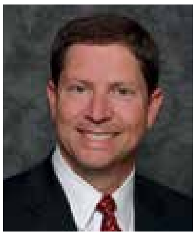
PATENT FILE

How patent enforcement laws may be getting some new ink



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SCOTUS takes on printer cartridges and the exhaustion doctrine. **Kenneth Parker** and **Brittany Parks** examine

On 2 December 2016, the Supreme Court of the US (SCOTUS) decided to review the US Court of Appeals for the Federal Circuit's (CAFC) decision in *Impression Products v Lexmark Intl.*[1] The case presents two significant questions regarding the theory of "patent exhaustion":

- Whether patent law can restrict the use or resale of a patented item after the first authorised sale of that item in the US; and
- Whether the authorised sale of a patented item outside the US exhausts the US patent rights in that item.

The answers to these questions will have an important impact on patent enforcement in the US and internationally. Due to the complexity of the case, this article will first summarise the relevant background issues and procedural history, and then discuss the significant repercussions that SCOTUS' decision may have on the technology industry.

The patent exhaustion doctrine

For over a century, the patent exhaustion doctrine, also called the "first sale" doctrine, has limited the scope of patent rights. It holds that the first authorised sale of a patented item terminates the patent rights to that item. In other words, a patent holder's rights are "exhausted" upon the first authorised sale of a patented item.[2] A patent holder, therefore, cannot use patent law to enforce post-sale restrictions on the use or resale of the item. For instance, the patent exhaustion doctrine allows everyday people to buy patented electronics, or even running shoes, and resell them at a garage sale or online without any interference from the original patent holder.

The facts

Lexmark International ("Lexmark") is a laser printer manufacturer that patented certain aspects of their printer's toner cartridges. Once a cartridge's ink is used up, a new or refurbished and refilled cartridge must be placed in the printer. Lexmark sells new cartridges both in the US and internationally under two types of programmes. First, Lexmark sells new cartridges at a substantial premium, often costing over a hundred dollars for a single cartridge, without any post-sale restrictions. Secondly, Lexmark sells "Return Programme" cartridges at a discount of 20%. The Return Programme cartridges carry two post-sale restrictions: (1) the buyer cannot reuse the used cartridge and, (2) the buyer can only resell the used cartridge to Lexmark.

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Remanufacturers like Impression Products ("Impression") acquire used Lexmark cartridges originally sold both inside and outside the US, refurbish and refill them with ink, and sell them in the US at competitive prices. The cartridges Impression refurbishes include both the unrestricted and restricted Lexmark versions. In response to this business practice, Lexmark sued several remanufacturers, including Impression, for direct and contributory patent infringement. Lexmark alleged: (1) Impression violated the no-resale and no-reuse restrictions on cartridges sold in the US; and (2) Impression unlawfully imported cartridges sold internationally. In response, Impression relied on the patent exhaustion doctrine and asserted that once Lexmark sold its cartridges it could no longer enforce its patent rights over the use and resale of the cartridges in the US or abroad.

The procedural history

Issue one: post-sale restrictions

In the CAFC, Impression argued that SCOTUS' decision in *Quanta Computer, Inc v LG Electronics, Inc*[3] – holding that a licensee's patent rights were exhausted upon the first authorised sale of the patented item – overruled previous decisions on the issue. The CAFC disagreed and reaffirmed its previous decisions, holding that a patent holder who sells a patented item in the US can enforce clearly communicated and lawful restrictions on the use and resale of the item. Therefore, any use or resale of a patented item that runs afoul of the agreed-upon restrictions results in an infringement of the patent holder's rights. The court distinguished *Quanta* by noting that it dealt with a licensee, not a patent holder, who authorised a sale that was not subject to any post-sale restrictions. The court reasoned that a patent holder's rights are exhausted only when the first authorised sale of an item is without restriction, or unconditional.

Issue two: international sales

The CAFC affirmed its previous decision in *Jazz Photo Corp v International Trade Commission*,[4] holding that when a US patent holder authorises the international sale of a patented item, the sale does not presumptively or conclusively exhaust the patent holder's rights to that item in the US. The CAFC recognised that while a foreign sale does not automatically exhaust US patent rights, an express or implied licence may be found based on the circumstances of the sale. In making its decision, the court found that an earlier SCOTUS ruling on the issue, *Kirtsaeng v John Wiley & Sons, Inc*,[5] applied only to copyright law and, therefore, did not apply to the case at hand.

