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The author suggests a way to harmonize the Federal Circuit's line of cases on international patent exhaustion with the Supreme Court's holding in *Kirtsaeng*.

Whether International Sales Under Worldwide Licenses Exhaust U.S. Patents: The Days of the *Jazz Photo*, *Ninestar* and *Benun* Line of Cases May Be Numbered

BY GINO CHENG

In *Quanta*, the U.S. Supreme Court reiterated that ''the right to vend is exhausted by a single, unconditional sale, the article sold being thereby carried outside the monopoly of the patent law and rendered free of every restriction which the vendor may attempt to put upon it.''[1] And although its decision in *Quanta* opened the door for exhausting method claims by the unrestricted, authorized sale of components that substantially embodied them,[2] it did not expressly address whether there the patent exhaustion defense was extraterritorial in nature, or hold that an international sale could exhaust an embodied claim.

Since *Quanta*, different Federal Circuit panels have given mixed signals as to whether lower courts should impose a territorial requirement. In *Benun II*[3]—the last among the related *Jazz Photo* line of cases[4]—the Federal Circuit imposed such a requirement and accord-

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[1] *Quanta Computer Inc. v. LG Elecs. Inc.*, 553 U.S. 617, 626, 2008 BL 122107, 86 U.S.P.Q.2d 1673 (2008) (76 PTCJ 205, 6/13/08) (hereinafter, ''*Quanta*'') (*citing Motion Picture Patents Co. v. Universal Film Mfg. Co.*, 243 U.S. 502, 516 (1917)). For additional analysis of *Quanta*, please see Gino Cheng et al., PRIP TOKYO, N.P.O., UNIVERSITY OF TOKYO, RCAST, AND THE NATIONAL GRADUATE INSTITUTE FOR POLICY STUDIES (GRIPS), ''*Quantafiable Differences in U.S. Law on Patent Exhaustion*,'' Tokyo, Japan, April 16, 2015, *available at* http://www.winston.com/en/who-we-are/attorneys/cheng-gino.html.

[2] *See Quanta*, 553 U.S. at 638 (''Intel's microprocessors and chipsets substantially embodied the LGE Patents because they had no reasonable noninfringing use and included all the inventive aspects of the patented methods. Nothing in the License Agreement limited Intel's ability to sell its products practicing the LGE Patents.'').

[3] *Fujifilm Corp. v. Benun*, 605 F.3d 1366, 1371, 95 U.S.P.Q.2d 1985 (Fed. Cir. 2010) (80 PTCJ 196, 6/11/10) (hereinafter ''*Benun II*'') (''*Quanta Computer, Inc. v. LG Electronics, Inc.* did not eliminate the first sale rule's territoriality requirement.''); *cf. Fuji Photo Film Co. v. Benun*, 463 F.3d 1252, 82 U.S.P.Q.2d 1476 (Fed. Cir. 2006) (72 PTCJ 488, 9/1/06) (hereinafter ''*Benun I*'').

[4] *See Jazz Photo Corp. v. ITC*, 264 F.3d 1094, 59 U.S.P.Q.2d 1907 (Fed. Cir. 2001) (62 PTCJ 402, 8/31/01) (hereinafter ''*Jazz Photo I*''); *Fuji Photo Film Co. v. Jazz Photo Corp.*, 394 F.3d 1368, 73 U.S.P.Q.2d 1678 (Fed. Cir. 2005) (69 PTCJ 274, 1/21/05) (hereinafter ''*Jazz Photo II*''); *and Ninestar Tech. Co. v. ITC*, 667 F.3d 1373, 1378, 101 U.S.P.Q.2d 1603 (Fed. Cir. 2012) (83 PTCJ 530, 2/17/12) (''As stated in *Jazz Photo*, 'United States patent rights are not exhausted by products of foreign provenance. To invoke the protection of the first sale doctrine, the authorized first sale must have occurred under the United States patent.' '') (internal citation omitted).

ingly held that the lawful, overseas sale of a single-use, disposable camera covered by a U.S. patent did not exhaust the patentee's right to sue for infringement when the discarded cameras were subsequently refurbished, imported, and resold in the U.S. There is tension between this holding and the imminent course correction that the Federal Circuit may be suggesting with its more recent *LifeScan*[5] and *Helferich*[6] opinions which each referenced *Kirtsaeng*, a post-*Benun II* decision by the Supreme Court that held copyright exhaustion had no such territoriality requirement.[7]

