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Supreme Court Report

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Supreme Court Holds That Patent Exhaustion Applies to All Sales, Domestic and International, Regardless of Post-Sale Restrictions

On May 30, 2017, in *Impression Products, Inc. v. Lexmark International, Inc.*, the Supreme Court ruled 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.” By expanding the exhaustion doctrine, the case limits patent owners’ ability to use patent law to impose post-sale restrictions on their products, expanding downstream consumers’ freedom to reuse or resell goods. The Supreme Court left open the possibility that contract law principles could still restrict those activities, though as *Impression Products* itself demonstrates, doing so may face practical limitations.

Background

Lexmark sells toner cartridges for printers through two programs. Under the program at issue before the Supreme Court, Lexmark sold “Regular” cartridges at a full price without any restrictions on use. It also operated a “Return Program” that sold cartridges at a roughly 20 percent discount in exchange for customers contractually agreeing to use the cartridge only once and return it to Lexmark. Impression refurbishes

and resells cartridges originally sold by Lexmark in the United States or abroad.

In 2010, Lexmark sued Impression, alleging infringement of Lexmark patents. Impression argued that Lexmark exhausted all of its patent rights when it sold the cartridges, regardless of any post-sale restrictions. In turn, Lexmark claimed that Impression infringed by reselling Return Program cartridges that Lexmark originally sold in the United States and abroad. Accordingly, the case involved issues of both domestic and international exhaustion.

Supreme Court Proceedings and Decision

The Federal Circuit had upheld Lexmark’s program, relying on, among other cases, *Mallinckrodt, Inc. v. Medipart, Inc.* [976 F.2d 700 (Fed. Cir. 1992)] and *Jazz Photo Corp. v. International Trade Commission* [264 F.3d 1094 (Fed. Cir. 2001)]. In *Mallinckrodt*, the Federal Circuit had held that a patent holder could sell an item and retain the right to enforce patents through “clearly communicated, ... lawful restriction[s] as to post-sale use or resale.” In *Jazz Photo*, the Federal Circuit had held that a sale outside the United States did not terminate the patent holder’s right to sue for infringement someone who imported the product into the United States.

The Supreme Court overruled both lines of Federal Circuit precedent in *Impression Products*, holding that “patent exhaustion is uniform and automatic.” Once a sale has occurred, the Court found, “[t]he sale ‘terminates all patent rights to that item.’”

From Lexmark’s perspective, both its “Return Program” and international sales had exhausted Lexmark’s patent rights in the toner cartridges sold.

On domestic exhaustion, the Court relied on the common law principle against restraints on alienation. That doctrine generally deems void a condition or conditional limitation on alienation attached to a transfer of the entire interest in an item. The Court rejected any potential inconsistency between allowing patentees to impose restrictions in patent licenses but not on product sales, reasoning that “[a] patentee can impose restrictions on licensees because a license does not implicate the same concerns about restraints on alienation as a sale.” Justice Roberts’s opinion noted the example of used cars, stating as a policy matter that exhaustion permits resale without fear of patent infringement, as “extending the patent rights beyond the first sale would clog the channels of commerce, with little benefit from the extra control that the patentees retain.”

Regarding international exhaustion, the Court applied similar principles, finding that “nothing in the text or history of the Patent Act shows that Congress intended to confine that borderless common law principle to domestic sales.” The majority cited and aligned with the Court’s recent decision in *Kirtsaeng v. John Wiley & Sons, Inc.* [568 U. S. 519, 538 (2013)], which applied international exhaustion to copyright law under the first sale doctrine.

Implications

The Supreme Court has expanded consumer rights while simultaneously limiting patent owners’ options for controlling post-sale uses of their products. Resellers like Impression can now operate with less fear of patent infringement claims. By negating existing post-sale restrictions from patent

owners, prices for used products might also decrease for consumers. This also could help retailers who sell complex products with many components.

At the same time, patentees may need to identify new strategies for maximizing their return on patented products. The Supreme Court indicated that state contract law could provide some remedies for companies such as Lexmark, as “whatever rights Lexmark retained are a matter of the contracts with its purchasers.” However, companies that may wish to rely on contract principles will need to consider their distribution channels more carefully, including which parties may be subject to contract restrictions, how to flow-down restrictions through the distribution channel, the form that those restrictions may take, and which parties may be practically sued on contract law theories when those restrictions are breached. Consideration also should be given to whether products can and should be licensed, and not sold.

Patent owners may need to impose different or stricter terms on their international distributors to control the flow of their products consistent with antitrust and other legal principles too. Moreover, patentees could decide to have less international price differentiation for their products, reducing the incentive for third parties to arbitrage those differences. These changes could also affect pharmaceutical and medical device companies, who have used post-sale restrictions to prevent reuse of health-related products or importation of drugs sold more cheaply abroad.

This case likely will affect organizations that license patent portfolios, as they may face significant push-back in trying to execute broad-based licensing programs against supply chains and end users. This may be especially true of organizations attempting to license patents against technologies and methods with components from many different sources.

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