. Cir. 2013) (“Rejecting a claim of exhaustion in this case would be particularly problematic because LifeScan would be permitted to eliminate competition in the sale of the strips even though the strips do not embody the claimed invention and are themselves not patentable.”).

<sup>127</sup> *Id.*

<sup>128</sup> 243 U.S. 502 (1917).

<sup>129</sup> *LifeScan*, 734 F.3d at 1373.

tying concerns to address here. The first is whether requiring a purchaser to use LifeScan's unpatented test strips in order to purchase their blood glucose meter is patent misuse. The second is whether it constitutes patent misuse for LifeScan to seek contributory infringement actions against competitors manufacturing test strips compatible with their meters.

A. *Requiring Use of Unpatented Test Strips To Purchase LifeScan's Blood Glucose Meter Did Not Constitute Patent Misuse*

To prove that the tying of a patented good to an unpatented tied good constitutes patent misuse, one must demonstrate that the two products are indeed tied, the tied product is a staple good, and the patentee has market power in the market of the tying product.<sup>130</sup> Using the *LifeScan* facts, it is apparent that a sales model such as LifeScan's alone likely did not constitute patent misuse and, therefore, was within the "physical or temporal scope" of the rights granted by the patent in the meter.<sup>131</sup>

First, it must be determined if the transaction between LifeScan and its customers constituted a tying arrangement. There are two alternative possibilities for details of the transaction, each of which would point to the existence of a tie.<sup>132</sup> If LifeScan had formed contracts with its customers to require them to purchase its test strips at the same time as receiving their meters, and would not give or sell the meters without also selling the test strips, this would fit the classic tying scenario.<sup>133</sup> However, even if the contract specified that purchasers could only use LifeScan's test strips with the device, and did not require purchase at the same time, that would constitute a tie for

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<sup>130</sup> See *supra* Part I.B.

<sup>131</sup> *Blonder-Tongue Labs., Inc. v. Univ. of Ill. Found.*, 402 U.S. 313, 343 (1971).

<sup>132</sup> It is worth noting that the Federal Circuit itself acknowledges that the situation is similar to a tying arrangement. *LifeScan*, 734 F.3d at 1373 ("Allowing LifeScan to control sale of the strips would be akin to allowing a tying arrangement whereby the purchasers of the meters could be barred from using the meters with competing strips.").

<sup>133</sup> *HOVENKAMP ET AL.*, *supra* note 60 ("In patent cases, this classic form of tying involves the insistence by a patent owner that those who would license the patent (or purchase a product covered by the patent) must purchase a separate product not covered by that patent from the patentee.").

purposes of patent misuse.<sup>134</sup> In *Morton Salt Co. v. G.S. Suppiger Co.*,<sup>135</sup> the Supreme Court held that requiring purchasers of a patented machine for depositing salt tablets into cans to purchase the staple salt tablets from the patentee constituted patent misuse.<sup>136</sup> Therefore, even absent an express contract making the sale contingent on the simultaneous purchase of an unpatented staple good, just requiring the future purchase of that staple is sufficient to constitute tying in the context of patent misuse.

Second, it must be determined whether the test strips constituted a staple good. In the context of patent misuse, a good is a nonstaple good if its sole substantial use is in connection with the patented invention, while a good is considered a staple if it has commercial uses other than those related to the patent.<sup>137</sup> This is a fact-finding determination that was not made in the *LifeScan* decision, but one may be able to impute an answer from the determinations made by the court in its exhaustion analysis.

The feature that enabled these test strips to work with the meter was that there were two electrodes instead of one, and one was downstream of the other, which would enable better determinations of errors in detecting blood glucose levels.<sup>138</sup> During the course of prosecution of the original patent with the United States Patent and Trademark Office (“PTO”), the concept of a biosensor containing multiple electrodes was determined to be disclosed in the prior art.<sup>139</sup> This prior art disclosure caused the patent examiner to reject the claims on the test strips themselves, although the method patent for the process of examining blood glucose was allowed.<sup>140</sup> The Federal Circuit asserted, in its exhaustion analysis, that “[t]he fact that the prior art strips might have required some reconfiguration to use with LifeScan’s meters is irrelevant.”<sup>141</sup>

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<sup>134</sup> See *id.* (citing *Morton Salt Co. v. G.S. Suppiger Co.*, 314 U.S. 488 (1942)).

<sup>135</sup> 314 U.S. 488.