The *LifeScan* panel's endorsement[8] of the reasoning in *Kirtsaeng* is non-trivial, because the exhaustion (or ''first sale'') defense for both copyright and patent law derive from the same common law principles. In particular, they both hail from a tradition of ''impeccable historic pedigree''[9] that did not discriminate between forms of tangible or intangible property, tracing back to ''the common law's refusal to permit restraints on the alienation of chattels.''[10] Further, at its roots, this common law doctrine made no geographical distinctions.[11] Thus, while *Kirtsaeng* was not a case about patent rights, its rationale and subsequent acceptance by the *LifeScan* and *Helferich* panels in a pair of patent exhaustion cases are indicative of the predisposition of at least two panel majorities on the extraterritorial application of the first sale doctrine in patent law. *LifeScan* and *Helferich* also lay the groundwork for the Federal Circuit to either relax or forswear the territoriality requirement in the pending *Lexmark* appeal en banc.[12]

To be sure, *LifeScan* did not reach the question of international patent exhaustion, the disputed activity having taken place within the U.S.[13] However, *LifeScan* acknowledged lessons in copyright as being instructive, noting how ''[t]he Supreme Court has frequently explained that copyright cases inform similar cases under patent law.''[14] And in *Kirtsaeng*, the Supreme Court presumed that although Congress had codified in statute certain exhaustion-related principles, Congress did not mean to overwrite the common law with respect to other parts of the first sale doctrine on which the copyright statute was silent—such as its extraterritorial application. Thus, applying that same rationale to the issue in the context of patent law, where no part of the exhaustion defense has yet been codified, *Kirtsaeng*'s deference to the historic roots of the first sale doctrine and its extraterritorial reach should operate with at least equal if not more force.[15] Hence, *LifeScan*'s reliance on *Kirtsaeng* might be read as foreshadowing how an authorized sale of a patented article outside the U.S. will prevent the patentee from prevailing on an infringement against the purchaser (and subsequent downstream purchasers) for the importation and resale of that article in the U.S.

But what impact would this have on *Benun II*[16] and is there a way to do less violence to the *Jazz Photo* line of cases, each of which declined to find patent exhaustion despite the first sale having occurred overseas? The panel in *Jazz Photo I* had held that ''a lawful foreign purchase does not obviate the need for license from the United States patentee before importation into and sale in the United States.''[17] To the extent these cases impute a territorial restriction, their conclusions are not grounded in—and indeed run counter to— the common law origins of the first sale doctrine.[18,19] Short of over-

[5] *LifeScan Scotland Ltd. v. Shasta Techs., LLC*, 734 F.3d 1361, 1375-76, 108 U.S.P.Q.2d 1757 (Fed. Cir. 2013) (87 PTCJ 64, 11/8/13).

[6] *Helferich Patent Licensing, LLC v. New York Times Co.*, 778 F.3d 1293, 1305, 113 U.S.P.Q.2d 1705 (Fed. Cir. 2015) (89 PTCJ 953, 2/13/15).

[7] As a result, in *Kirtsaeng*, the accused infringer who had lawfully purchased foreign copies of textbooks overseas was not prohibited under U.S. copyright law to import and resell those textbooks in the U.S., the U.S. copyright holder's rights having been exhausted by the authorized sales activity that had occurred abroad. *See Kirtsaeng v. John Wiley & Sons, Inc.*, 133 S. Ct. 1351, 106 U.S.P.Q.2d 1001 (2013) (85 PTCJ 695, 3/22/13).

[8] *LifeScan*, 734 F.3d at 1374-75.

[9] *Kirtsaeng*, 133 S.Ct. at 1363.

[10] *Id.*

[11] *See id.*

[12] Appeal Nos. 2014-1617 and 2014-1619 from *Lexmark Int'l, Inc. v. Impression Prods., Inc.*, No. 1:10-cv-00564 (S.D. Ohio April 14, 2015) (First of two legal issues to be briefed: ''In light of *Kirtsaeng v. John Wiley & Sons, Inc.*, 133 S. Ct. 1351 (2012), should this court overrule *Jazz Photo Corp. v. International Trade Commission*, 264 F.3d 1094 (Fed. Cir. 2001), to the extent it ruled that a sale of a patented item outside the United States never gives rise to United States patent exhaustion.''). For discussion on the other issue that the Federal Circuit will be briefing—whether post-sale restraints can rescue a sold, embodying article from exhausting any patent remedies—please see Gino Cheng, ''*Finding a Place for* Mallinckrodt *and Conditional Sales in the Patent Exhaustion Doctrine: Will 'Lex' Mark the Spot?*'', NEW MATTER, Vol. 40, No. 3, Fall 2015 (forthcoming).

