

Lexmark Could Profoundly Impact Patent Exhaustion

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The U.S. Supreme Court has just granted a writ of certiorari in the case of *Impression Products Inc. v. Lexmark International Inc.* The ultimate decision by the court could have a profound impact on the judicial doctrine of patent exhaustion, potentially extinguishing long-standing precedent. Due to the complexity of this case, it is worthwhile summarizing the relevant issues.



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Doctrine of Patent Exhaustion

Under the doctrine of patent exhaustion, a patentee's right to restrict sale of a product are "exhausted" with a first authorized sale: resale is not an infringement. Exhaustion of exclusionary rights under United States patent law is based entirely on the meaning of "authority" in 35 U.S.C. § 271(a), which states:

Except as otherwise provided in this title [35 USC §§ 1 et seq.], whoever without authority makes, uses, offers to sell, or sells any patented invention, within the United States or imports into the United States any patented invention during the term of the patent therefor, infringes the patent.

Holding by the Federal Circuit in *Lexmark v. Impression*

While straightforward in principle, "patent exhaustion" historically has been difficult to apply. Most recently, for example, in *Lexmark International Inc. v. Impression Products Inc.*, 816 F.3d 721 (Fed. Cir. 2016), from which the petition for certiorari was filed, the United States Court of Appeals for the Federal Circuit held that sales of a patented article in the United States can be limited by restrictions on resale and reuse so long as those restrictions were communicated to the buyer at the time of sale. Further, the Federal Circuit held that foreign sale of an article patented in the United States does not exhaust the patentee's exclusionary right on importation of that article absent an express or implied license.

Origination and Facts of *Lexmark v. Impression*

The Federal Circuit, in an extraordinary move, *sua sponte* decided to hear this case initially en banc. The subsequent holdings were based on two earlier decisions by the Federal Circuit, *Mallinckrodt Inc. v. Medipart Inc.*, 970 F.2d. 700 (Fed. Cir. 1992) and *Jazz Photo Corp. v. International Trade Commission*, 264 F.3d. 1094 (Fed. Cir. 2001) cert. denied, 122 S. Ct. 2644 (2002), both of which were viewed by the dissent in *Lexmark* to be wrongly decided and inconsistent with Supreme Court precedent as improper

restraints on trade.

The lawsuit began as an infringement action by Lexmark against Impressions for refurbishing toner cartridges originally sold at a discount as “return program cartridges” for single use without resale. Impression purchased spent return program cartridges from Lexmark’s customers, and refurbished and resold them both in the United States and abroad. Return program cartridges that were initially sold abroad were refurbished and then imported into the United States. Regular toner cartridges, sold without restriction, were also purchased and refurbished by Impressions overseas and then imported into the United States.

Majority Opinion

In the majority opinion, authored by Judge Richard Taranto, the Federal Circuit agreed with its earlier, 1992 decision in *Mallinckrodt*, which held that “a patentee, when selling a patented article subject to a single-use/no-sale restriction that is lawful and clearly communicated to the purchaser, does not by that sale give the buyer, or downstream buyers, the resale/reuse authorization that has been expressly denied.” Against an argument by Impression that a subsequent Supreme Court decision, *Quanta Computer Inc. v. LG Electronics Inc.*, 553 U.S. 617 (2008), overruled *Mallinckrodt*, the majority stated that “*Quanta* did not involve a patentee’s sales at all, let alone one subject to a restriction or, more particularly, a single-use/no-resale restriction.” Rather, *Quanta* involved sales by a licensee under an agreement that provided no restriction on subsequent sale. Moreover, earlier Supreme Court precedent, including *General Talking Pictures v. Western Electric Co.*, 304 U.S. 175 (1938), “observed that a restrictive license to a particular use was permissible, and treated the purchaser’s unauthorized use as infringement of the patent.” Despite categorical statements broadly stating the scope of patent exhaustion doctrine, the Federal Circuit concluded that *Quanta* did not overrule *Mallinckrodt*, even “*sub silentio*” as asserted by the district court. Further, “there is no sound reason, and no Supreme Court precedent, requiring a distinction that gives less control to a practicing-entity that makes and sells its own product [such as in *Lexmark* and *Mallinckrodt*] than to a non-practicing-entity patentee that licenses others to make and sell the product [such as in *Quanta*].” In other words, patentees, under *Mallinckrodt* and *Lexmark*, can put restrictions on use and resale by direct purchasers in the United States of patented articles.

