No. 06-937

In the Supreme Court of the United States

QUANTA COMPUTER, INC., QUANTA COMPUTER USA, INC., Q-LITY COMPUTER, INC.,

Petitioners,

v.

LG ELECTRONICS, INC.,

Respondent.

On Writ of Certiorari
to the United States Court of Appeals
for the Federal Circuit

BRIEF OF *AMICUS CURIAE* PAPST LICENSING GMBH & CO. KG IN SUPPORT OF RESPONDENT

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QUESTION PRESENTED

Whether a patentee that grants the licensee a right to use and sell patented systems and methods in a specified manner retains the right to bring infringement actions against the licensee's customers who knowingly use the patented systems and methods in a manner inconsistent with the licensing agreement.

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INTEREST OF THE AMICUS CURIÆ

Papst Licensing GmbH & Co. Kg ("PAPST") is in the business of licensing technology from its portfolio of over one hundred patents, including patents directed to innovative electric motor, fan, and hard disk drive technologies that are used in millions of computer related products around the world.[1] PAPST began as a manufacturer of electric fans and motors, but eventually sold its manufacturing business while retaining its patent portfolio, and has enforced that portfolio to obtain fair compensation for the use of its innovative technologies. PAPST has successfully litigated issues similar to those presented here as discussed hereinafter. PAPST files this amicus brief in an effort to assist the Court in understanding the economic rationale for patent licensing arrangements of the type at issue in this case, and the potential anticompetitive implications of the position pressed on this Court by petitioners and their amici.

STATEMENT

Respondent owns several patents related to systems and methods of transmitting and receiving data in personal computers. Pet. App. 2a. Respondent has entered a licensing agreement with Intel Corporation "covering its entire portfolio of

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[1] The written consent to the filing of this brief of all parties has been lodged with the Clerk. No counsel for a party has authored this brief in whole or in part, and no person or entity other than PAPST has made a monetary contribution to the preparation or submission of this brief.

patents on computer systems and components." Pet. App. 4a. Intel, in turn, sells microprocessors and chipsets to petitioners, who install them in computers. Pet. App. 2a. The licensing agreement between Intel and respondent "expressly disclaims granting a license allowing computer system manufacturers to combine Intel's licensed parts with other non-Intel components. Moreover, this conditional agreement required Intel to notify its customers of the limited scope of the license, which it did." Pet. App. 5a. Petitioners accordingly were made aware that Intel's license did not permit any combination of the patented systems and methods with non-Intel products. Pet. App. 5a.

Respondent brought an infringement action alleging that petitioners had combined microprocessors or other chipsets with other computer components in violation of respondent's patents covering those combinations. Pet. App. 2a. The district court ruled that respondent's licensing the right to practice its patents to Intel precluded it from suing Intel's customers under the doctrine of patent exhaustion. Pet. App. 52a-61a. The court of appeals reversed, concluding that the patent exhaustion doctrine does not apply to a conditional sale that grants the licensee only a limited right to practice a patent. Pet. App. 5a-6a.

SUMMARY OF THE ARGUMENT

When a patentee makes an unconditional sale of a patented invention, the law presumes that the patentee has bargained for and received the full value of the patented invention, which exhausts the patentee's rights under patent law. In these circumstances, the purchaser has the right to resell the invention free from any patent claims – the so-called doctrine of patent exhaustion. In this fashion, patent exhaustion ensures that a patentee receives a royalty reflecting the full value of its invention, but no more.

Nothing in the patent laws requires a patentee to make an unconditional sale that enables it to recoup the value of its patent rights in a single transaction. Indeed, in many circumstances, buyers who wish to use a patented invention in specific ways do not wish to purchase the full value of the patent rights at issue; and sometimes they cannot afford to do so. In these circumstances, a conditional sale of the patented good promotes competition and consumer welfare by permitting the licensee to acquire limited rights at a correspondingly lower cost, while permitting the patentee to police unauthorized uses of the patented good through the use of patent infringement actions against unauthorized uses and users.