[13] In *LifeScan*, the panel majority held for the accused replacement test strip supplier, concluding that the patentee's asserted method claims for using the blood glucose test meter were exhausted by the initial sale or gifting away of those meters. *LifeScan*, 734 F.3d at 1374.

[14] *LifeScan*, 734 F.3d at 1375 n.9; *see also id.* at 1375-76 (''In the Supreme Court's recent decision in *Kirtsaeng v. John Wiley & Sons, Inc.*, the Court held that the first sale doctrine in copyright law (*comparable to the patent exhaustion doctrine*) applies equally whether the copyrighted work is manufactured in the United States or abroad.'') (emphasis added, citation omitted).

[15] For additional discussion about the implications of *Kirtsaeng*, please see Gino Cheng et al., ''*Helping the U.S. Federal Circuit Find a Place for* Jazz Photo *in the Legal Landscape of International Patent Exhaustion: Will ''Lex'' Mark the Spot?*,'' KEEP YOUR COUNSEL, July 15, 2015, available at http://www.winston.com/en/who-we-are/attorneys/cheng-gino.html.

[16] *Benun II*, 605 F.3d at 1371 (''*Quanta Computer, Inc. v. LG Electronics, Inc.* did not eliminate the first sale rule's territoriality requirement.'').

[17] *Jazz Photo I*, 264 F.3d at 1105.

[18] The *Jazz Photo* line of cases is also premised on a misreading of *Boesch v. Graff*, 133 U.S. 697, 701–703 (1890), where the lawful purchase of the article in Germany occurred under a German patent that belonged to a different patentee from the one holding the U.S. patent, and therefore there was no exhaustion of the latter entity's rights to recover with its U.S. patent. Accordingly, one could easily reinterpret *Boesch* as denying exhaustion on the basis of the lack of authorization from the U.S. patentee, as opposed to crediting the result to a territorial restriction that has yet to be enunciated by Congress.

[19] Another point of distinction may be observing how the patentee and manufacturer of the disposable cameras did not contemplate that its disposable cameras, after being thrown out, would be scavenged, refurbished abroad, and then resold in the U.S. market. Because the patentee was not attempting to double-dip, the Court may have sympathetically declined to fault the patentee's failure to factor that possibility into the ini-

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turning *Jazz Photo I* and its progeny on that basis, however, perhaps they may be distinguished or reinterpreted on the grounds that none of them involved a worldwide patent license. In the same vein, the Federal Circuit may shift the inquiry away from the geographical aspect of the sale and toward the aspect of authorization instead—*viz*. how an unconditional worldwide license from the U.S. patentee authorizes its licensee's customers, regardless of where the initial sales transaction is consummated, to subsequently import the purchased good into the U.S. free from an infringement suit under the same patent. In other words, one possible rule to harmonize *Jazz Photo* with the thrust of *Kirtsaeng* and the outcome of *Quanta* would be as follows:

- An article that practices a U.S. patent and that is acquired outside the U.S. without the patentee's authorization *does not* exhaust the embodied claims.

- Conversely, even assuming that the mere overseas purchase of an item that practices a U.S. patent does not give the purchaser a right to import it into the U.S., doing so under a negotiated worldwide license agreement[20] or other form of authorization *does* exhaust the embodied claims.

This approach may have already found some support in the Federal Circuit's *Tessera* opinion,[21] albeit another panel reverted back to the *Jazz Photo* reasoning in the subsequently decided *Ninestar* case.[22,23] In *Tessera*, the accused infringer Elpida imported products incorporating chips practicing Tessera's patent.[24] Elpida had purchased these chips from overseas manufacturers who had signed Tessera's TCC license agreements.[25] Finding against Tessera, the court concluded that the doctrine of patent exhaustion applied even though the authorized sales from the licensees to Elpida were made overseas.[26]

One difference between *Tessera* and *Jazz Photo*—and that which could be pegged as a sufficient and deciding factor—is the existence of a worldwide license.[27] Under such a license to, e.g., ''make, use, sell (directly or indirectly), offer to sell, import or otherwise dispose of''[28] a product that practices the licensed patent(s), the geographical location of the lawful sale becomes moot. Unless this were so, then despite the sales of the same product occurring under the same ''worldwide'' license, the patentee would be allowed to extract an additional fee for those products destined for the U.S. but merely sold elsewhere first.[29]

In light of the convenience that worldwide sales revenues offer in the way of royalty-calculation, this rule makes further practical sense. Because a patentee typically demands royalties based on global revenues stemming from sales even to jurisdictions where it holds no patents, there is some equitable symmetry in demanding its forfeiture of whatever rights it may have had in the jurisdictions where it does hold patents. In addition, the same formulation has the added benefit of being reconcilable with the result in *Quanta*, which also involved a worldwide license[30] and international sales,[31] and the outcome of which was a finding of exhaustion of LGE's U.S. patents.

