Tessera: **Remedial Effects of Licensees' Failure to Pay**

Thomas G. Field, Jr.

Professor Field welcomes a refusal to "cast a cloud of uncertainty" over prior sales.

As Judge Callahan recently pointed out, "A copyright holder may wish to enforce violations of license agreements as copyright infringements for several reasons. First, breach of contract damages are generally limited to the value of the actual loss caused by the breach. …. In contrast, copyright damages include the copyright owner's actual damages and the infringer's actual profits, or statutory damages…. Second, copyright law offers injunctive relief, seizure of infringing articles, and awards of costs and attorneys' fees. Third, copyright law allows copyright owners a remedy against 'downstream' infringers with whom they are not in privity of contract." MDY Indus., LLC v. Blizzard Entertainment, Inc., 629 F.3d 928, 941 n.3 (9th Cir. 2010) (as amended, 2011) (citations omitted).

Although statutory damages are not available for patent infringement, remedies are nevertheless superior to those for breach of contract. Also, as with copyright, downstream infringers escape liability absent infringement. The latter proposition is well illustrated in Tessera, Inc. v. International Trade Com'n, 2011 WL 1944067 (Fed. Cir. 2011), an action aimed at excluding eighteen respondents' semiconductor chips that were alleged to infringe three patents. . *Id.* at *1.

But only one patent and two parties, referred to collectively as "Elpida." were affected by differences between infringement and contract liability. *Id.* The ITC found the patent

in question to be valid. Also, absent authorization, Elpida was found to infringe. *Id.* at *3. Importation was found permissible, however, through exhaustion. All chips in question had been purchased from Tessera's licensees, and, despite the fact that some had indisputably "fallen behind on their obligations to pay royalties," licensees' sales to Elpida were authorized. *Id.*

As a purchaser from licensees, the consequences for Elpida were more significant than for parties subject to differing remedies for infringement and breach of contract. If Tessera's licensees were infringers by virtue of making unauthorized sales, Elpida's goods were subject to exclusion. If those licensees simply breached contractual obligations, however, Elpida could import and sell with no liability whatsoever.

To avoid review of the exhaustion determination, the ITC and Elpida argued that Tessera's challenge had not been timely raised. But Judge Linn, writing for the panel, finds judicial review to have been sought within the time permitted after the ITC's determination became final. *Id.* at *10.

On the merits, Tessera argued that sales by licensees in arrears did not exhaust its rights. "Noting that patent exhaustion is designed to prevent a double recovery," it urged that, under these circumstances, application of the exhaustion doctrine "would deprive it from receiving even a single recovery." *Id.*

As noted above, it is true that exhaustion would eliminate Elpida's liability. But it would not prevent recovery from licensees. Also, "recovery" in the ITC is impossible. Judge Linn made that clear in an opinion reviewing an earlier ITC disposition involving

Tessera. *See* Spansion, Inc. v. International Trade Com'n, 629 F.3d 1331, 1359 (Fed. Cir. 2010) ("[A]n injunction is the only available remedy for violations of Section 337."). Indeed, that is one of the reasons his opinion in *Spansion* concludes that *eBay's* limitations on injunctive relief inapplicable to ITC's remedies. *Id.* at 1359 (referring to eBay Inc. v. MercExchange, L.L.C., 547 U.S. 388 (2006)).

In the present case, Judge Linn does not discuss whether any or all of Tessera's licensees in arrears might be judgment proof, were it to sue them for breach of contract. But he regards that as irrelevant, pointing out that the sole issue bearing on exhaustion, "as in *Quanta,* is whether the patentee has authorized certain sales of products embodying the asserted patent." *Tessera* at *10 (citing Quanta Computer, Inc. v. LG Elecs., Inc., 553 U.S. 617, 636 (2008)).

Moreover, Judge Linn finds Tessera's additional "arguments [to] add unnecessary complexity to a rather straightforward analysis. The proper focus is on whether the sales were authorized. Tessera overlooks important aspects of the structure of… agreements [that] expressly authorize licensees to sell the licensed products and to pay up at the end of the reporting period." *Id.* at *11.

In particular, he characterizes Tessera's "argument that the sale is initially unauthorized until it receives the royalty payment [as] hollow and unpersuasive." *Id.* He finds unacceptable the necessary consequence that sales initially authorized would become unauthorized upon licensees' failure to pay. Such a result therefore seems aptly characterized as "absurd" because it would "cast a cloud of uncertainty over every sale, and every product in the possession of a customer of the licensee." *Id.*

Licensees who refuse to pay and improvidently challenge their obligations to do so seem thereafter to be properly regarded as infringers. Also, when payment can be construed as a condition precedent to sales, licensees could infringe for failure to pay. In *MDY,* Judge Callahan may have contemplated such circumstances when saying, “A licensee arguably may commit copyright infringement by continuing to use the licensed work while failing to make required payments….” 629 F.3d 928, 941 n..4.

In *Tessera,* Judge Linn illuminates an important limitation on that proposition. It is difficult to conceive of any situation that would justify finding good-faith sales made before payment is due to be unauthorized. “Hollow,” “unpersuasive” and “absurd” are harsh characterizations, but they seem appropriately applied to arguments for a rule that would unavoidably “cast a cloud of uncertainty over” many, if not most, purchases from copyright as well as patent and other kinds of licensees. *Tessera* at *11.