This case involves such a conditional sale. The terms of the license at issue make plain that Intel did not bargain for or receive an unconditional right to use the patented systems and methods; nor did it pay respondent for such an unconditional right. Instead, respondent sold only the right to use its patents with Intel's components; the license preserved the balance of respondent's patent rights, forcing those who wished to combine Intel's licensed products with non-Intel components to negotiate a license with respondent or face infringement liability. When petitioners used the patented systems and methods with non-Intel components, they accordingly infringed a patent right that had been preserved by the conditional license agreement between respondent and Intel. For that reason, the court of appeals properly held that this infringement action did not run afoul of the doctrine of patent exhaustion.

ARGUMENT

1. The doctrine of patent exhaustion rests on the rule that a patentee is "entitled to but one royalty for a patented machine, and consequently when a patentee has himself constructed the machine and sold it . . . and the consideration has been paid to him for the right, he has then *to that extent* parted with his monopoly, and ceased to have any interest whatever in the machine . . . ." *Bloomer v. Millinger*, 68 U.S. (1 Wall.) 340, 350 (1863) (emphasis supplied). A patentee, however, might choose to part with only a portion of its patent rights, and to receive accordingly more limited consideration. In such cases, the parties can by contract agree that the patentee will surrender only a portion of its patent rights, preserving the balance. After all, nothing in the patent laws repeals freedom of contract.

In *General Talking Pictures Corp. v. Western Electric Co.*, 304 U.S. 175, adhered to on rehearing, 305 U.S. 124 (1938), for example, the patentee granted a license "limited to the manufacture and sale of the [patented] amplifiers for private use, as distinguished from commercial use." *Id.* at 179. Nevertheless, the licensee "knowingly did sell the amplifiers in controversy to the petitioner for that use." *Id.* at 180. The Court observed that "[t]he owner of a patent may grant licenses to manufacture, use, or sell upon conditions not inconsistent with the scope of the monopoly," *id.* at 181, and added that "[t]here is no warrant for treating the sales of amplifiers to petitioner as if made under the patents or the authority of their owner." *Id.* at 182. Accordingly, the Court held that "[p]etitioner, having with knowledge of the facts bought at sales constituting infringement, did itself infringe the patents embodied in the amplifiers when it leased them for use as talking picture equipment in theaters." *Id.* *General Talking Pictures* is no anomaly; it is part of a long line of cases holding "any conditions which are not in their very nature illegal with regard to this kind of property, imposed by the patentee and agreed to by the licensee for the right to manufacture or use or sell the [patented] article, will be upheld by the courts." *E. Bement & Sons v. National Harrow Co.*, 186 U.S. 70, 91 (1902). Accord, *e.g.*, *United States v. General Electric Co.*, 272 U.S. 476, 489-94 (1926); *Mitchell v. Hawley*, 83 U.S. (16 Wall.) 544, 547-51 (1873).

Petitioners and the United States associate the rule that a patented good may be conditionally licensed with the decision in *Henry v. A.B. Dick Co.*, 224 U.S. 1 (1912), which the Court later repudiated in *Motion Picture Patents Co. v. Universal Film Mfg. Co.*, 243 U.S. 502 (1917). *See* Pet. Br. 20-23; U.S. Br. 13. Yet in *General Electric*, the Court expressed a different view of *Motion Picture Patents.* In *General Electric*, the Court explained that *Motion Picture Patents* had invalidated a licensing agreement that required that a patented component of a film projector be used only to exhibit the patentee's own films because "the materials or pictures upon which the machine was operated was no part of the patented machine, or of the combination that produced the patented result." 272 U.S. at 493. In contrast, General Electric's enforcement of a license restricting the price at which a patented invention could be resold through the use of infringement actions did not fall within the rule of *Motion Picture Patents* because "[t]he price at which a patented article sells is a circumstance having a more direct relation and is more germane to the rights of the patentee than the unpatented material with which the patented article may be used." *Id.* For that reason, the Court held that General Electric could properly sue purchasers of the patented item for infringement based on a violation of the licensing resale restriction. *See id.* at 493-94. Subsequently, in *General Talking Pictures* the Court similarly sustained an infringement action based on a restriction as to the type of venues in which the patented invention could be used, as we explain above.[2]

Thus, it should be plain that the rule permitting infringement actions when a patented invention is sold in violation of a licensing restriction survived the demise of *A.B. Dick*, at least when the licensing restriction is not an invalid effort to extend the scope of patent rights to nonpatented articles, as in *Motion Picture Patents*. Indeed, as *General Talking Pictures* explained, "the patentee may grant a license 'upon any condition the performance of which is reasonably

