

INSIGHT: PATENT EXHAUSTION IN VIEW OF IMPRESSION PRODS., INC. V. LEXMARK INT'L, INC.

Sep 10 2018 12:05:43

Summary

After nearly a decade of silence on the patent exhaustion doctrine, the Supreme Court granted certiorari in *Impression Products, Inc. v. Lexmark International, Inc.* to address two patent exhaustion questions: (1) whether a patentee that sells an item under an express restriction on the purchaser's right to reuse or resell the product may enforce that restriction through an infringement lawsuit, and (2) whether a patentee exhausts its patent rights by selling its product outside the United States, where American patent laws do not apply. **581 U.S. 1523, 137 S. Ct. 1523** (2017).

By Audra Eidem Heinze and Timothy Meece

(Bloomberg Law) --
Summary

After nearly a decade of silence on the patent exhaustion doctrine, the Supreme Court granted certiorari in *Impression Products, Inc. v. Lexmark International, Inc.* to address two patent exhaustion questions: (1) whether a patentee that sells an item under an express restriction on the purchaser's right to reuse or resell the product may enforce that restriction through an infringement lawsuit, and (2) whether a patentee exhausts its patent rights by selling its product outside the United States, where American patent laws do not apply. **581 U.S. 1523, 137 S. Ct. 1523** (2017).

Overtaking 25 years of Federal Circuit precedent, the Supreme Court held a patentee's decision to sell a product exhausts all of its patent rights in that item, regardless of (1) any restrictions the patentee purports to impose or (2) the location of the sale. This decision ostensibly creates a bright-line test for applying the patent exhaustion doctrine and significantly narrows the rights of patent owners.

The Supreme Court's decision has an immediate impact on the business community in that companies can now sell articles protected by U.S. patent rights, regardless of the location of the initial sale or any post-sale restrictions, without fear of infringement. The Supreme Court's decision also raises questions that lawyers will grapple with going forward, such as the distinction between a sale and a lease, the use of contract law to enforce post-sale restrictions, the extent to which a licensee's sale is "authorized," and the applicability of copyright law to patent law and vice versa.

I. Introduction to the Impression Products Case

Before *Impression Products*, the Supreme Court and the Federal Circuit had long recognized the right of patent owners to transfer less than all of their patent rights. In *General Talking Pictures Corporation v. Western Electric Co.*, the Supreme Court affirmed infringement findings as to both a licensee and a purchaser where the sale by the licensee was outside the scope of the license. **305 U.S. 124** (1938). The Federal Circuit in *Mallinckrodt, Inc. v. Medipart, Inc.* applied *General Talking Pictures* to uphold the patentee's restriction on reuse of the patented products. **976 F.2d 700** (Fed. Cir. 1992). And, in *Boesch v. Graff*, the Supreme Court recognized that the sale of a patented product abroad does not automatically transfer United States patent rights. **133 U.S. 697** (1890). The Federal Circuit in *Jazz Photo Corporation v. International Trade Commission* applied *Boesch* to hold that United States patent rights are not exhausted by products of foreign provenance. **264 F.3d 1094** (Fed. Cir. 2001).

Under this legal framework, Lexmark sold patented print cartridges under limited and unlimited restrictions in the United States and around the world. Lexmark's "Regular Cartridges" were unrestricted and sold at full price. Lexmark's "Return Program Cartridges" were subject to an express single-use license and sold at a reduced price. As to all cartridges, region-specific contracts, labels, and technology made clear that Lexmark cartridges were not licensed for worldwide use and importation. From the moment they left Lexmark's hands, the cartridges at issue were subject to these territorial and use limitations, which were emblazoned on the cartridge, included in contracts with resellers and end-users, and programmed into microchips embedded in the cartridges themselves.

Impression Products acquired spent (i.e., used) Lexmark-made cartridges, installed hacked microchips to circumvent the cartridges' territorial and use restrictions, and sold the cartridges in the United States. Impression Products' business model, and its position in the case, depended on the proposition that any sale of a Lexmark cartridge, whether in the United States or overseas, automatically exhausted all United States patent rights in that cartridge.