<sup>136</sup> *Id.* at 491. This decision predates the addition of the market power requirement to find such a tie.

<sup>137</sup> *VAKERICS*, *supra* note 57.

<sup>138</sup> *LifeScan Scot., Ltd. v. Shasta Techs., LLC*, 734 F.3d 1361, 1369 (Fed. Cir. 2013).

<sup>139</sup> *Id.*

<sup>140</sup> *Id.* at 1369–70.

<sup>141</sup> *Id.* at 1373.

While the level of modification the prior art would need to undergo to be compatible with LifeScan's meter was not relevant to the Federal Circuit's decision, it is highly relevant in determining if Shasta's strips constituted a staple good. The existence of test strips with multiple electrodes in the prior art increases the likelihood that a court would find Shasta's strips as staple goods, but the analysis does not end there. In the entire existing market for test strips, only some portion of them have the multiple working electrodes required by the LifeScan meter.<sup>142</sup> Even then, these multiple electrode test strips lacked the proper layout to be compatible with LifeScan's meter.<sup>143</sup> With this being the case, a court could find that the test strips produced by Shasta lacked "substantial non-infringing uses."<sup>144</sup> Shasta's strips could be considered a nonstaple good as they were designed to work specifically with LifeScan's meters, which suggests that the strips lack any noninfringing use.<sup>145</sup>

Prior to the Patent Misuse Reform Act of 1988, the analysis would have ended there with a determination of whether there was per se misuse or not.<sup>146</sup> However, Congress explicitly limited the original common law rule to add the additional element of market power in the tying good as a requirement to finding patent misuse; therefore, an additional inquiry must be made to complete the analysis.<sup>147</sup>

It is important to note that market power in this case is not defined as monopolistic power, which would be the gathering of a large amount of market power.<sup>148</sup> Instead, market power exists when a firm has the power to charge more than the marginal costs by reducing output in such a way that the rest of the market would be unable to replace.<sup>149</sup>

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<sup>142</sup> *See id.* at 1363–64.

<sup>143</sup> *See id.* at 1373 (suggesting that existing prior art strips with multiple electrodes would require reconfiguration to be used with LifeScan's meter).

<sup>144</sup> VAKERICS, *supra* note 57.

<sup>145</sup> *LifeScan*, 734 F.3d at 1365.

<sup>146</sup> HOVENKAMP ET AL., *supra* note 60.

<sup>147</sup> *Id.*

<sup>148</sup> *Id.* § 4.1.

<sup>149</sup> *Id.*

According to market research in 2008, LifeScan was one of four competitors who, combined, controlled 89.7% of the market in self-testing blood glucose meters.<sup>150</sup> It is not necessary that LifeScan possess the majority of market share, or even the largest piece of market share to be said to have market power. Instead, the test is whether its output reduction would reduce market-wide output in such a way that rivals would not be able to quickly replace the lost volume.<sup>151</sup> While it is possible that the competitors in the market would be able to replace approximately a quarter of the total market with increased production, it is unlikely that one would consider this an “inconsequential” impact on the market price.<sup>152</sup> Also, since LifeScan does own the patent to its improvement on the meter, one can impute some amount of market power from this as well.<sup>153</sup> However, it is important to note that any finding of market power may not solely be the result of the existence of the patent.<sup>154</sup> Given both the ability to manipulate prices and the existence of the patent, it is likely that LifeScan would be determined to have market power.

Under this analysis, LifeScan’s requiring use of the unpatented test strips in order to receive the glucose meter embodying their method patent would not constitute patent misuse because the test strips did not constitute a staple good. The remaining question is whether an attempt by LifeScan to prevent the sale of this nonstaple product constitutes patent misuse.

*B. Preventing Competitors from Selling Compatible Test Strips Likely Constitutes Patent Misuse*

In earlier versions of the patent misuse doctrine, the Supreme Court held that a patentee could misuse his patent by attempting to control the sale of component products used in a patented invention even if they were nonstaple products.<sup>155</sup> This

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<sup>150</sup> Mark D. Hughes, *The Business of Self-Monitoring of Blood Glucose: A Market Profile*, 3 J. DIABETES SCI. & TECH. 1219, 1221 (2009). LifeScan is the second in the market with 27.2% market share, with the market leader controlling 30.8%. *Id.*

<sup>151</sup> HOVENKAMP ET AL., *supra* note 60, § 4.1.

