Patent Exhaustion Under US Law

On February 12, 2016, the US Court of Appeals for the Federal Circuit rendered an en banc decision in *Lexmark International v. Impression Products* (Nos: 2014-1617, 2014-1619). In this, the court reviewed the law on patent exhaustion based both on its own previous decisions and decisions by the US Supreme Court. The basic conclusions reached may be summarized as:

1. A patentee can validly restrict the resale of its products by initial purchasers to avoid patent exhaustion provided that the restriction is clear and does not violate other laws (particularly antitrust price fixing and tie-in laws).

2. Even in the absence of an express restriction on resale, the initial sale of a product in a foreign country will not exhaust patent rights in the US. In the absence of an express or implied license to resell in the US, such sales constitute patent infringement.

3. Contractual rights may form a basis for an action against a reseller that is independent of the issue of infringement. In light of this, and in light of the dissent which argued that foreign sales should constitute an exhaustion of patent rights in the absence of an express prohibition on resale, it would appear advisable for companies wishing to avoid patent exhaustion to expressly prohibit resale.

Overall, the *Lexmark* decision should be of value to patentees attempting to enforce rights subsequent to an initial sale provided that they have not granted an express or implied license to a reseller and have not engaged in price fixing or tie-in arrangements that might give rise to antitrust issues. One caveat is that there is a possibility that the US Supreme Court will choose to review this case and overturn it. However, in the absence of such Supreme Court intervention, this decision appears to represent the most authoritative and most current law on patent exhaustion.

I. Patent Exhaustion Issues Considered in the *Lexmark* Decision

Companies selling their products internationally often market the same product at widely different prices depending on the country of sale and this may provide an opportunity for a third party to profit by arbitrage. For example, a company may sell product X in country A at price P1 and sell the same product X in country B at price P2. If P2 is substantially higher than P1, then a profit may be made by a third party buying X in country A, importing it into country B and selling it at a price between P1 and P2. This is clearly damaging to the companies that have developed and marketed the product and such companies will often attempt to prevent arbitrage by bringing a patent infringement suit against the reseller.

However, if X has been patented in both countries A and B, then, depending on local law, a legal rationale for non-infringement may be provided by the doctrine of patent exhaustion. The exhaustion doctrine holds that once a patented product has been sold, either by the patent owner

or by a party authorized to do so by the patent owner, the rights under the patent have been exhausted and the purchaser is free to use and sell the product in any way that it sees fit. Under Article 6 of the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS), each member of the World Trade Organization (WTO) is free to adopt their own rules with regard to the exhaustion of patent rights except that, as provided in Articles 3 and 4, goods from foreign WTO countries should generally be treated consistently with respect to one another and with respect to goods produced locally.

In *Lexmark International v. Impression Products*, the Federal Circuit extensively reviewed its decisions regarding patent exhaustion in light of US Supreme Court cases and addressed two specific topics: a) whether a patent owner may avoid patent exhaustion by expressly reserving certain rights; and b) the extent to which the foreign sale of patented products may exhaust patent rights in the US.

II. Review of Case Law

A. *Mallinckrodt, Inc. v. Medipart, Inc.*

A seminal decision by the Federal Circuit with respect to the ability of a patentee to avoid patent exhaustion by imposing restrictions on the purchasers of a patented product is *Mallinckrodt, Inc. v. Medipart, Inc.* (976 F.2d 700 (Fed. Cir. 1992)). The facts of the case involved medical devices sold by Mallinckrodt with a "single use only" restriction. Despite this restriction, hospitals using the devices sent them to Medipart who refurbished and returned the devices to the hospitals for reuse. On appeal, the Federal Circuit reversed a district court decision that Mallinckrodt could not validly impose a restriction on reuse and held that the actions by Medipart constituted an infringement. The rationale underlying the court's decision was that patent enforceability is based on a right to exclude and this right can be waived by a patentee in whole or in part. Restrictions on the subsequent use or sale of patented subject matter by a purchaser may be validly imposed by a patentee as long as the restrictions do not extend the patentee's rights beyond the patent grant and produce an impermissible anticompetitive effect, *e.g.*, due to a tie-in or price fixing arrangement.