More specifically, after stipulating to infringement, Impression Products' defense raised two issues: (1) whether Lexmark's United States patent rights were exhausted in Return Program Cartridges first sold in the United States (i.e., the domestic exhaustion issue), and (2) whether Lexmark's United States patent rights were exhausted in cartridges (whether Regular Cartridges or Return Program Cartridges) first sold outside the United States (i.e., the foreign exhaustion issue).

II. The Federal Circuit's En Banc Decision

The Federal Circuit's near 100-page en banc decision by Judge Taranto sided with Lexmark on both exhaustion issues (i.e., domestic exhaustion and foreign exhaustion). *Lexmark*, **816 F.3d 721** (Fed. Cir. 2016). The Federal Circuit began its decision by looking to the language of the statute at issue, 35 U.S.C. §271(a). Central to the Federal Circuit's analysis of both exhaustion issues is the word "authority" in §271(a): "If ordinary congressional supremacy is to be respected, exhaustion doctrine in the Patent Act must be understood as an interpretation of §271(a)'s 'without authority' language." *Id.* at 734.

As to domestic exhaustion, 10 judges reaffirmed the holding of *Mallinckrodt*, concluding that "a patentee, when selling a patented article subject to a single-use/no-resale restriction that is lawful and clearly communicated to the purchaser, does not by that sale give the buyer, or downstream buyers, the resale/reuse authority that has been expressly denied." *Id.* at 726. Simply put, "[u]nless granting 'authority' is to be a legal fiction, a patentee does not grant authority by

denying it.” *Id.* at 742. Conversely, where the restriction is not “lawful and clearly communicated,” i.e., the sale is “unrestricted,” the Federal Circuit recognized that it may be “reasonable” for courts to treat a sale of an article by a patentee as “*presumptively* granting ‘authority’ to the purchaser to use it and resell it.” *Id.*

The Federal Circuit also dismantled the government’s position that distinguished between licensee-sales and patentee-sales as “wrong as a matter of basic patent law,” relying on the Supreme Court’s decision in *General Talking Pictures Corp. v. Western Electric Co.* *Id.* at 745. In *General Talking Pictures*, the patent owner authorized a licensee to sell the patented product subject to a field of use restriction. *Id.* at 736 (quoting *Mallinckrodt*, 976 F.2d at 705, and discussing *General Talking Pictures*, 304 U.S. 175 (1938)). The licensee sold the product to a purchaser, which knew of the restriction, but, nevertheless, used the product contrary to the restriction. *Id.* The Supreme Court in *General Talking Pictures* affirmed the infringement findings as to both the purchaser and the licensee. *Id.*

With *General Talking Pictures* in mind, the Federal Circuit reasoned that, if a purchaser who bought from a licensee can be sued for infringement when acting contrary to the restriction, then a patentee should also be able to enforce restrictions under the patent laws when making sales directly. *Id.* at 737–38. In other words, there is no reason to distinguish between patentee-sales and licensee-sales. *Id.*

As to foreign exhaustion, the Federal Circuit unanimously held that sales outside the United States do not automatically exhaust U.S. patent rights. *Id.* at 754. To that end, the Federal Circuit dismissed Impression Products’ reliance on the Supreme Court’s decision in *Kirtsaeng v. John Wiley & Sons*, *Id.* at 756 (discussing *Kirtsaeng*, 568 U.S. 519 (2013)), which held that the first sale doctrine in §109 of the Copyright Act is not “limited to copies manufactured in the United States, but applies regardless of the place of manufacture” *Id.* at 756 (quoting *Kirtsaeng*, 568 U.S. at 524–54). The Federal Circuit explained that *Kirtsaeng* “says nothing about patent law; and it does not address, even in the context of copyright law, the exhaustion question presented by the Patent Act.” *Id.* (citations omitted).