<sup>152</sup> *Id.*

<sup>153</sup> *Id.* § 3.2.

<sup>154</sup> *Id.*

<sup>155</sup> *Id.* § 3.3a2 (citing *Mercoid Corp. v. Mid-Continent Inv. Co.*, 320 U.S. 661 (1944); *Mercoid Corp. v. Minneapolis-Honeywell Regulator Co.*, 320 U.S. 680 (1944)).

would cause a situation like the one in LifeScan to fall firmly within patent misuse; just the act of suing Shasta for contributory infringement would remove liability from Shasta for the act of contributory infringement itself.

Congress restricted the doctrine by passing the 1952 Patent Act, which included changes reversing these decisions<sup>156</sup> by setting the edge of the patent misuse doctrine to where contributory infringement began.<sup>157</sup> This amendment added two sections to the statute. First, 35 U.S.C. § 271(c) defined contributory infringement as producing or selling components of patented devices or methods.<sup>158</sup> To be liable as a contributory infringer, the part being sold cannot be “a staple article or commodity of commerce suitable for substantial noninfringing use.”<sup>159</sup> Second, the amendment added, in relevant part:

No patent owner otherwise entitled to relief for infringement or contributory infringement of a patent shall be denied relief or deemed guilty of misuse or illegal extension of the patent right by reason of his having done one or more of the following: (1) derived revenue from acts which if performed by another without his consent would constitute contributory infringement of the patent; (2) licensed or authorized another to perform acts which if performed without his consent would constitute contributory infringement of the patent; (3) sought to enforce his patent rights against infringement or contributory infringement . . . .<sup>160</sup>

One example of an application of the new amendment to a case dealing with contributory infringement is *Dawson Chemical Co. v. Rohm & Haas Co.*<sup>161</sup> There, the Supreme Court heard a case dealing with the unpatented chemical, propanil.<sup>162</sup> This chemical, although known for some time, did not constitute a staple good because it had no use other than practicing the

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<sup>156</sup> 35 U.S.C. § 271(d)(1)–(3) (2012).

<sup>157</sup> HOVENKAMP ET AL., *supra* note 60, § 3.3a2.

<sup>158</sup> 35 U.S.C. § 271(c) (2012).

<sup>159</sup> *Id.*

<sup>160</sup> *Id.* § 271(d)(1)–(3).

<sup>161</sup> 448 U.S. 176 (1980).

<sup>162</sup> *Id.* at 185.

plaintiff's patented method of use as an herbicide.<sup>163</sup> The Court held that under the statute, excluding defendants from selling the nonstaple good did not constitute misuse.<sup>164</sup>

Under *Dawson Chemical*, attempts by LifeScan to prevent Shasta from producing compatible test strips would appear to not constitute patent misuse. Test strips compatible with LifeScan's meter would likely not constitute staple goods because there would be no noninfringing use of a test strip specifically designed to work only with LifeScan's meters, which embody its patented method of blood glucose monitoring.<sup>165</sup> Similar to the herbicide propanil, the only use for the Shasta strips was in connection with LifeScan's patent. Therefore, in a vacuum, a court might find that LifeScan did not misuse its patent here.

However, Shasta's best argument is the prosecution history of LifeScan's patent. LifeScan sought a device patent on the test strips themselves, but was denied due to disclosures in the prior art.<sup>166</sup> By attempting to use the method patent to prevent others from manufacturing competing test strips, LifeScan is attempting to broaden their patent to cover the unpatentable strips as well. This attempt to expand the scope of the method patent to cover unpatentable devices would likely be found to have "impermissibly broadened" the patent right in a way that misuse doctrine seeks to prevent, barring LifeScan from recovery.<sup>167</sup>

One final consideration is whether filing a contributory infringement action in and of itself would constitute patent misuse in these circumstances. The Supreme Court cases before the 1952 Patent Act held that this action did constitute misuse.<sup>168</sup> This amendment to the statute added, in relevant part:

No patent owner otherwise entitled to relief for infringement or contributory infringement of a patent shall be denied relief or deemed guilty of misuse or illegal extension of the patent right

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<sup>163</sup> *Id.* at 185–86.

<sup>164</sup> *Id.* at 223.

<sup>165</sup> *See supra* Part III.A.

<sup>166</sup> *LifeScan Scot., Ltd. v. Shasta Techs., LLC*, 734 F.3d 1361, 1369–70 (Fed. Cir. 2013).

