Supreme Court Limits Patent Owners' Ability to Control Post-Sale Use of Patented Products

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The Supreme Court last week issued its long-awaited decision regarding patent exhaustion in *Impression Products, Inc. v. Lexmark International*. The decision, which overturns longstanding Federal Circuit precedent, curtails patent owners' ability to control the downstream use of their products after a sale. The Court held that restrictions such as "for research use only" on domestic sales of a product cannot be enforced under patent law. The Court also held that a patent owner's authorized sale of a patented product exhausts its U.S. patent rights in the product, precluding it from asserting a patent infringement claim for subsequent importation. As a result of this decision, patent owners will need to rely more heavily on contract and trademark law to enforce sales restrictions, to the extent possible.

Background

The case before the Court involved Lexmark's sales of refillable printer toner cartridges. Lexmark sold these cartridges at a 20% discount through its "Return Program" with a condition on the sale that the buyer will not reuse or refill the printer cartridge, and instead the buyer has the option to return the cartridge to Lexmark to be refilled. Impression Products has no direct sales relationship with Lexmark, but has made its own business refilling Lexmark printer cartridges. This practice violates the restriction on Lexmark's cartridges. Lexmark sued Impression Products for patent infringement. Impression Products argued that under the doctrine of patent exhaustion, an authorized sale by the patent owner "exhausts" the patent owner's rights as to that product.

In the unanimous decision written by Chief Justice Roberts, the Court reversed the Federal Circuit's en banc decision below upholding *Mallinckrodt v. Medipart*, 976 F.2d 700 (Fed. Cir. 1992). The Supreme Court held that the sale of a product by the patent owner terminates all of the patent owner's patent rights to that item. The Court explained that the restrictions in Lexmark's customer contracts "may have been clear and enforceable under contract law, but they do not entitle Lexmark to retain patent rights in an item that it has elected to sell." The Court further reasoned that "[p]atent exhaustion reflects the principle that, when an item passes into commerce, it should not be shaded by a legal cloud on title as it moves through the marketplace." By contrast, the Court explained, a patentee has the authority to limit licensees' (as opposed to purchasers') use of a patented good post-license. However, the Court cautioned that a patent owner's authority to limit licensees does not mean that patentees can use licenses to impose post-sale restrictions on purchasers.

In a 7-1 decision, the Court reversed the Federal Circuit's decision below reaffirming *Jazz Photo Corp. v. ITC*, 264 F.3d 1094 (Fed. Cir. 2001), that an authorized foreign sale does not exhaust U.S. patent rights. Under *Jazz Photo*, if the product sold abroad was later imported into the United States, the patent owner could sue for infringement. The Court relied on its recent decision in *Kirtsaeng v. John Wiley & Sons, Inc.*, 568 U.S. 519 (2013), which held that international sales exhaust U.S. copyrights under the Copyright Act. The Court reasoned that patent exhaustion, like copyright exhaustion, originates from the common law's hostility toward restraints on alienation, and which made no geographical distinctions as to the location of the sale. According to the Court, "nothing in the text or history of the Patent Act shows that Congress intended to confine that borderless common law principle to domestic sales." Justice Ginsburg dissented, emphasizing that the Patent Act does not have extraterritorial effect, and that patent protection is much less uniform globally compared to copyright protection.

Strategies Going Forward

This case raises significant concerns for businesses and trade organizations who manufacture and sell products covered by their own patents. It is particularly problematic for the biopharmaceutical and agricultural industries who rely heavily on patents to protect their

long-term investments. In these industries, patent owners rely on the ability to make restricted sales and the lack of international exhaustion to broadly disseminate their products to different markets at prices which those markets can bear. For example, companies often sell a product for "research use only" at a price lower than the same product "for diagnostic use." The ruling also discourages the use of regional pricing by pharmaceutical companies, which often sell drugs at lower prices in developing countries based on what each population can afford. By removing the option of asserting patent infringement, the Supreme Court's decision makes it more likely that goods will enter the United States through the gray market.

In light of the decision, contract law and privity with downstream resellers will be very important. Companies employing "restricted use" contracts or regional pricing should look carefully at existing contracts and consider revisions to strengthen enforcement mechanisms available to them. In their agreements, companies also should require audits of their foreign distributors and their resellers to identify "leaks" to the gray market. Rather than relying on sales contracts with post-sale restrictions, companies may consider whether to shift to granting licenses to downstream distributors or users instead.

In addition, manufacturers may also be able to rely on trademark law to restrict the distribution and resale of its branded products if a "material difference" exists between the manufacturer's genuine goods and the resold goods, or a material difference exists in quality control procedures. Many courts define "material difference" broadly to include any difference that exists between the authorized and unauthorized goods that a consumer would likely consider relevant when purchasing the product. Physical differences may include modifications to the actual goods or packaging, as well as labeling and package inserts approved by foreign regulatory agencies rather than the FDA. Non-physical differences may include differences in warranty protection or quality control procedures.

Barbara A. Fiacco, Sarah S. Burg and Steve Bychowski authored an amicus brief on behalf of BIO and CropLife, which advocated for maintaining the Federal Circuit's *Mallinckrodt* and *Jazz Photo* precedents.

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