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U.S. Supreme Court Sets the Tone for Patent Exhaustion

by Bruce Rose, Lindsey Yeargin, and Lindsay Church

Earlier this week, the Supreme Court altered the landscape of patent exhaustion in *Impression Products Inc. v. Lexmark International Inc.* The Court, in reversing the Federal Circuit, held that a patentee's decision to sell a product exhausts all patent rights in that item, regardless of any restrictions the patentee purports to impose or the location of sale.

As a result, a patentee who sells a product, whether domestically or internationally, cannot later sue for patent infringement relating to use or resale of that item. Rather, patentees who sell products under their U.S. patents, but who want to restrict downstream use or resale of those products, will have to rely on, and enforce, contract rights against their customers. Similarly, patentees who license their U.S. patent rights will need to craft their licenses very carefully to delineate what is licensed and what is not and to consider enforcement mechanisms and strategies that will enable them to achieve their licensing goals.

The Doctrine of Patent Exhaustion

The Patent Act, 35 U.S.C. § 154(a), grants patentees the "right to exclude others from making, using, offering for sale, or selling [their] invention[s]." But this right to exclude is limited by the doctrine of exhaustion. At its core, patent exhaustion concerns the level of control a patentee has over its products *after* they are sold. Under the doctrine, once a patent owner sells a patented product, it cannot later claim that the use or resale of that product infringes the patent.

The dispute between Impression Products and Lexmark centered on Impression Products' attempts to circumvent restrictions on the refilling and resale of Lexmark's printer toner cartridges. When Lexmark sells its cartridges, it provides consumers with two options: to buy a cartridge at full price with no restrictions or to participate in the Return Program, meaning to buy a cartridge at a discount and agree to use the cartridge only once and refrain from transferring that cartridge to any party other than Lexmark. But remanufacturers, including Impression Products, acquire empty cartridges from purchasers in the U.S., refill them with toner, and then resell. Such companies also acquire cartridges from purchasers overseas and import them into the U.S.

Impression Products argued that Lexmark's sales in the U.S. and abroad exhausted its patent rights in the cartridges, so Impression Products was free to resell and import the used products. The Federal Circuit disagreed, finding instead that patent owners may sell a product domestically and retain the right to enforce—through patent infringement actions, for example—clearly communicated, lawful restrictions on post-sale use or resale of the patented products. Further, the Federal Circuit held that when a patentee sells a product overseas, it does not exhaust its U.S. patent rights in that item.

Supreme Court Opinion

The Supreme Court revisited domestic and international patent exhaustion earlier this week and reversed the Federal Circuit's decision.

Addressing the domestic patent exhaustion issue, as exemplified by the Return Program, the Court held that Lexmark exhausted its patent rights in the cartridges the moment it sold them. While the single-use and no-resale restrictions may create enforceable contract rights, they did not entitle Lexmark to retain any patent rights. The Court first explained that the exhaustion rule marks the point where patent rights yield to the common law principle against restraints on alienation. In doing so, the Court emphasized the historical role of this principle in the copyright context and Congress's repeated revisions of the Patent Act against the backdrop of hostility toward restraints on alienation. As an illustration, the Court compared patent rights to an auto shop that restores and resells used cars, noting that the business works because the shop can rest assured that it is free to repair and resell those vehicles.

The Court then considered its prior holdings that, even when a patentee sells an item under an express restriction, the patentee does not retain patent rights in that product. The Court further relied on its 2008 decision in *Quanta Computer v. LG Electronics*, which held that the "authorized sale … took its products outside the scope of the patent monopoly," to conclude that once sold, the Return Program cartridges passed outside of the patent monopoly, and whatever rights Lexmark retained are a matter of contracts with its purchasers rather than patent law.

Addressing the international patent exhaustion issue, involving Impression Products' practice of purchasing used cartridges abroad and importing them into the U.S., the Court held that an authorized sale outside the U.S. also exhausts all rights under the Patent Act. The Court looked to the application of the analogous "first sale doctrine" in copyright law, which applies to copies of a copyrighted work lawfully made and sold abroad. "Applying patent exhaustion to foreign sales," the Court noted, "is just as straightforward."