Accordingly, the Federal Circuit held that, because Lexmark’s patent rights were not exhausted in either Return Program cartridges sold domestically or cartridges sold outside the United States, Impression Products infringed. *Id.* at 773–774.

III. The Supreme Court

The Supreme Court reversed the Federal Circuit’s decision in an 18-page opinion that adopted a bright-line test for patent exhaustion, holding that a “patentee’s decision to sell a product exhausts all of its patent rights in that item, regardless of any restrictions the patentee purports to impose or the location of the sale.” *Impression Prods.*, 137 S. Ct. at 1529.

Responding to the Federal Circuit’s decision, the Supreme Court declared that the Federal Circuit reached “a different result largely because it got off on the wrong foot.” *Id.* at 1533. While the Federal Circuit understood the exhaustion doctrine as an interpretation of the “without authority” language in §271(a), the Supreme Court found that the exhaustion doctrine is a “limit on the ‘the scope of the *patentee’s rights*.’” *Id.* at 1534 (quoting *U.S. v. Gen. Elec. Co.*, 272 U.S. 476 (1926)) (emphasis in original). The Supreme Court explained: “The right to use, sell, or import an item exists independently of the Patent Act. What a patent adds—and grants exclusively to the patentee—is a limited right to prevent others from engaging in those practices. Exhaustion extinguishes that exclusionary power. As a result, the sale transfers the right to use, sell, or import because those are the rights that come along with ownership, and the buyer is free and clear of an infringement lawsuit because there is no exclusionary right left to enforce.” *Id.* at 1534 (citations omitted).

Addressing the domestic exhaustion issue, the Supreme Court described as “misplaced” the Federal Circuit’s concern about creating an artificial distinction between licensee-sales and patentee-sales. *Id.* The Supreme Court reasoned a “patentee can impose restrictions on licensees because a license does not implicate the same concerns about restraints on alienation as a sale.” *Id.* As to a license, “[b]ecause the patentee is exchanging rights, not goods, it is free to relinquish only a portion of its bundle of patent protections.” *Id.* But once “a patentee decides to sell—whether on its own or through a licensee—that sale exhausts its patent rights, regardless of any post-sale restrictions” *Id.* at 1535.

Importantly, the Court did not overrule *General Talking Pictures*; instead, it described the case as involving a “fundamentally different situation.” *Id.* Specifically, both the licensee and the purchaser in *General Talking Pictures* knowingly acted outside the scope of the license. *Id.* In other words, “if a patentee has not given authority for a licensee to make a sale, that sale cannot exhaust the patentee’s rights.” *Id.*

Addressing the foreign exhaustion issue, the Supreme Court referred to its *Kirtsaeng* decision. *Id.* at 1535–36. While *Kirtsaeng* began with the text of §109(a), the Supreme Court explained that was not decisive. *Id.* at 1536. Rather, “[w]hat helped tip the scales for global exhaustion was the fact that the first sale doctrine originated in ‘the common law’s refusal to permit restraints on the alienation of chattels.’” *Id.* (quoting *Kirtsaeng*, 568 U.S. at 538). The Supreme Court reasoned that patent exhaustion also has “its roots in the antipathy toward restraints on alienation.” *Id.* at 1536. Finding that the patent exhaustion and copyright first sale doctrines share a “‘strong similarity . . . and identity of purpose,’” the Supreme Court explained that the “bond between the two leaves no room for a rift on the question of international exhaustion.” *Id.* (quoting *Bauer & Cie v. O’Donnell*, 229 U.S. 1 (1913)).

Accordingly, the Supreme Court held that Lexmark’s patent rights were exhausted, and, thus, Impression Products did not infringe.

IV. Ramifications of the Supreme Court Decision and Strategies Going Forward

The Supreme Court delineated what appears to be a bright-line test for patent exhaustion, which will impact businesses on both sides of the issue. For example, pharmaceutical companies have often sold medicines protected by U.S. patents in foreign countries at substantially lower prices (or even distributed them for free). That practice may be disrupted because other companies can now purchase those lower-priced medicines in foreign countries and import them into the United States for sale at a much higher price without fear of infringing U.S. patent rights. See *LifeScan Scotland v. Shasta Techs.*, 734 F.3d 1361 (2013) (“We therefore conclude that patentees cannot circumvent the application of patent exhaustion principles by distributing a product embodying the patent for free.”).