[2] Another example that postdates the demise of *Dick* is provided by *Brulotte v. Thys Co.*, 379 U.S. 29 (1964), in which the Court held that a royalty agreement became unenforceable upon the expiration of the patents at issue, *see id.* at 30, but acknowledged that a post-sale licensing restriction prohibiting the removal of the patented machine Yakima County was, prior to the expiration of the patent, "apt and pertinent to protection of the patent monopoly . . . ." *Id.* at 32.

within the reward which the patentee by the grant of the patent is entitled to secure.'" *General Talking Pictures*, 305 U.S. at 127 (quoting *General Electric*, 272 U.S. at 489).

2. Petitioners and their amici rely heavily on *United States v. Univis Lens*, 316 U.S. 241 (1942), in which the Court held that a manufacturer could not enforce a licensing agreement that dictated the terms on which patented lens blanks for glasses could be resold after finishing by both wholesalers and retailers. *See id.* at 250-54. To be sure, the Court's opinion states that "the authorized sale of an article which is capable of use only in practicing the patent is a relinquishment of the patent monopoly," *id.* at 249, but this observation is made in the context of the transactions at issue in that case, which had afforded the patentee full compensation for the value of its patent monopoly once original sales to the wholesalers and retailers had been completed:

> Sale of a lens blank . . . is . . . both a complete transfer of ownership of the blank, which is within the protection of the patent law, and a license to practice the final stage of the patent procedure. In the present case the entire consideration and compensation for both is the purchase price paid by the finishing licensee to the lens company.

Id. at 249-50. It followed that when it sold the blanks, the manufacturer "ha[d] received in the purchase price every benefit of that monopoly that patent law secures to him." *Id.* at 252. Yet, "the purpose of the patent laws 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, and once that purpose is realized the patent law affords no basis for restraining the use and enjoyment of the thing sold." *Id.* Thus, in *Univis*, the compensation that the patentee had received represented the full value of its patent monopoly, and the resale price agreements were an improper effort to inhibit competition in the wholesale and retail markets. For that reason, the Court held the agreements violated the Sherman Act by extending the patent monopoly into the wholesale and retail markets for the patented blanks. *See id.* at 252-54.[3]

Indeed, in each of the cases in which the Court has applied the doctrine of patent exhaustion, the patentee had received full value for the patented invention upon the sale that was deemed to exhaust its patent rights. *See*, *e.g.*, *Aro Manufacturing Co. v. Convertible Top Replacement Co.*, 377 U.S. 476, 496-97 (1964) (agreement requiring licensee to use only licensed replacement materials for patented automobile top improperly extended monopoly rights to nonpatented repair materials and was inconsistent with the implied license to use and repair that accompanied the sale); *Keeler v. Standard Folding Bed Co.*, 157 U.S. 659, 666-67 (1895) (purchaser's use of patented good outside of territory in which licensee had been granted exclusive rights

[3] *Univis* is part of a line of cases that refuses to treat violations of resale price restrictions as infringements because the initial sale gave the patentee the full value of its patent rights. *See United States v. Masonite Corp.*, 316 U.S. 265, 277-82 (1942) (manufacturer's restrictions on the price and terms of resale at retail); *Boston Store of Chicago v. American Gramophone Co.*, 246 U.S. 8, 25-26 (1918) (manufacturer's restriction on price of resale at retail); *Bauer v. O'Donnell*, 229 U.S. 1, 16-18 (1913) (same).

was not an infringement because patentee received full value when conveying the exclusive right to sell the patented item within the identified territory); *Adams v. Burke*, 84 U.S. (17 Wall.) 453, 456 (1873) (same). The Court accordingly had no occasion in *Univis* or the other cases on which petitioners rely to consider a license structured so that the licensee was not required to pay the full value of the patented item. In *Univis*, in particular, the Court did not purport to reconsider the soundness of *General Talking Pictures*, and it expressly declined to reconsider the holding in *General Electric*. *See* 316 U.S. at 252.

