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CLIENT ALERT

Supreme Court Holds That Patent Exhaustion Applies to All Sales, Foreign and Domestic

MAY 31, 2017

Impression Products, Inc. v. Lexmark International, Inc.

In yet another rebuke to the Federal Circuit, the U.S. Supreme Court held yesterday in *Impression Products v. Lexmark International* that the doctrine of patent exhaustion bars a patentee from interfering with a legitimate purchaser's downstream uses of a patented product. The decision is important both for industries that sell the same products in domestic and foreign markets, and for companies that distribute their patented products under restrictive sales terms.

Under the decision, once a patented item is sold, domestically or abroad, the patentee's patent rights in that particular item are "exhausted." Thus, by virtue of a legitimate first sale, the patentee relinquishes the right to restrict the buyer's reuse or resale by way of a patent infringement lawsuit. This is true even if the first sale took place outside of the United States and was therefore subject to foreign rather than U.S. patent law. With respect to domestic sales, Chief Justice Roberts wrote for a unanimous Court; with respect to sales abroad, the decision was 7-1, with Justice Ginsburg dissenting on the same grounds as her dissent in *Kirtsaeng v. John Wiley & Sons, Inc*., which involved similar issues under the Copyright Act's "first sale" doctrine. Justice Gorsuch did not participate in the decision.

In reaching this conclusion the Court accepted Lexmark's right to distribute its products subject to restrictions on post-sale use or resale. But by authorizing a first sale, Lexmark gave up the right to sue buyers or users for patent infringement—even if they violated the limitations on post-sale use or resale. The Court explained that Lexmark's remedy, if any, is to sue the original buyer for breach of contract. Subsequent purchasers cannot be sued for breach of contract (because they were not in privity with Lexmark in the first place) and cannot be sued for patent infringement (because Lexmark's patent rights were exhausted by the first sale).

The Court's opinion provides important guidance on the limits of patents and the rights of purchasers (including purchasers abroad) to use and import patented goods.

Background

Lexmark designs and sells toner cartridges for laser printers, and owns a variety of patents on the cartridges and their use in printers. Cartridges can be refilled and reused, and there is a robust market for used cartridges in the U.S. and abroad. Lexmark attempts to restrict this aftermarket by offering discounts to buyers who agree (contractually) to use the cartridges only once, and then to return their empty cartridges only to Lexmark. Buyers, however, often buy the discounted cartridges, use them, and then sell the empty cartridges to aftermarket refillers—some in the U.S., some overseas—rather than Lexmark.

Rather than suing its customers for violating the no-resale provision of their contracts, Lexmark sued U.S. and foreign aftermarket refillers for patent infringement. The case that reached the Supreme Court involved Impression Products, which both refills cartridges in the United States and also imports refilled cartridges from abroad. When Lexmark sued, Impression Products moved to dismiss Lexmark's complaint as to both categories of products, claiming that Lexmark's patent rights were exhausted by the initial sale of the cartridges. The district court granted Impression's motion with respect to domestic products, but denied it with respect to imported products. Both sides appealed.

The Federal Circuit, sitting en banc, ruled for Lexmark, reversing the district court's decision as to the domestic products. The court reasoned that, because a patentee may choose to sell less than the full "bundle of rights" granted by a patent, a subsequent sale that exceeds the scope of the initial terms of sale is "without authority," and hence infringing. The court also affirmed the district court's decision as to international products, holding that because patents are territorial (a patent only applies in the country that issues it), a foreign sale cannot exhaust U.S. patent rights. Two judges dissented, arguing that patent exhaustion applies to both domestic and foreign sales unless in connection with foreign sales the seller expressly reserves its rights under U.S. law.

The Supreme Court granted certiorari to determine the scope of both domestic and international patent exhaustion, and reversed.

The Court's Decision

A. Domestic Patent Exhaustion

The Court first considered domestic products refilled in violation of the single-use/no-resale restrictions in Lexmark's customer contracts. The Court held that, although these restrictions "may have been clear and enforceable under contract law," they "do not entitle Lexmark to retain patent rights in an item that it has elected to sell." The doctrine of patent exhaustion imposes an affirmative limit on patent rights: once a patented product is sold, it becomes the exclusive property of the buyer, and the patentee cannot use its patent rights to impose any further restrictions on what the buyer can do. The Court found support for its conclusion in *Quanta Computer v. LG Electronics*, a 2008 decision holding that any "authorized sale" takes a particular product "outside the scope of the patent monopoly." Lexmark had no claim against Impression Products because any rights in the products Impression refilled were exhausted when Lexmark first sold them. "[W]hatever rights Lexmark retained are a matter of the contracts with its purchasers, not the patent law."

B. International Patent Exhaustion

The Court then addressed whether patent exhaustion likewise applies when the patented product is sold abroad. This fact pattern was not addressed in *Quanta*, and Justice Ginsburg argued in dissent that it is qualitatively different: because intellectual property laws are territorial in nature, a sale abroad does not necessarily imply that domestic patent rights also have been conveyed. The Court's majority disagreed: "An authorized sale outside the United States, just as one within the United States, exhausts all rights under the Patent Act."

In reaching this decision, the Court looked to analogous case law under the Copyright Act. In *Kirtsaeng v. John Wiley & Sons*, a 2013 decision, the Court held that authorized copies of books purchased abroad could be imported into the United States without infringing the publisher's copyrights. This, the Court explained, was a "straightforward application" of the copyright first sale doctrine, which in turn hearkens back to the common law's rule against restraints on alienation. "Applying patent exhaustion to foreign sales is just as straightforward."

The Court rejected the view that foreign sales are somehow different from domestic sales of the same product: "A purchaser buys an item, not patent rights." So long as that item was authorized for sale by the patentee, patent rights are exhausted, notwithstanding that "[t]he patentee may not be able to command the same amount for its products abroad as it does in the United States." Offering the analogy of a refurbished used car, the Court held that a contrary rule would unnecessarily interfere with commerce and create too much uncertainty in everyday business transactions.

In holding that patent exhaustion has essentially the same effect whether the product in question is sold in the U.S. or instead is sold abroad and later imported, the Supreme Court distinguished *Impression Products* from an 1890 decision, *Boesch v. Gräff*, that allowed a domestic patentee to block the import of a German product. In *Boesch*, the German and U.S. patents were held by different and unrelated entities. Thus, a sale of the patented product by the German entity—though perfectly legal in Germany—did not exhaust the American patentee's rights, since the American patentee had neither approved of nor benefitted from the German sale. Boesch could conceivably form the kernel of some new patent-holding strategies intended to ensure that foreign sales of patented goods do not trigger exhaustion of U.S. patent rights.

Conclusion

Both prongs of the Supreme Court's decision rely heavily on the common-law prohibition against restraints on alienation; in addition to its more recent IP precedents, the Court cites to compilations of common law dating back to the 1600s and a variety of cases from near the turn of the last century. In this way, the Court continues to nudge patent law into conformity with generally applicable legal principles. The Court also continued its pattern of allowing copyright precedents to inform patent decisions (and vice versa), focusing on the "historic kinship between patent law and copyright law" and in particular the "strong similarity … and identity of purpose" of patent exhaustion and copyright's first sale doctrine.

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