

**In the
UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT**

Case No. 03-16987

ARIZONA CARTRIDGE REMANUFACTURERS ASSOCIATION, INC.,

Plaintiff-Appellant,

v.

LEXMARK INTERNATIONAL, INC.,

Defendant-Appellee.

**On Appeal from the United States District Court
for the Northern District of California, Oakland Division,
Case No. D.C. No. CV-01-04626-SBA/JL**

**BRIEF OF AMICUS CURIAE
ELECTRONIC FRONTIER FOUNDATION**

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OTHER ENTITIES WITH A DIRECT FINANCIAL INTEREST IN
LITIGATION**

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4. EFF is not a trade association.

February 11, 2004

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I. STATEMENT OF INTEREST

The Electronic Frontier Foundation (EFF) is a nonprofit, membership-supported civil liberties organization working to protect consumer interests, innovation and free expression in the digital world. EFF and its 11,000 dues-paying members have a strong interest in assisting the courts and policy-makers in striking the appropriate balance between intellectual property and the public interest. Because this case may call on this Court to address the proper scope of the patent exhaustion doctrine as applied to post-sale restrictions on the use of patented goods, a doctrine of critical interest to consumers, EFF believes it may have a perspective to share that is not represented by the parties to this appeal, neither of whom directly represents the interests of consumers or the public interest generally.

EFF files the instant motion pursuant to Federal Rule of Appellate Procedure 29(a), together with a motion for leave to file made necessary by Appellee Lexmark's refusal to consent to the filing of this brief.

II. INTRODUCTION

Until 1992, it was black-letter law for over a century that a patent owner could not invoke the patent laws to restrict how its customers used patented products purchased from the patent owner or its authorized distributors and licensees. A customer did not commit patent infringement when using the legitimately purchased product—where ever, however, and for whatever purpose. The customer also had the unfettered right to resell or repair the product without fear of a suit for infringement. To put the matter

simply, when a consumer “end-user” bought a patented product in a typical retail sale, she owned it outright and the patent owner could not thereafter invoke patent law to restrict its post-sale use, repair or resale.¹

These principles, collectively referred to as the “patent exhaustion” doctrine, was confirmed and developed by a long line of Supreme Court precedents.² The doctrine effectively resolved, in the customer’s favor, a collision between two competing property interests—the intangible property rights of the patent owner and the tangible property interests of the customer.

That changed in 1992, when the Federal Circuit in *Mallinckrodt, Inc. v. Medipart, Inc.*, 976 F.2d 700 (Fed. Cir. 1992), held that the patent exhaustion doctrine reached only “unconditional” sales. In other words, the court held that patent owners could, through the mechanism of a “conditional sale,” impose post-sale restrictions on end-users and enforce those restrictions through suits for infringement. This ruling sent shock

¹ Patent exhaustion does not leave a patent owner’s quiver entirely empty of arrows. For example, the patent owner (1) can impose and enforce restrictions against purchasers as a matter of contract law; (2) can offer limited licenses to “make and vend” licensees, thereby preserving a patent infringement action against them for exceeding the scope of their licenses; and (3) retains patent rights against repairs that go too far, crossing the line into “reconstruction.”

² In the words of one commentator: “[I]t seemed clear for most of this century that a patentee could go virtually nowhere in limiting its customers’ conduct, except for restrictions shown necessary to protect health, safety, and product reliability.” Richard H. Stern, *Post-Sale Patent Restrictions After Mallinckrodt—An Idea in Search of Definition*, 5 ALB. L.J. SCI. & TECH 1, 5 (1994) (hereafter Stern, *Post-Sale Patent Restrictions After Mallinckrodt*).

waves through the patent community, leading one commentator to exclaim that “a century of law under the exhaustion doctrine was abruptly swept away.” Stern, *Post-Sale Patent Restrictions After Mallinckrodt*, *supra*, at 6.

The consequences for consumers, innovators and competition are potentially dire. Shortly after the decision issued, commentators predicted that patent owners would likely exploit *Mallinckrodt* as an opportunity to impose over-reaching restrictions on formerly permitted post-sale uses, repairs, modifications and resale. *See id.* at 12-19. Consumers would soon confront “single use only” notices. *See id.* at 12-14. Innovators would stumble over labels announcing “modifications prohibited.” *See id.* at 14-15. Patent owners could use “label notices” to encumber products with “field of use” restrictions and bring infringement actions to clear the field of aftermarket competitors. *See id.* at 16-19.