Petitioners, for their part, claim that the validity of a licensing agreement turns on the technicalities of the passing of title; they argue that licensing restrictions can preserve patent rights only in a "conditional sale . . . in which a party does not convey title to the buyer until performance of a conditional precedent," Pet. Br. 19 (footnote omitted), and add that "th[is] principle does not permit sellers to impose conditions subsequent to the transfer of title," *id.* at 20 (emphasis deleted). Accord U.S. Br. 20-21. None of the pertinent cases, however, attach talismanic significance to the moment at which title transfers, and *General Talking Pictures* in particular appears quite inconsistent with this submission. Indeed, petitioners and the United States appear to recognize that the restriction at issue in *General Talking Pictures* operated after title had passed, and instead argue that infringement liability was recognized in that case because the sale made by the licensee was not authorized by the patent license. *See* Pet. Br. 29; U.S. Br. 17-18. As explained above, however, the Court held in *General Talking Pictures* that commercial use of the patented amplifiers even after title had passed to the licensee infringes because of the purchaser's unauthorized use of the licensed product. Just as the unauthorized use of the patented amplifiers represented an infringement of patent rights by the purchasers, the unauthorized use of Intel components in this case represents an infringement no less.

In any event, precedent aside, the patent laws make plain that the fact that a patentee has authorized what would otherwise be an infringing use – whether by transferring title or otherwise – does not affect its ability to bring an infringement action against unauthorized use: "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 . . . licensed or authorized another to perform acts which if performed without his consent would constitute contributory infringement of the patent." 35 U.S.C. § 271(d)(2).[4] Moreover, basic principles of property law make plain that a purchaser who has obtained only a limited right to practice a patented invention free from infringement claims cannot convey to its purchasers any greater right, whether or not title has passed to the purchaser. After all, as the Court observed in *Mitchell*, "no one can convey . . . any better title than he owns unless the sale is made in market overt, or under circumstances which show that the sell lawfully represented the owner." 83 U.S. at 550.

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[4] This provision was added to the statute after the decision in *Univis* on which petitioners and their amici so heavily rely. *See* July 19, 1952, c. 950, 66 Stat. 811.

Equally important, the economic realities of licensing argue against the view taken by petitioners and their amici. Patent exhaustion is a doctrine based on substance and not form. As we explain above, patent exhaustion reflects economic reality – an unconditional sale of the right to practice a patent includes a payment to the patentee representing the full value of the patent rights, and for that reason provides the patentee with all the compensation that the patent laws properly support. In a transaction in which the parties agree to convey only more limited rights in the patented item, receiving in turn more limited compensation while preserving the ability of the patentee to police unauthorized use through the patent laws, economic reality is inconsistent with patent exhaustion. Indeed, as we now explain, extending the doctrine of patent exhaustion to transactions that convey only limited rights in return for proportionately limited compensation – whether or not they involve a transfer of title – would be both inefficient and anticompetitive.

3. As the Department of Justice and the Federal Trade Commission have recognized, licensing rather than the unconditional sale of intellectual property frequently has procompetitive effects:

> Field-of-use, territorial, and other limitations on intellectual property licenses may serve procompetitive ends by allowing the licensor to exploit its property as efficiently and effectively as possible. These various forms of exclusivity can be used to give a licensee an incentive to invest in the commercialization and distribution of products embodying the licensed intellectual property

> and to develop additional applications for the licensed property. The restrictions may do so, for example, by protecting the licensee against free-riding on the licensee's investments by other licensees or by the licensor. They may also increase the licensor's incentive to license, for example, by protecting the licensor from competition in the licensor's own technology in a market niche that it prefers to keep to itself. These benefits of licensing restrictions apply to patent, copyright, and trade secret licenses, and to know-how agreements.

U.S. Dep't of Justice & Fed'l Trade Comm'n, *Antitrust Guidelines for the Licensing of Intellectual Property* 5 (April 6, 1995) [hereinafter cited as "*Antitrust Guidelines*"]. The experience of PAPST is consistent with this view.