The issues for SCOTUS

As previously noted, SCOTUS recently granted *certiorari* and will tackle the two issues presented: (1) "[w]hether a US patent owner may invoke patent law to enforce restrictions on the use or resale of a patented article after the first authorized sale of the article in the US," and (2) "[w]hether … a US patent owner may authorise the sale of a patented article in a foreign country, either under a foreign patent or otherwise in accordance with foreign law, while reserving its exclusive rights under US patent law."[6]

The potential impacts of the case

Issue one: post-sale restrictions

The CAFC has permitted post-sale restrictions on the use and resale of patented items since 1992. Many patent holders have taken advantage of these restrictions to control the use of their products post-sale, including companies like Lexmark, LG Electronics, and Apple.[7] If SCOTUS rules contrary to the current longstanding precedent, many patent holders will have to reconsider the meaning of their post-sale restrictions. More specifically, technology companies will have to review and restructure their current sale agreements to assure that they do not contain post-sale restrictions. If a company leaves unenforceable sales restrictions in place after a SCOTUS holding that such restrictions are unenforceable, that act could be construed as anti-competitive conduct, subjecting the company to anti-trust liability or liability under state unfair competition laws.[8] A holding limiting post-sale restrictions could also expose technology companies to increased litigation over patent rights, as thousands of existing licence agreements will likely be called into question.

On the other hand, a decision for Lexmark may negatively impact the secondary market for patented products by placing restraints on alienation. The district court cautioned that allowing patent holders to restrict the use and resale of an item would "create significant uncertainty for downstream purchasers and end users who may continue to [be] liable for infringement even after an authorised sale to the consumer has occurred".[9] Thus, post-sale restrictions may limit the scope of the patent market as a whole by promoting anti-competitive ideals – allowing the elimination, in theory, of every secondary market for every single patented item sold by a patentee (think used cars). Moreover, allowing post-sale restrictions may render the exhaustion doctrine moot, as patent holders may simply place such restrictions on the sale of each of their patented items to avoid the doctrine's limitations.

Issue two: international sales

SCOTUS' decision may have drastic implications for global commerce and technology companies. Since its decision in *Jazz Photo*, the CAFC has held that the foreign sale of a patented item does not automatically exhaust a US patent holder's rights. Accordingly, many large commercial companies have understood this to be the default rule and have made contracts reflecting this principle. If SCOTUS holds that foreign sales do exhaust US patent rights, the ruling will have a substantial impact on a large number of US companies' longstanding business operations overseas, because those companies will have to restructure each of their foreign licensing agreements.

Then again, if the court holds that the foreign sale of a patented article does not exhaust a US patent holder's rights, large technology companies will be forced to review the patent licences of their entire international supply chain to confirm that their licences explicitly state that their authorised foreign purchases exhaust US patent rights. For example, iPhones are made up from hundreds of parts made around the world and are covered by approximately 250,000 patents.[10] For technology companies who sell complex products like the iPhone, reviewing hundreds of thousands of patents for each and every product would impose an enormous administrative burden on those companies and increase the cost of doing business with international entities. Thus, US consumers would eventually have to pay higher prices for technological and pharmaceutical products that utilise imported patented components, which may ultimately de-incentivise US companies from doing business overseas.

Summary

As it has in the past two terms, SCOTUS has a chance to dramatically alter patent law, affecting parties both within the US and internationally. Whatever the outcome may be, it will have important implications for US patent rights and technology companies. Patent holders and consumers should keep a sharp lookout for this decision, which will likely come out in the late spring or early summer of 2017.

Footnotes

1. *Impression Prods, Inc v Lexmark Intl, Inc*, 816 F 3d 721 (Fed Cir 2016), *cert* granted (US 2 Dec 2016) (No 15-1189).
2. *Quanta Comput, Inc v LG Elecs, Inc*, 553 US 617, 625 (2008); *Bloomer v McQuewan*, 55 US (14 How) 539, 549 (1852).
3. *Quanta Comput, Inc v LG Elecs, Inc*, 553 US 617 (2008).
4. *Jazz Photo Corp v Int'l Trade Comm'n,* 264 F 3d 1094 (Fed Cir 2001).
5. *Kirtsaeng v John Wiley & Sons, Inc,* 133 S Ct 1351 (2013).
6. Brief for the US as *amicus curiae* supporting petitioner in part, *Impression Prods, Inc v Lexmark Int'l* (filed 12 Oct 2016, No 15-1189).
7. See, eg, Single purchase agreement (2011), https://store.apple.com/Catalog/US/Images/eduspa.pdf.
8. See, eg, *Princo Corp v ITC*, 616 F 3d 1318, 1327-28 (Fed Cir 2010); See *Nat'l Collegiate Athletic Ass'n v Bd of Regents of Univ of Okla*, 468 US 85, 100 (1984).
9. *Lexmark Int'l, Inc v Ink Techs Printer Supplies, LLC*, No 1:10-CV-564, 2014 WL 1276133, at *7 (SD Ohio 27 Mar 2014), *rev'd and remanded sub nom Lexmark*, 816 F 3d at 779 (citing *Tessera, Inc v Int'l Trade Comm'n,* 646 F 3d 1357, 1370 (Fed Cir 2011)).
10. See Ian Barker, 'The global supply chain behind the iPhone 6', *betanews* (23 Sept 2014), http://tinyurl.com/jrsxpxq.

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