<sup>167</sup> *Windsurfing Int'l, Inc. v. AMF, Inc.*, 782 F.2d 995, 1001 (Fed. Cir. 1986) (citing *Blonder-Tongue Labs., Inc. v. Univ. of Ill. Found.*, 402 U.S. 313, 343 (1971)).

<sup>168</sup> *HOVENKAMP ET AL.*, *supra* note 60, § 3.3a2 (citing *Mercoid Corp. v. Mid-Continent Inv. Co.*, 320 U.S. 661 (1944); *Mercoid Corp. v. Minneapolis-Honeywell Regulator Co.*, 320 U.S. 680 (1944)).

by reason of his having done one or more of the following: . . . (3) sought to enforce his patent rights against infringement or contributory infringement . . . .<sup>169</sup>

This amendment prevents any finding of patent misuse for the sole reason of a patentee attempting to vindicate his rights against an infringer or contributory infringer.<sup>170</sup> Therefore, under this new framework, LifeScan would not be found to be misusing its patent by filing a contributory infringement suit against Shasta for producing compatible test strips for its blood glucose meters.

In sum, LifeScan would likely be found to have misused the patent on its blood glucose meter. While Shasta's actions in specifically designing their competing test strips to work specifically with LifeScan's meter is probative, LifeScan attempting to use their method patent to get around the PTO's decision to reject their device claim for the strips is more so. Under these facts, LifeScan "impermissibly broadened the 'physical or temporal scope' of the patent grant with anticompetitive effect."<sup>171</sup> Despite the outcome being the same, applying patent misuse provides a more fine-tuned analysis of potential anticompetitive issues. This is especially true in situations where patented goods sold for below cost are tied together with higher profit unpatented goods, rather than the *LifeScan* court's adoption of a per se rule expanding patent exhaustion.

#### IV. CASE STUDY: EXAMINING THE PROBLEMS OF EXPANDING PATENT EXHAUSTION

The *LifeScan* decision might be considered a situation where easy cases make bad law. After all, the court could have instead relied on Lifescan's attempt to expand its method patent to cover a device which the PTO decided was not patentable to reach the same result. However, to put the potential ramifications of the Federal Circuit's decision into sharper focus, a hypothetical scenario raising these concerns is warranted.

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<sup>169</sup> 35 U.S.C. § 271(d)(3) (2012).

<sup>170</sup> HOVENKAMP ET AL., *supra* note 60, § 3.3a2.

<sup>171</sup> *Windsurfing Int'l, Inc. v. AMF, Inc.*, 782 F.2d 995, 1001 (Fed. Cir. 1986) (quoting *Blonder-Tongue Labs., Inc. v. Univ. of Ill. Found.*, 402 U.S. 313, 343 (1971)).

A group of recent Ph.D. graduates in the fields of computer science, physics, and engineering worked together as part of their doctoral thesis. Together, they invented a novel approach to optical media far superior to currently available CD, DVD, and Blu-Ray technology. CD and DVD players utilize a red laser to read information off of the disc as it spins, while Blu-Ray readers can use a more efficient blue laser to read all three forms of media.<sup>172</sup> This group has invented a process for using ultraviolet lasers to play all three formats, as well as a new format called UVD. This new process enables older formats to be read faster than with red or blue lasers, as well as allowing the use of the new UVDs, which only works with ultraviolet readers and can store vastly greater amounts of data, while still maintaining faster speeds than any existing optical format.

The group obtains a method patent for the process of reading all four formats using ultraviolet lasers, with such a use not being disclosed in the prior art. The scientists form a company, UV Inc., for the sole purpose of manufacturing and selling both UVD players as well as UVDs. They find that the components needed to produce their players and discs are roughly equivalent in price to those required to make modern Blu-Ray players. In order to break into the firmly established Blu-Ray market, UV Inc. decides to sell their players for significantly below cost. Their goal is to establish themselves as a simultaneously cheaper and superior alternative to the older formats in order to recoup their short-term losses in the UVD market, which are priced well above costs similarly to Blu-Ray discs. UV Inc. also includes a term in its license agreement that the purchaser of a UVD player cannot play UVDs that were not produced by UV Inc. or one of its licensees with the player. If a third party came into the market for UVDs, would UV Inc. be unable to hold them liable for contributory infringement of its method patent after the *LifeScan* decision?