The Court also rejected Lexmark's argument that the territorial limit on patent rights serves as a basis for treating international exhaustion differently, instead observing that a "purchaser buys an item, not patent rights." The Court here distinguished *Boesch v. Graff*, an 1890 decision holding that a sale abroad did not exhaust a patentee's rights when the patentee had nothing to do with the transaction. There, a foreign manufacturer was authorized under German law to make the patented product, but the German manufacturer had no ties to the U.S. patentees. The U.S. patentees sued a retailer for infringement when the retailer imported that product from Germany into the U.S. The Court rejected the argument that the German manufacturer's sale exhausted the American patentees' rights because the U.S. patentees were not involved in the sale.

The United States, as a third-party amicus, advocated a middle-ground position that "a foreign sale authorized by the U.S. patentee exhausts U.S. patent rights unless those rights are expressly reserved." The Court also rejected this argument because "sparse and inconsistent decisions" provided no basis for an expectation that patentees may reserve patent rights when they sell abroad. The Court further noted that it is not the parties' expectations (which can be addressed through contract law) that give rise to exhaustion. Rather, what matters is the patentee's decision to make the sale—a decision premised on the long-standing principle against restraints on alienation.

Justice Ruth Bader Ginsburg, who dissented in part, argued that a foreign sale does not exhaust an inventor's domestic patent rights because patent law is territorial.

Implications for Patent Owners

The Supreme Court's holding is relatively straightforward for patentees who make and sell products under their own patents. Going forward, those patentees will know that they cannot prevent exhaustion by placing restrictions on such sales or by selling abroad. In order to limit or prevent certain downstream uses of the products, patentees will need to rely on, and enforce, contracts with their purchasers.

Perhaps most noteworthy is the effect this decision will have on patentees who license their patent rights to others. For instance, if a U.S. patentee also has patent rights abroad and no facilities to manufacture abroad, but nonetheless wants to monetize its patent rights abroad by licensing, the patentee is now at risk that the licensed products made abroad could later flood the U.S. market and impact that patentee's U.S. business. The Supreme Court explained that the patentee can require the licensee to impose restrictions in its purchasers (such as, for example, refraining from importing to the U.S. or refraining from using the patented product in certain applications), but in such instances, the patentee may nonetheless be left with only a breach of contract claim against the licensee if it fails to do so. Moreover, if the licensee complies and imposes such a restriction on its customer, but the licensee's customer violates that restriction and imports to the U.S. or uses in a restricted application, then the U.S. patentee may be left with no recourse.

Going forward, licensors of U.S. patents will need to be creative and thorough in drafting their licenses and managing their patent portfolios in order to ensure that their licenses do not convey more rights than intended and to ensure that proper enforcement mechanisms are put in place. Additionally, because the Supreme Court's ruling likely applies retroactively (as most judicial decisions do), patentees will need to examine their existing licenses to determine the potential impact the decision may have on those licenses and, if possible, may need to renegotiate with licensees.

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If you have any questions or wish to discuss further, please contact any of the following members of Alston & Bird's Intellectual Property Group:

Shri Abhyankar
404.881.7687
shri.abhyankar@alston.com

Wesley C. Achey
404.881.4930
wes.achey@alston.com

Ross R. Barton
704.444.1287
ross.barton@alston.com

Philippe Bennett
212.210.9559
philippe.bennett@alston.com

Kirk T. Bradley
704.444.1030
kirk.bradley@alston.com

Xavier M. Brandwajn
650.838.2066
xavier.brandwajn@alston.com

Keith E. Broyles
404.881.7558
wkeith.broyles@alston.com

Natalie C. Clayton
212.210.9573
natalie.clayton@alston.com

Michael S. Connor
704.444.1022
mike.connor@alston.com

Patrick J. Flinn
404.881.7920
patrick.flinn@alston.com

David S. Frist
404.881.7874
david.frist@alston.com

John D. Haynes
404.881.7737
john.haynes@alston.com

Matthew W. Howell
404.881.7349
matthew.howell@alston.com

Yitai Hu
650.838.220
yitai.hu@alston.com

Ryan W. Koppelman
650.838.2009
ryan.koppelman@alston.com

Robert L. Lee
404.881.7635
bob.lee@alston.com

Jitty Malik, Ph.D.
919.862.2210
jitty.malik@alston.com

Richard M. McDermott
704.444.1045
rick.mcdermott@alston.com

Deepro R. Mukerjee
212.210.9501
deepro.mukerjee@alston.com

Michael J. Newton
214.922.3423
mike.newton@alston.com

A. Shane Nichols
404.881.4540
shane.nichols@alston.com

Thomas J. Parker
212.210.9529
thomas.parker@alston.com

Scott J. Pivnick
202.239.3634
scott.pivnick@alston.com

S. Benjamin Pleune
704.444.1098
ben.pleune@alston.com

Bruce J. Rose
704.444.1036
bruce.rose@alston.com

Casondra K. Ruga
213.576.1133
casondra.ruga@alston.com

Holly Hawkins Saporito
404.881.4402
holly.saporito@alston.com

Frank G. Smith, III
404.881.7240
frank.smith@alston.com

M. Scott Stevens
704.444.1025
scott.stevens@alston.com

Helen Su
650.838.2032
86.10.85927588
helen.su@alston.com

Paul Tanck
212.210.9438
paul.tanck@alston.com

Jamie D. Underwood
202.239.3706
jamie.underwood@alston.com

ALSTON & BIRD

WWW.ALSTON.COM

ATLANTA: One Atlantic Center ▪ 1201 West Peachtree Street ▪ Atlanta, Georgia, USA, 30309-3424 ▪ 404.881.7000 ▪ Fax: 404.881.7777
BEIJING: Hanwei Plaza West Wing ▪ Suite 21B2 ▪ No. 7 Guanghua Road ▪ Chaoyang District ▪ Beijing, 100004 CN ▪ +86 10 8592 7500
BRUSSELS: Level 20 Bastion Tower ▪ Place du Champ de Mars ▪ B-1050 Brussels, BE ▪ +32 2 550 3700 ▪ Fax: +32 2 550 3719
CHARLOTTE: Bank of America Plaza ▪ 101 South Tryon Street ▪ Suite 4000 ▪ Charlotte, North Carolina, USA, 28280-4000 ▪ 704.444.1000 ▪ Fax: 704.444.1111
DALLAS: 2828 North Harwood Street ▪ 18th Floor ▪ Dallas, Texas, USA, 75201 ▪ 214.922.3400 ▪ Fax: 214.922.3899
LOS ANGELES: 333 South Hope Street ▪ 16th Floor ▪ Los Angeles, California, USA, 90071-3004 ▪ 213.576.1000 ▪ Fax: 213.576.1100
NEW YORK: 90 Park Avenue ▪ 15th Floor ▪ New York, New York, USA, 10016-1387 ▪ 212.210.9400 ▪ Fax: 212.210.9444
RESEARCH TRIANGLE: 4721 Emperor Blvd. ▪ Suite 400 ▪ Durham, North Carolina, USA, 27703-85802 ▪ 919.862.2200 ▪ Fax: 919.862.2260
SAN FRANCISCO: 560 Mission Street ▪ Suite 2100 ▪ San Francisco, California, USA, 94105-0912 ▪ 415.243.1000 ▪ Fax: 415.243.1001
SILICON VALLEY: 1950 University Avenue ▪ 5th Floor ▪ East Palo Alto, California, USA, 94303-2282 ▪ 650-838-2000 ▪ Fax: 650.838.2001
WASHINGTON, DC: The Atlantic Building ▪ 950 F Street, NW ▪ Washington, DC, USA, 20004-1404 ▪ 202.239.3300 ▪ Fax: 202.239.3333