The majority in *Lexmark* also agreed with the 2001 decision in *Jazz Photo* that, as stated by the majority, “a U.S. patentee merely by selling or authorizing the sale of a U.S.-patented article abroad, does not authorize the buyer to import the article and sell and use it in the United States, which are infringing acts in the absence of patentee-conferred authority.” The majority did not accept an attempted parallel by Impression with a Supreme Court decision, *Kirtsaeng v. John Wiley & Sons Inc.*, 133 S.Ct. 1351 (2013), permitting copyrighted articles to be imported by their owners “without the authority” of the copyright holder. In essence, the majority opinion in *Lexmark* distinguished the controlling statutory language of the Copyright Act from that of the Patent Act, finding that the Copyright Act “makes sale location irrelevant.” Further, Judge Taranto for the majority stated that, “the patent statute gives the right to exclude others from ‘use,’ whereas the copyright statute does not.” Therefore, comparison of the holding in *Kirtsaeng* to patent law was inapposite because the owners of copyrighted materials are not subject to “use” restrictions after purchase, regardless of the location of sale.

The Dissent

Judge Timothy Dyk, joined by Judge Todd Hughes, dissented from the majority opinion in *Lexmark*, finding that *Mallinckrodt* was wrongly decided and effectively overruled by the Supreme Court in

Quanta. According to the dissent, while Quanta did not “expressly overrule *Mallinckrodt*,” the Supreme Court did, nevertheless, confirm the broader doctrine that “[t]he authorized sale of an article that substantially embodies a patent exhausts the patent holder’s rights” and, also consistent with Supreme Court precedent, viewed an “authorized sale” as one in which any and all conditions for the sale had been satisfied. Under this interpretation, any restriction on the use of patented subject matter subsequent to consummation of its sale was barred. The dissent also took issue with the majority’s extension to patentees of the right to impose restrictions on the direct sale of a patented article to a purchaser, rather than by a licensee, stating that the “Supreme Court has clearly distinguished between sales and licenses, holding that while a patentee cannot impose post-sale restrictions on an authorized sale, it can impose restrictions on the licensee.” Further, according to the dissent, “[t]he Supreme Court has never even decided that an authorized sale by a licensee with a limited license does not exhaust the patentee’s patent rights in the item sold.” Judges Dyk and Hughes did, however, agree with *Jazz Photo* to the extent that a “mere foreign sale does not in all circumstances lead to exhaustion of United States patent rights,” but further argued that “foreign sale should result in exhaustion if the authorized seller does not explicitly reserve its United States patent rights.”

Petition for Certiorari

In its petition for certiorari, *Impression* also understood *Quanta* to overrule the Federal Circuit’s decision in *Mallinckrodt*. Reciting *Edward Coke*, *Impression* stated that, “since at least the seventeenth century, the common law has strongly disfavored restraints on the alienation of chattels because they interfere with the functioning of secondary markets.” According to the petition, as “a common law rule that has not been codified by Congress,” exhaustion is a consequence of the “sale of a patented article” wherein, as stated by the dissent, “[t]he question of whether the seller has ‘authorized’ the buyer to use or resell the item is simply irrelevant.” Contrary to the majority opinion, *Impression* argued that the prohibition against post-sale restrictions under Supreme Court precedent is not limited to resale price or requirements to buy related unpatented products only from the patentee. Rather, as held in an earlier Supreme Court case, *United States v. Unis Lens Co.*, 316 U.S. 241 (1942), “sale of [an article] exhausts the monopoly in that article and the patentee may not thereafter, by virtue of his patent, control the use or disposition of the article.” To hold otherwise, as the majority has done, according to *Impression*, renders “patent exhaustion doctrine meaningless, because the patentee could avoid the doctrine entirely by specifying a restriction in connection with the first sale.”