PAPST has found that potential purchasers of its intellectual property are frequently unwilling or unable to purchase the full value of a patent. Sometimes, a patent is of particular interest in a fledgling industry in which potential purchasers are poorly capitalized and able to afford to purchase only highly limited proprietary rights. Other industries operate on limited profit margins, again inhibiting their ability to pay for full patent rights. Under these and a variety of other circumstances, the most efficient result can be achieved if the parties are able to negotiate a limited license that permits the licensee to practice the patent in the fashion that is of the greatest value to it, paying only for the limited rights conveyed by the license, while permitting the patentee to retain its patent rights with respect to unauthorized uses of the patented invention. In this fashion, the patentee can use the remedies available under the patent law to police the limitations on the license it has granted. After all, if a licensee resells an item in violation of an otherwise valid licensing restriction, then both the licensee and its transferee are users of a patented technology and therefore infringing parties. *See* 35 U.S.C. § 271.

A pertinent example is provided by the patent license between PAPST and Minebea Co., Ltd. That license granted Minebea, a manufacturer of electric motors for use in computer hard disk drives, the right to make, use and sell its motors under certain PAPST patents that covered its motors. *See Minebea Co. v. Papst*, 444 F. Supp. 2d 68, 100-05 (D.D.C. 2006). Papst also owned patents covering the hard disk drive ("drive patents") products that Minebea's customers made and sold. *Id.* However, because the cost of a license that would permit Minebea to convey the drive patent rights to its customers was considerably higher, Minebea did not purchase such a license. *Id.* PAPST notified each of Minebea's customers they would need to obtain a license in order to use the patented devices by incorporating them into infringing hard disk drives. *Id.* In this fashion, Minebea was able to obtain the right to use the patented motor technology at a price it was willing to pay, in part because PAPST was able to assume the cost of policing the licensing restriction by retaining the right to sue Minebea's customers for infringement of the drive patent rights.[5] Such an

[5] Referring to the *Minebea* case, petitioners suggest that under the rule adopted by the court of appeals, infringement actions could be brought "even against purchasers without notice." Pet. Br. 48 (emphasis deleted). In fact, in *Minebea*, PAPST placed each of the purchasers on notice that

arrangement enhances competition by permitting the parties to determine the most efficient way to allocate the costs of policing the licensing restriction.

Accordingly, a rule that a patentee must demand the full value of the patented item when it is sold to others would lead to many anomalies. It could, for example, prevent patentees from licensing others who may be able to do so more efficiently to manufacture the patented invention. Similarly, without the ability to enter a limited license that preserves the licensor's patent rights against unauthorized uses, a combination manufacturer could be forced to buy the component at a much higher price than would be dictated in a market in which more limited licensing rights are available. In such situations, economic efficiency and social welfare are enhanced by permitting the parties negotiating a patent license to decide whether post-sale patent rights should be preserved.[6]

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they needed to obtain a license from PAPST to utilize PAPST's hard disk drive technology, even though they may have purchased a motor from a motor licensee such as Minebea. *See* 444 F. Supp. 2d at 159 n.67. Petitioners were also placed on notice in this case that Intel's license did not permit them to combine the patented systems and methods with non-Intel products. *See* Pet. App. 5a. Moreover, as we explain below, truly innocent purchasers without notice of a license restriction are usually protected.

[6] Thus, petitioners' bold claim that "[n]o rational company would pay [respondent] any significant royalty for a 'license' to make and sell products that did not include the ability to sell those products free and clear of [respondent]'s patent claims," is inconsistent with PAPST's experience, as well as with the views of the Department of Justice and the Federal Trade Commission we discuss above.

Amicus International Business Machines Corporation agrees that patent law allows "a purchaser to waive exhaustion through express agreement," but adds that the restrictions should not be enforceable against subsequent purchasers "absent an additional express agreement with a downstream purchaser." IBM Br. 21, 22. This approach, however, fails to yield the competitive benefits of our submission. Most obviously, the transaction costs involved in identifying all potential downstream purchasers and negotiating individual licensing agreements with each would be substantial. It would be equally difficult to use state contract law to enforce licensing restrictions against those who have purchased the patented invention from the licensee; such purchasers have no contractual relationship with the patentee that render them liable in contract to the patentee, and the licensee may itself have limited resources, ability, and incentive to enforce contractual restrictions against their own customers.[7]

IBM's proposal would also effectively inhibit cross-license agreements that enable innovators to make "patent peace." Frequently, licensing agreements are reached between parties who want to be able to conduct their respective businesses without the expense of evaluating every one of their potential product against the other's patent claims (which may run into the hundreds or thousands), but who have no interest in policing their respective