Lexmark has been a pioneer in fulfilling these dark predictions, pushing the boundaries of *Mallinckrodt*'s anti-consumer and anti-competitive possibilities. In 1997, Lexmark launched its “Prebate” toner cartridge program, carefully tailored to exploit the *Mallinckrodt* rule. Its aim is to secure an effective monopoly in the toner cartridge market for its printers by eliminating the aftermarket created by cartridge refillers, such as those represented by Appellant ACRA. Should Lexmark succeed, consumers will see a net wealth transfer from their pockets into Lexmark's.³

³ Lexmark will no doubt respond that they are offering consumers “choices,” protecting the environment, and ensuring print quality. With respect to the

Commentators predicted that Lexmark’s Prebate program might ultimately force the Federal Circuit to revisit its controversial holding in *Mallinckrodt*. See Steven A. Maddox & David W. Slaby, *Despite a Recent Case Holding that Refilling Patented Cartridges Does Not Constitute Infringement, Manufacturer Claims its ‘Single-User’ Patent is Tenable*, NAT. LAW J. at B4 (Feb. 9, 1998). Thanks to the unique posture of the instant case, the matter has found its way to this Court instead.

Mallinckrodt was wrongly decided. The Federal Circuit’s holding there cannot be squared with a century of Supreme Court authority. Moreover, as demonstrated by the facts of this case, the *Mallinckrodt* rule intrudes deeply into property rights traditionally and properly reserved to consumers with respect to the products they purchase at retail. If allowed to stand, *Mallinckrodt* will jeopardize consumers, innovation and competition in a wide variety of markets.

EFF urges this Court, if it reaches Lexmark’s *Mallinckrodt* arguments in this case, to independently consider the proper scope of the patent exhaustion doctrine and reject the misguided view adopted by the Federal

issue of “choice,” it is at least as likely that Lexmark’s decision to offer “regular” cartridges unencumbered by the Prebate restrictions was motivated by antitrust concerns as by magnanimous concern for consumer choice. Lexmark knows full well that the vast majority of Optra owners will prefer the cheaper Prebate cartridges, thereby constraining the supply of cartridges in the secondary market. As for Lexmark’s other rationales for the Prebate program, history teaches that, as between the self-serving statements of a monopolist and robust marketplace competition, consumers are better off trusting the latter.

Circuit in *Mallinckrodt*.

III. ARGUMENT

A. **Lexmark’s sale to its distributors was unconditional, and thus Lexmark’s patent rights were exhausted before end-users purchased the Prebate cartridges.**

As a threshold matter, this Court need not reach the *Mallinckrodt* doctrine in order to resolve this appeal. To the extent the undisputed facts demonstrate that there was an *unconditional* first sale here—from Lexmark to its distributors—such a sale fully exhausts Lexmark’s patent rights and requires that the district court’s ruling on ACRA’s motion for summary adjudication be reversed.

One fundamental tenet of patent exhaustion was left undisturbed by *Mallinckrodt*: “an unconditional sale of a patented device exhausts the patentee’s right to control the purchaser’s use of the device thereafter.” *B. Braun Medical, Inc. v. Abbott Labs*, 124 F.3d 1419, 1426 (Fed. Cir. 1997); accord *Hewlett-Packard Co. v. Repeat-o-Type Stencil Mfrg.*, 123 F.3d 1445, 1453-54 (Fed. Cir. 1997) (applying same principle in holding that unconditional sale exhausted patent rights in ink jet printer cartridges).

Here, it appears that Lexmark sold its Prebate cartridges to its top-level distributors without imposing any conditions on them relating to the refilling of the cartridges.⁴ The Prebate labels by their own terms impose

⁴ EFF has had no access to the record in this case, some of which is filed under seal. Nevertheless, it appears from the district court’s order and Appellant’s opening brief that Lexmark imposed no contractually enforceable conditions on its distributors with respect to the “single use”

“conditions” only on those who *open* the cartridge packages. Distributors and retailers do not open these packages, and thus sales to them were not “conditioned” by the Prebate labels. *See Softman v. Adobe Systems, Inc.*, 171 F.Supp.2d 1075, 1087 (C.D. Cal. 2001) (holding that distributor that never uses the software it vends is not bound by shrinkwrap license aimed at end-users). Unless Lexmark can point to contrary evidence, it would appear that its sales to distributors and retailers were unconditional. *Cf. Pioneer Hi-Bred Int’l v. Ottawa Plant Food, Inc.*, 283 F.Supp.2d 1018, 1024 (N.D. Iowa 2003) (describing arrangement where every level in the distribution chain was required to enter into agreements restricting subsequent sales).