Since *Ninestar*, the Federal Circuit has had many an occasion to speak to patent exhaustion, the latest being *Keurig*,[32] *LifeScan* and *Helferich*. However, because none of them involved overseas sales, none of them provides closure on this critical question. Instead, the issue

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tial sale price. Nonetheless, the recent trend has been to disfavor weighing the subjective intent of the parties and evaluating the hypothetical fair value of the patented good's sale. *See, e.g.*, *Helferich*, 778 F.3d at 1308 (''But that principle [against double recoveries] has never served as an independent test for determining whether exhaustion applies. It is hard to see how it could do so unless courts first established the dollar value of the proper reward to determine when the patentee had received it and therefore had to stop seeking additional recoveries.''). For additional analysis of *Helferich*, please see Gino Cheng, ''Quanta-*fying* Helferich Patent Licensing's *Contribution To The Exhaustion Doctrine*,'' BLOOMBERGBNA'S PATENT TRADEMARK & COPYRIGHT JOURNAL, April 10, 2015 (89 PTCJ 1647, 4/10/15).

[20] At least those that are executed in the U.S. or are otherwise governed by U.S. law.

[21] *Tessera, Inc. v. ITC*, 646 F.3d 1357, 98 U.S.P.Q.2d 1868 (Fed. Cir. 2011) (82 PTCJ 108, 5/27/11).

[22] *Ninestar*, 667 F.3d at 1378-79 (affirming the International Trade Commission's ruling that Ninestar's refurbishing of genuine used Epson ink cartridges of Asian and European origin was in violation of its exclusion order, rather than excused under a patent exhaustion defense).

[23] Curiously, Judge Linn sat on both panels and authored the *Tessera* opinion. But because Judge Linn was also a member of the panels that concluded there was no exhaustion in *Jazz Photo II* and *Benun II*, rather than asking why he found no exhaustion in *Ninestar*, perhaps the more appropriate question is why he found exhaustion in *Tessera*. One explanation may be that on appeal, Tessera did not raise the issue of extraterritoriality and instead directed the *Tessera* panel to the question of whether the failure by its licensees to pay royalties was a violation of an alleged condition subsequent in the TCC license that retroactively rendered unauthorized the semiconductor chip sales to the licensees and, in turn, to their downstream purchasers as well. On this narrow question, the panel concluded that non-payment of royalties did not impact Tessera's ''unconditional grant of a license 'to sell . . . and/or offer for sale' the accused products'' and affirm the Commission's final determination not to disturb the administrative law judge's finding Tessera's patent exhausted. *Tessera*, 646 F.3d at 1370.

[24] *Tessera*, 646 F.3d at 1362 and 1367.

[25] *Id*. at 1362-63, 1367, 1370.

[26] *Id*. at 1369-71; *see also Multimedia Patent Trust v. Apple Inc.*, No. 10-CV-2618-H-KSC, 2012 WL 6863471, at *5 (S.D. Cal. Nov. 9, 2012) (''In *Tessera*, the Federal Circuit found that the doctrine of patent exhaustion applied . . . even though the authorized sales were made in a foreign jurisdiction.'').

[27] *Tessera*, 646 F.3d at 1370 (''Each of the TCC License agreements contains an unconditional grant of a license 'to sell . . . and/or offer for sale'' the accused products.' '').

[28] *See, e.g.*, *Quanta*, 553 U.S. at 623.

[29] To the extent the parties intend to allow the patentee to reward itself with a different amount of recovery for sales destined for the U.S., creative licensed schemes and carve-outs may be explored.

[30] *See, e.g.*, *LG Elecs., Inc. v. Hitachi, Ltd.*, 655 F. Supp.2d 1036, 1047, 2009 BL 51964 (N.D. Cal. 2009) (holding in the alternative that an unconditional worldwide license ''constitutes a sale for exhaustion purposes.'').