The petitioners further viewed *Kirtsaeng* as a “common law determination” that “applies equally to patent law” and, as stated by the court in *Kirtsaeng*, “[t]he common-law doctrine makes no geographical distinctions.” Relying on the 1885 district court case of *Holiday v. Mattheson*, 24 F. 185 (C.C.S.D.N.Y. 1885), the petitioners also asserted that, when a “foreign sale is authorized by the U.S. patentee, the common-law rule ... controls, and the patentee’s U.S. patent rights are exhausted.” Territoriality of the sale is irrelevant because, according to the petitioners, a “first sale” under exhaustion doctrine “need not infringe a patent right.” Therefore, according to the petitioners, while the dissent stated that a foreign sale would exhaust domestic patent rights absent an express reservation by the patentee, the petitioners viewed exhaustion abroad to be equivalent to exhaustion consequent to a sale in the United States. Specifically, for *Impression*, “a patentee cannot impose any patent-based post-sale restriction following an ‘initial authorized sale,’” regardless of where that sale occurs. To this extent, the petitioners believed *Jazz Photo*’s “domestic-only exhaustion rule” to result in “substantial market inefficiencies, [which] frustrates innovation, and creates a distinction between copyright and patent law that will produce substantial practical problems.”

Respondent's Argument

Needless to say, Lexmark, as respondents to the petition, disagreed and argued that Impression's "flimsy case for certiorari ... rests on illusory tension with a 1628 English treatise [Coke's], an 1885 district court ruling [Holiday], and a 2012 interpretation of the Copyright Act [Kirtsaeng]." For the respondents, the "parade of horrors imagined by amici turns on facts and claims wholly absent from this case and, in any event, has not come to pass under the long-standing precedent reaffirmed below." Instead, "Impression's petition is, at bottom, a request for error correction that identifies no error," and if it were to prevail, "would throw off this long-standing rule [of limiting patent exhaustion to domestic sales] and require every sale anywhere in the world to convey — and include compensation for — U.S. patent rights." As stated by the respondents, "[e]ffectively requiring patentees to price the value of U.S. patent rights into every foreign sale would dramatically intrude on the authority of other nations to balance innovation and access in a manner tailored to their own markets."

Position of the Federal Government

In a brief just filed on behalf of the federal government as amicus curiae, Acting Solicitor General Ian Gershengorn began with the reminder that "[p]atent infringement is a strict-liability tort; neither scienter, nor contractual privity is necessary for liability." Repeating a footnote of the petitioner, the government stated that "enforceability of downstream restrictions after an authorized sale arises only 'as a question of contract, not as one under the inherent meaning and effect of the patent laws.'" They also agreed that the Federal Circuit "misconstrued" the meaning of "unconditional sales" to mean "sales unaccompanied by any restrictions on post-sale conduct." Rather, the intended meaning, according to long-standing judicial precedent, is "without any conditions," specifically, conditions "to a sale in which title to the article did not pass to the buyer until the performance of a condition precedent." Also, the government stated that, simply because, "a sale made by a licensee in violation of the license terms is not an authorized sale" (General Talking Pictures), does not mean that compliance by the licensee would make a buyer liable as an infringer for the buyer's violation of any restriction under that license. Instead, the sale would be "authorized," and exhaustion would apply regardless of any such license restriction. Therefore, according to the government, the majority in Lexmark is wrong to conclude that, "if respondent's own sales trigger exhaustion, respondent would be disadvantaged vis-à-vis patentees who sell through licensees."

Regarding foreign sales, the government proposed adopting a rule of "presumptive international exhaustion," which has been long-recognized in lower court decisions, and contrary to the petitioner's position that sales, wherever made, would necessarily exhaust patent owner rights. Instead, the patentee should be permitted to "reserve his U.S. rights as part of a foreign sale if he does so expressly." The government also disagreed with the petitioner's parallel to Kirtsaeng, stating that, "patent and copyright law 'are not identical twins,'" at least because "the Patent Act contains no analog to 17 U.S.C. § 109(a)," barring restrictions on alienation of the copyrighted material by a purchaser.

Next Steps

All of the parties and amici stressed the potential impact of this case on patent exhaustion as a judicial concept and on commerce.

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