This unconditional “first sale” fully and finally exhausted Lexmark’s patent rights. Nothing in patent exhaustion jurisprudence suggests that only *retail* sales trigger exhaustion—the first unconditioned sale anywhere in the distribution chain cuts off the patent tether. *See, e.g., United States v. Univis Lens Co.*, 316 U.S. 241 (1942) (first sale to top-level distributor exhausts patents in lens blanks, cutting off infringement actions against downstream lens finishers); *Adams v. Burke*, 84 U.S. 453 (1873) (sale of coffin lids by patent assignee to undertaker, who in turn sold to families of the deceased, exhausted patent rights in the lids).

In light of Lexmark’s unconditional sale of Prebate cartridges to its

restrictions on the Prebate cartridges, opting instead to simply sell them at wholesale for further resale to retailers, and thereafter to end-user consumers.

distributors, and the further unconditional sale of those cartridges by distributors to retailers, this Court may resolve this appeal by finding that Lexmark’s patent rights were fully exhausted before the Prebate cartridges ever found their way into consumer’s hands.

B. This Court should reject *Mallinckrodt*’s evisceration of the patent exhaustion doctrine.

Even if the Prebate label could be said to give rise to a “conditional” sale, it should not defeat the well-settled patent exhaustion principles consistently articulated by the Supreme Court since at least *Adams v. Burke*, 84 U.S. 453 (1873). To the extent *Mallinckrodt v. Medipart* suggests a different result, this Court should independently analyze the relevant precedents and decline to endorse the misconceived *Mallinckrodt* rule.

1. *Mallinckrodt* cannot be squared with the Supreme Court’s patent exhaustion precedents.

In *Mallinckrodt*, the district court got it right. In an unusually thorough and balanced opinion, Judge Will canvassed the Supreme Court precedents on patent exhaustion. *See Mallinckrodt v. Medipart*, 15 USPQ2d 1113 (N.D. Ill. 1990), *rev’d*, 976 F.2d 700 (Fed. Cir. 1992). He begins by noting that the earliest cases made it clear that unrestricted sales triggered exhaustion but left unanswered the question of whether a patent owner could, by express conditions, restrict post-sale uses of patented goods. *See id.* at 1116 (canvassing cases from 1873-1895).

He then turns his attention, however, to a number of later Supreme Court cases “which did involve patented goods and express attempts at

controlling use after purchase—specifically, attempts at resale price maintenance.” *See id.* Although these cases involved anticompetitive behavior by patent owners, Judge Will concludes that “their semantic reach is broader than that,” pointing out that a reading that limited them to the price-fixing context would render “the first-sale rule ... almost meaningless.” *Id.* at 1118.

On appeal, the Federal Circuit took precisely the path that Judge Will warned against. The appellate court effectively re-wrote the Supreme Court’s patent exhaustion precedents, limiting their application to occasions where the restriction in question would independently violate antitrust laws. *See Mallinckrodt v. Medipart*, 976 F.2d at 704 (“These cases established that price-fixing and tying restrictions accompanying the sale of patented goods were *per se* illegal.”).

Commentators have rushed to Judge Will’s defense, criticizing the Federal Circuit’s reading of the relevant Supreme Court precedents as disingenuous:

Of course, it would have been possible for the Supreme Court to have decided the exhaustion doctrine cases on the different rationale that the *Mallinckrodt* Court indicated that it preferred. But it is clear that the Supreme Court preferred, and deliberately selected, a different doctrinal route to its judgments, based on different legal concepts: its property law notions rather than any supposed abhorrence of price-fixing and tie ins.