B. Q*uanta Computer v. LG Electronics*

In 2008, the US Supreme considered patent exhaustion in Q*uanta Computer v. LG Electronics* (553 U.S. 617 (2008)). The facts of the Quanta case were that LG Electronics ("LGE") entered into a license agreement under which Intel Corporation was allowed to make and sell microprocessors and chipsets patented by LGE. The agreement expressly stated that the rights granted to Intel did not extend to third parties purchasing items covered by LGE's patents and that these third parties were not free to combine the items with other components. Although Intel gave written notice to its customers informing them of this restriction, Quanta, used items purchased from Intel and covered by the LGE patents to make computers. As a result, Quanta was sued by LGE for patent infringement.

On appeal of the Quanta case, the Supreme Court reversed a Federal Circuit finding of non-infringement. The Court pointed out that LGE's license agreement did not impose any limitations on Intel's authority to sell products covered by LGE's patents and that Intel's products substantially embodied the patents because they had no reasonable non-infringing use. As a result, LGE's patent rights were exhausted at the time its products were sold to Intel, and nothing remained that could be validly reserved with respect to products sold to Quanta.

C. Reconsideration of *Mallinckrodt* in Light of *Quanta*

In the *Lexmark* case, Impression Products argued that the Supreme Court's decision in *Quanta* overruled the *Mallinckrodt* decision sub silentio and that the principles set forth in *Mallinckrodt* were no longer valid. After thoroughly reviewing the Supreme Court's *Quanta* decision, the Federal Circuit concluded that:

> We find *Mallinckrodt*'s principle [that a patentee may avoid patent exhaustion by expressly reserving rights in an initial sale] to remain sound after the Supreme Court's decision in *Quanta Computer, Inc. v. LG Electronics, Inc.*, 553 U.S. 617 (2008), in which the Court did not have before it or address a patentee sale at all, let alone one made subject to a restriction, but a sale made by a separate manufacturer under a patentee-granted license conferring unrestricted authority to sell.

D. Review of *Jazz Photo* in View of *Kirtsaeng*

In *Jazz Photo Corp. v. International Trade Comm'n* (264 F.3d 1094 (2001)), the Federal Circuit held that the sale of products outside of the US did not exhaust the rights of a US patent covering the products. As long as the patentee did not grant the purchaser an express or implied license to make sales in the US, such sales constitute an act of infringement.

During the *Lexmark* case, Impression Products argued that *Jazz Photo* was no longer good law in light of the Supreme Court's decision in *Kirtsaeng v. John Wiley & Sons, Inc.*, 133 S. Ct. 1351 (2013)) a case in which the Court interpreted the Copyright Act as establishing that the first sale of a work in a foreign country exhausted the copyright owner's exclusive distribution right in the US. However, the en banc court found that the *Kirtsaeng* case was essentially irrelevant with respect to the *Jazz Photo* decision. It stated:

> *Kirtsaeng* is a copyright case holding that 17 U.S.C. § 109(a) entitles owners of copyrighted articles to take certain acts "without the authority" of the copyright holder. There is no counterpart to that provision in the Patent Act, under which a foreign sale is properly treated as neither conclusively nor even presumptively exhausting the U.S. patentee's rights in the United States.

III. Conclusion

The Federal Circuit summarized its holding in *Lexmark* as follows:

> We hold that, when a patentee sells a patented article under otherwise-proper restrictions on resale and reuse communicated to the buyer at the time of sale, the patentee does not confer authority on the buyer to engage in the prohibited resale or reuse. The patentee does not exhaust its § 271 rights to charge the buyer who engages in those acts - or downstream buyers having knowledge of the restrictions - with infringement. We also hold that a foreign sale of a U.S.-patented article, when made by or with the approval of the U.S. patentee, does not exhaust the patentee's U.S. patent rights in the article sold, even when no reservation of rights accompanies the sale. Loss of U.S. patent rights based on a foreign sale remains a matter of express or implied license.

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