To answer this question, it must be determined if the sale of the UVD player would exhaust UV Inc.'s patent rights. In *Quanta Computer, Inc. v. LG Elecs., Inc.*,<sup>173</sup> the Supreme Court held that for a method patent to be exhausted by the sale of a good, the good must be "capable of use only in practicing the

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<sup>172</sup> Elizabeth Armstrong, *DVD Lasers: Why Blue Beats Red*, WIRED (June 1, 2002, 12:00 PM), <http://wired.com/2002/06/dvd-lasers-why-blue-beats-red>.

<sup>173</sup> 553 U.S. 617 (2008).

patent” and must have “embodie[d] essential features of [the] patented invention.”<sup>174</sup> Here, the UVD by its design can only be read by a device utilizing an ultraviolet laser, for which UV Inc. has a patent.

The Court also held that a device substantially embodies the essential features of a method patent when “the only step necessary to practice the patent is the application of common processes or the addition of standard parts.”<sup>175</sup> Here, the patent is practiced with the addition of any existing optical format, including standard CDs, DVDs, and Blu-Ray discs. Since, under *LifeScan*, the sale requirement is fulfilled via the transfer of title instead of a sale for the full value of the good,<sup>176</sup> the sale of the UVD player would be considered an exhaustive transaction.

Since the transfer of title in the player is exhaustive, a third-party producer of UVDs would not be liable as a contributory infringer even though the actions of UV Inc. did not constitute patent misuse. Two of the elements required to constitute patent misuse are missing: the tied good being a staple good and market power.<sup>177</sup> The functionally tied UVDs would not constitute a staple good because they have no substantial use except in connection with UV Inc.’s patented process for reading them.<sup>178</sup> Also, under the circumstances described above, UV Inc. lacks market power, as they are a new startup company. All of this points to there being no anticompetitive problem with the hypothetical situation above, but it is still blocked by the newly expanded patent exhaustion doctrine.

Public policy would seem to favor not applying exhaustion in this case. If the third-party competitor were allowed to enter the market without fear of contributory infringement, the price of the UVD discs would be reduced to their marginal costs.<sup>179</sup> This would have negative impacts on both buyers who would have to pay substantially more for the device in order to get slightly cheaper media, as well as UV Inc. who would be unable to both build a customer base while also recouping on their

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<sup>174</sup> *Id.* at 631–32 (alterations in original) (quoting *United States v. Univis Lens Co.*, 316 U.S. 241, 249–51 (1942)).

<sup>175</sup> *Id.* at 633.

<sup>176</sup> *LifeScan Scot., Ltd. v. Shasta Techs., LLC*, 734 F.3d 1361, 1377 (Fed. Cir. 2013).

<sup>177</sup> *See infra* Part I.B.

<sup>178</sup> *VAKERICS*, *supra* note 57, § 11.02[6].

<sup>179</sup> *Katz*, *supra* note 90.

investment.<sup>180</sup> This is not a result of a misuse of the patent or an attempt to claw back on claims rejected by the PTO like in *LifeScan*. The only result here is that a third party who did not put in the monetary and human capital to develop a new beneficial process is able to profit off of the efforts of others to the detriment of the inventors and the portion of the public who would be priced out of the market. These are but some the potential unintended consequences of using the ax of an expanding patent exhaustion doctrine rather than the scalpel of patent misuse.

#### CONCLUSION

Patent exhaustion has a long and rich history in the common law, dating back over 150 years. The expansion of the rule advocated by the Federal Circuit is concerning because it does not appear to be consistent with that long and storied history. By broadening the concept of sales to purchasers for full value to any transfer of title, the court does not sufficiently maintain the balance between public interest in the free alienation of property and the fundamental goals of patent law. It could also end up harming consumers in the marketplace for such goods by causing patentees to abandon metered pricing and instead charge full value at the offset for their patented goods, which can price some consumers out of the market for these goods. Finally, any concerns about expansion of the patent monopoly by failing to expand the patent exhaustion doctrine are better resolved via the existing doctrine of patent misuse. This is true both with regards to tying arrangements in sales to consumers and seeking to exclude contributory infringers from entering the market of nonstaple goods. If such an expansion of patent exhaustion is indeed necessary, such a move should come from the Supreme Court overturning its own prior precedent, not the Federal Circuit on its own.

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<sup>180</sup> See *infra* Part II.B.