Richard H. Stern, *The Unobserved Demise of the Exhaustion Doctrine in US Patent Law*, 12 EUROPEAN INTELL. PROP. REP. 460, 464 (1993) (hereafter

Stern, *The Unobserved Demise*); accord James B. Kobak, Jr., *Contracting Around Exhaustion: Some Thoughts About the CAFC's Mallinckrodt Decision*, 75 J. PAT. & TRADEMARK OFF. SOC'Y 550, 555-58 (1993) (hereafter Kobak, *Contracting Around Exhaustion*).⁵

The Federal Circuit's chief criticisms of Judge Will's opinion, moreover, ring hollow. The appellate court's first attack focused on the purportedly inconsistent treatment that the traditional exhaustion rule imposed on purchases from patent owners, as opposed to purchases from licensed manufacturers. In the view of the Federal Circuit, the traditional precedents governing patent exhaustion created an insupportable dichotomy between licenses and sales—the former could include restrictions on subsequent uses, while the latter could not. *See generally* Stern, *The Unobserved Demise*, *supra* at 465 (discussing differing treatment of sales and licenses to manufacture).

This purported inconsistency arises from *General Talking Pictures v. Western Electric Co.*, 304 U.S. 175, *on reh'g*, 305 U.S. 124 (1938). In that case, the Supreme Court permitted an infringement action against a purchaser who had bought amplifiers from a manufacturer licensed to sell only into the “home use” market, where the purchaser and manufacturer both were aware that the amplifiers in question would be used for

⁵ These commentators, both esteemed patent practitioners as well as patent law instructors, do a thorough job analyzing the flaws in the Federal Circuit's reading of the relevant Supreme Court cases and explaining the dangerous practical implications of the *Mallinckrodt* rule.

commercial purposes and thus fell outside the manufacturer's license to make and vend. The Federal Circuit thought that by allowing an infringement suit against a purchaser after a first sale, this created an arbitrary distinction—"that the enforceability of a restriction to a particular use is determined by whether the purchaser acquired the device from a manufacturing licensee or from a manufacturing patentee." *Mallinckrodt*, 976 F.2d at 705.

The perceived inconsistency, however, is illusory. As Judge Will properly found, *General Talking Pictures* merely established that where a manufacturing licensee exceeds the scope of his license, there has been no *authorized* first sale, and thus patent exhaustion does not apply. *See General Talking Pictures*, 305 U.S. at 127 ("We have no occasion to consider what the rights of the parties would have been if the amplifier had been manufactured 'under the patent' and 'had passed into the hands of a purchaser in the ordinary channels of trade.'"). If, in contrast, the commercial user in *General Talking Pictures* had simply purchased the amplifiers in the secondary market from noncommercial users who had acquired the units from the licensed manufacturer, neither he nor the noncommercial users would have been subject to an infringement suit. In other words, the exhaustion doctrine applies equally to sales by patent owners and their manufacturing licensees. *See Kobak, Contracting Around Exhaustion, supra*, at 555 & n.16.

In any event, whatever frustration the Federal Circuit may have felt

about the license/sale distinction, it was not entitled to cast aside a clear body of Supreme Court precedent:

A central point in the Supreme Court’s *General Electric* decision is that, while it is “well settled” that restrictions on use after the patentee sells a product to a customer are without legal force, the rule is different in regard to a limitation on the scope of a license to manufacture the same product. Treating sales and licenses to manufacture as legally equivalent is contrary to a vast body of case law, including the *General Electric* decision from which the *Mallinckrodt* court extracted its rule governing legality. Licenses create relational interests; sales create property rights. The legal consequences are very different.

That is not to say that the sale-license distinction may not warrant legislative re-examination, or that policy arguments cannot be made for revising the law. But that is not what the *Mallinckrodt* Court did or said. It simply overruled the entire body of law in the field, in disregard of however “well settled” the Supreme Court said that body of law was.

Stern, *The Unobserved Demise*, *supra*, at 465.

The Federal Circuit also criticized Judge Will’s view of exhaustion as interfering with the a patent owner’s “freedom to contract concerning conditions of sale.” *Mallinckrodt*, 976 F.2d at 708. The court declared that “[p]atent owners should not be in a worse position, by virtue of the patent right to exclude, than owners of other property used in trade.” *Id.*

This criticism tilts at a straw man. The patent exhaustion doctrine, in blocking infringement suits based on post-sale use restrictions, does not put patent owners in any worse a position than other property owners—they are free to use *contract law* to regulate post-sale uses, exactly as other property owners may. But the exhaustion doctrine *should* properly prevent patent owners from being in a *better* position than owners of tangible property, who

are generally not permitted to use property law to create equitable servitudes that run with chattel, much less invoke the full arsenal of enhanced patent law remedies in such an effort. *See United States v. General Elec. Co.*, 272 U.S. 476, 489 (1926) (“[A] patentee may not attach to the article made by him, or with his consent, a condition running with the article in the hands of purchasers....”); *Mallinckrodt*, 15 USPQ2d at 1119 (intimating no view on whether *Mallinckrodt*’s “single use only” restriction might be enforced as a matter of contract or property law).