[31] *See, e.g.*, *Hitachi*, 655 F. Supp.2d at 1045 (''In addition, the Supreme Court in Quanta was aware that some sales under the license agreement were made overseas. . .'') and 1047 (dealing with the same license as that from *Quanta* and observing that ''*Quanta*'s holding—that exhaustion is triggered by the authorized sale of an article that substantially embodies a patent—applies to authorized foreign sales as well as authorized sales in the United States.'').

[32] *Keurig, Inc. v. Sturm Foods, Inc.*, 732 F.3d 1370, 108 U.S.P.Q.2d 1648 (Fed. Cir. 2013) (86 PTCJ 1281, 10/25/13).

was recently teed up in *San Disk*,[33] fully briefed, and scheduled for oral argument before the Federal Circuit on May 7, 2015. However, the case was settled before the hearing, temporarily depriving practitioners, patentees and purchasers of finality on this issue and market certainty.

Next at bat is *Lexmark*, where unauthorized foreign sales of refurbished, patented Lexmark ''Prebate'' printer cartridges were at issue. The district court had declined to find that *Kirtsaeng* overruled *Jazz Photo* and concluded that the foreign sales did not exhaust Lexmark's U.S. patent rights.[34] The appeal from this order was argued before a panel on March 6, 2015. On April 14, 2015, the Federal Circuit sua sponte agreed to hear the issue en banc.[35] It is currently scheduled to hear oral arguments on October 2, 2015.

In sum, the ongoing viability of *Jazz Photo* and its progeny unsettles the legal landscape and provides—to enterprising patentees desirous of arbitrage or multiple recoveries—the opportunity to structure their distribution chains in a way that circumvents the longstanding first sale doctrine. This notwithstanding, if the active bench of the Federal Circuit is willing to run with the seed planted in *LifeScan*,[36] *Lexmark* should offer definitive, much-needed guidance and reconcile the conflicting outcomes in *Jazz Photo* and *Quanta*, which also involved foreign first sales.[37] But until then, those who are aiming to avoid U.S. patent exhaustion from international sales should scrutinize their existing licensing agreements and avoid negotiating unconditional worldwide licenses,[38] and vice-versa.

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[33] Appeal No. 14-1678 from *San Disk Corp. v. Round Rock Research LLC*, No. CV-11–5243 (N.D. Cal. June 13, 2014) (Question presented: ''Whether the District Court erred in granting summary judgment of no infringement of U.S. Patent Nos. 6,570,791 and 6,845,053 for patent exhaustion and erred in denying summary judgment of infringement and no patent exhaustion of these patents.'').

[34] *See Lexmark Int'l, Inc. v. Impression Prods., Inc.*, 9 F. Supp.3d 830, 838 (S.D. Ohio March 27, 2014) (concluding that ''the Supreme Court did not intend to implicitly overrule *Jazz Photo* and that *Jazz Photo* remains controlling precedent on patent exhaustion abroad.''). Conversely, the district court held in a separate order that the domestically sold cartridges were exhausted despite the post-sale restriction on the use by purchasers under the Prebate Program, reasoning that the Supreme Court in *Quanta* had *sub silentio* overruled the Federal Circuit's previous endorsement of a ''single use'' post-sale restriction for medical equipment in *Mallinckrodt, Inc. v. Medipart, Inc.*, 976 F.2d 700, 24 U.S.P.Q.2d 1173 (Fed. Cir. 1992)). *See Lexmark Int'l, Inc. v. Impression Prods., Inc.*, No. 1:10-cv-00564, 2014 WL 1276133, at *6 (S.D. Ohio March 27, 2014) (''Under *Quanta*, those post-sale use restrictions do not prevent patent rights from being exhausted given that the initial sales were authorized and unrestricted.'').

[35] *See* note 12, *supra*.

[36] *See LifeScan*, 734 F.3d at 1376 (''The [*Kirtsaeng*] Court explained that the first sale doctrine was traceable to 'the common law's refusal to permit restraints on the alienation of chattels.' . . . The same policy undergirds the doctrine of patent exhaustion.'') (citation omitted).

[37] *See* note 31, *supra*.

[38] Note, however, that opting for a conditional license in lieu of an unconditional one still may not guarantee avoidance of patent exhaustion. Whether a conditional sale may, in effect, retroactively revoke a patent holder's authorization is a separate issue that the Federal Circuit will be briefing in *Lexmark*. *See* note 12, *supra*.

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