[7] These practical difficulties are ignored as well by the other amici who advocate the use of contract law to enforce licensing restrictions against those who purchase patented inventions from the licensee. *See* Automotive Engine Rebuilders Ass'n Br. 9-10; Consumer Union Br. 18-20.

customers for infringement of the other's patents, or in buying licenses for their customers. The Department of Justice and the Federal Trade Commission have recognized the procompetitive character of such licensing agreements: "These arrangements may provide procompetitive benefits by integrating complementary technologies, reducing transaction costs, clearing blocking positions, and avoiding costly infringement litigation." *Antitrust Guidelines*, *supra* at 28.

In short, it is unreasonable to expect that multiple or even an omnibus patent license is always going to be more efficient than recognizing the right of a patentee to sue each infringer who refuses to reach a negotiated agreement. When the use of contract law to enforce licensing restrictions is more efficient, then the parties likely will end up going that route, but it makes more sense for the parties to work that out in each case than for this Court to announce a nonstatutory doctrine of patent law that would compel the use of state contract law in every case.

4. Petitioners also seek refuge in what they claim is a general rule against post-sale restrictions that run with personal property. *See* Pet. Br. 19, 46-48. They add that although they were on notice that the licensing agreement between respondent and Intel did not permit them to combine the patented systems and methods with non-Intel parts, respondent's submission threatens even innocent purchasers without notice of a licensing restriction with infringement liability. *See id.* at 48. *See also* Consumers Union Br. at 6-7. In fact, this threat is an empty one.

The Uniform Commercial Code provides protections for purchasers of patented products by implying a warranty against infringement by a seller of a device:

> Unless otherwise agreed a seller who is a merchant regularly dealing in goods of the kind warrants that the goods shall be delivered free of the rightful claim of any third person by way of infringement or the like but a buyer who furnishes specifications to the seller must hold the seller harmless against any such claim which arises out of compliance with the specifications.

U.C.C. § 2-312 (2005). Thus, the law puts the burden on the seller of an infringing device to secure whatever patent rights are necessary to protect its customer, and protects the customer by an implied-in-law warranty. Notably, this provision of the Uniform Commercial Code has not been interpreted to protect purchasers whose own actions give rise to liability for infringement by combining a licensed component into a larger infringing device. *E.g.*, *Chemtron, Inc. v. Aqua Prods.*, 830 F. Supp. 314, 315 (E.D. Va. 1993) ("a buyer, such as Aqua, should not be entitled to purchase goods from a seller, such as Viking, which are not subject to any infringement action, use the non-infringing component goods in an infringing device and incur liability to a third party patentee, Chemtron, and then turn around and attempt to impose liability on the original seller of the component parts."). Thus, our submission does not threaten ordinary retail purchasers with infringement liability, but it properly offers no safe haven for those who buy a licensed invention and then undertake an infringing use without ascertaining the limits of the licensee's authority.

Accordingly, to impose an exhaustion rule in these circumstances would turn the commercial law and commercial expectations on their head by creating an unintended class of third party beneficiaries who are effectively granted royalty-free licenses. Petitioners' proposed exhaustion rule, in turn, deprives a patentee of its rights whether or not the purchaser had notice of restrictions on its use of the patented component.

Unless the terms of the licensing agreement between Intel and respondent prohibiting any use of the patented systems and methods with non-Intel components are treated as complete surplusage, they necessarily prevented Intel from conveying to any of its purchasers a right to use the patented systems and methods as they did, and equally prevented petitioners from obtaining such a right. Petitioners purchased the patented systems and methods and combined them with non-Intel products with notice of this restriction. Presumably the price they paid for the patented systems and methods was correspondingly reduced because of their awareness of the restriction, just as the price that Intel paid respondent presumably reflected the restrictions that accompanied Intel's license. Yet rather than negotiate an appropriate license with respondent, petitioners enjoyed an unearned windfall – they bought a limited right, and treated it as if it were unlimited in character. Under these circumstances, the patent laws permit respondent to police its patent rights by obtaining an appropriate remedy for infringement.

CONCLUSION

For the foregoing reasons, the judgment of the court of appeals should be affirmed.

Dated: December 9, 2007

Respectfully submitted,

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