In fact, post-*Mallinckrodt* precedents have made it even more evident that the *Mallinckrodt* rule is really an arbitrary windfall of “super-remedies” for patent owners in what would otherwise be simple contract disputes. In a series of cases, the Federal Circuit has made it clear that in order to qualify as a “conditional sale” under *Mallinckrodt*, the conditions must be part of an enforceable contract between the patent owner and purchaser. *See Jazz Photo Corp. v. ITC*, 264 F.3d 1094, 1108 (Fed. Cir. 2001); *Hewlett-Packard v. Repeat-o-Type*, 123 F.3d at 1453.

This development, while it limits the scope of the *Mallinckrodt* rule to some degree, underscores how arbitrary and unmoored from any principled rationale the rule has become. Why should patent owners be able to transform contract disputes with purchasers regarding post-sale restrictions into infringement actions, thereby obtaining liberal damage rules, treble damages for willfulness, a presumption in favor of injunctive relief, and the exclusive jurisdiction of the Federal Circuit for any appeals? *See Kobak*,

Contracting Around Exhaustion, supra, at 559 (discussing remedies and appellate jurisdiction advantages accorded by *Mallinckrodt* to patent owners against customers). The Federal Circuit in *Mallinckrodt* offered no reason to prefer this bizarre outcome to the traditional exhaustion doctrine, which sensibly separated patent infringement from contract law principles, giving patent owners no worse, but also no better, than property owners generally enjoy with respect to post-sale restrictions on chattel.

2. Adoption of the *Mallinckrodt* rule would harm consumers, hobble innovators, and undermine competition.

As Judge Will put it, “This is not, however, simply a question of semantics. It is a practical question.” *Mallinckrodt*, 15 USPQ2d at 1119. As the facts of this case demonstrate, the *Mallinckrodt* rule adopted by the Federal Circuit in 1992 has meant that consumers shopping the aisles of their local Office Depot now face contracts of adhesion and “label notices” that aim to impose a variety of post-sale restrictions on the use of patented goods they buy. In the case of Lexmark Optra printer cartridges, Lexmark hopes that its “label notices” will make unassailable its “give away the razors, then sell you the blades” business model. This business model, in turn, is not designed to spur innovation, but instead to take advantage of imperfect information in the marketplace—the common penchant of consumers when buying products to gravitate toward the lowest up-front price, while overlooking the “life cycle cost” (e.g., the purchase price of the printer combined with the lifetime cost of ink replacement in a monopolized

market). It is difficult to perceive how the patent monopoly is generating innovation or social value here.

In the end, however, an endorsement of the *Mallinckrodt* rule is likely to have negative consequences far beyond Lexmark printer cartridges. Software vendors have already generated considerable controversy with their practice of using “shrinkwrap licenses” in the copyright context to impose myriad unreasonable post-sale terms on consumers, much to the consternation of many courts and commentators.

If Lexmark succeeds in imposing its Prebate “single use only” label notice on consumers, it could well result in the widespread “shrinkwrap-ification” of a wide variety of goods beyond software. Labels sporting “no modifications or repair permitted” will be used to deter legitimate reverse engineering and shut down repair services. Field-of-use licensing (e.g., “for home use only”) intended to enable price discrimination will likely make a comeback. Aftermarkets could be entirely eliminated through the use of labels such as “for use only as automobile component, no resale as such.”

As discussed above, this result is precisely the one rejected by the numerous Supreme Court opinions that developed the patent exhaustion doctrine, precedents that stand for the proposition that when consumers purchase products, their legitimate property interests necessarily cut off the patent owner’s ability to further intermeddle with their quiet enjoyment of the goods purchased. There is nothing in the Federal Circuit’s *Mallinckrodt* rationale that justifies a departure from these principles, or explains why

patent owners should be accorded *more* power to encumber chattel with post-sale restrictions than any other owner of tangible property. This Court should reject the Federal Circuit's view in favor of Judge Will's sensible embrace of the traditional exhaustion doctrine.

IV. CONCLUSION

For the reasons examined above, amicus EFF respectfully asks this Court to reverse the district court's rulings and remand for further proceedings consistent with the traditional scope of patent exhaustion.

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