Notably, when discussing foreign exhaustion, the Supreme Court was also quick to equate copyrights and patents, *Impression Prods.*, 137 S. Ct. at 1536 (“differentiating the patent exhaustion and copyright first sale doctrines would make little theoretical or practical sense”), despite the fact that they are distinct forms of intellectual property protection, subject to different laws. In fact, in the Supreme Court’s first case to apply the first sale doctrine under copyright law, *Bobbs-Merrill v. Straus*, the Court hesitated to apply cases involving patent exhaustion, explaining: “If we were to follow the course taken in the argument, and discuss the rights of a patentee, under letters patent, and then, by analogy, apply the conclusions to copyrights, *we might greatly embarrass the consideration of a case under letters patent*, when one of that character shall be presented to this court.” 210 U.S. 339, 345–46 (1908) (citations omitted) (emphases added). The Supreme Court’s *Impression Products* decision is silent as to *Bobbs-Merrill*. See generally *Impression Prods.*, 137 S. Ct. 1523. However, Justice Ginsburg’s dissent issues a warning against equating patent law and copyright law. *Id.* at 1538–39.

While *Impression Products* effectively halted the ability of patentees to use patent law to enforce post-sale restrictions, the Supreme Court has suggested the use of contract law to enforce these restrictions as between the patentee and the purchaser. For example, the Court in *Impression Products* noted that the

patentee and the purchaser are free to negotiate a contract, and that whatever rights a patentee might seek to retain are a matter of contract law, not patent law. *Id.* at 1531, 1533, 1535. The Supreme Court made similar observations in *Quanta Computer, Inc. v. LG Electronics, Inc.*, though it declined to state whether “contract damages might be available even though exhaustion operates to eliminate patent damages.” *Quanta*, 553 U.S. at 637 n.7. Of course, contract law has other limitations, most notably the requirement of privity of contract.

Other strategies for patentees to employ going forward to enforce post-sale restrictions may include the use of unfair competition law and technological countermeasures. Additionally, a patentee may be able to avoid exhaustion by leasing a product rather than selling it. That said, courts will not necessarily rely on the label parties choose to ascribe to an exchange of goods, e.g., by characterizing an exchange as a “lease” as opposed to a “sale,” but will instead look to the circumstances of the exchange to determine whether it is, in fact, a “lease.”

V. Conclusion

The Supreme Court's *Impression Products* decision upset decades of Federal Circuit jurisprudence in favor of an ostensibly bright-line test for patent exhaustion; that is, a patentee's decision to sell a product exhausts all of its patent rights in that item. The impact of this holding on the business community is far-reaching. Additionally, while the holding crystallizes many patent exhaustion issues, other issues remain unclear, including as to strategies patentees may employ going forward in attempt to avoid exhaustion.

Audra C. Eidem Heinze is a principal shareholder in the Chicago office of Banner & Witcoff, Ltd. She handles complex litigation, opinion work and transactional issues involving patents, trademarks and copyrights. Her experience involves an extensive range of fields, including imaging devices and supplies, computer hardware and software, and athletic footwear, apparel and equipment.

Timothy C. Meece is a principal shareholder in the Chicago office of Banner & Witcoff, Ltd. He has more than 20 years of experience litigating and trying complex patent infringement cases relating to electrical, electronic, computer hardware/software, and mechanical technology, and copyright infringement suits involving computer software. He has also won numerous inter partes review trials before the Patent Trial and Appeal Board.

The authors may be contacted at Banner & Witcoff, Ltd. in Chicago, 312.463.5000, <http://www.bannerwitcoff.com>

Reproduced with permission from Copyright 2018 The Bureau of National Affairs, Inc. (800-372-1033) www.bna.com.