

Supreme Court Expands Patent Exhaustion, Leaving Many Unanswered Questions, Including Effects on Copyright Law's First-Sale Doctrine

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On May 30, 2017, the United States Supreme Court expanded the concept of patent exhaustion. *Impression Products, Inc. v. Lexmark International, Inc.*, No. 15-1189 (U.S. May 30, 2017). Before making its decision, the Court considered two questions. First, if a patentee sells an item in the U.S. with an express restriction on the purchaser's rights to resell the item, can it enforce that right through an infringement lawsuit? And second, does a patentee's first sale abroad exhaust its patent rights in the U.S.? In a 7-1 decision, the Court found that the patentee's U.S. patent rights were exhausted in both scenarios.

The dispute centered on whether refilling and reselling printer cartridges constituted patent infringement. Lexmark, the patentee, manufactured printer cartridges and sold them under two schemes. One, without any post-sale restrictions, leaving the cartridges to be reused or resold; and two, for approximately 20 percent less under its "Return Program," where the customer contractually agreed that it would only use the cartridge once and that it would not transfer the empty cartridge to anyone other than Lexmark. The cartridges were sold under both schemes within the U.S. and abroad. Lexmark sued a number of "remanufacturers," including Impression Products. Impression Products moved to dismiss, arguing Lexmark's sales under the "Return Program" exhausted its patent rights and that foreign sales, with or without post-sale restrictions, also exhausted Lexmark's U.S. patent rights.

The district court concluded that Lexmark had exhausted its patent rights with respect to any sales made in the U.S., and despite Lexmark's "Return Program" restrictions, it could not sue the remanufacturers for infringement. The court concluded, however, that foreign sales, including the ones without the "Return Program" restriction, did *not* exhaust Lexmark's U.S. patent rights. In other words, foreign sales never exhausted U.S. patent rights. The Federal Circuit reversed-in-part, finding that neither the U.S. "Return Program" sales nor any of the foreign sales, exhausted Lexmark's U.S. patent rights. The Supreme Court disagreed with the Federal Circuit as to both issues.

Regarding the post-sale restrictions (i.e. the sales under the "Return Program"), the Supreme Court found "that a patentee's decision to sell a product exhausts all of its patent rights in that item, regardless of any restrictions the patentee purports to impose." Slip Op. at *2. For this holding, the Court focused on the harm

that restraints on alienation would cause, noting 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." *Id.* at *11. It said that this was particularly true in this day and age where "advances in technology, along with increasingly complex supply chains, magnify the problem." *Id.* at *8.

The Supreme Court quoted from its prior ruling in *Kirtsaeng v. John Wiley & Sons, Inc.*, 568 U.S. 519, 538 (2013), that "exhaustion has an 'impeccable historical pedigree,' tracing its lineage back to the 'common law's refusal to permit restraints on the alienation of chattels.'" Slip. Op. at *6. *Kirtsaeng* involved the application of the first sale doctrine in a copyright case.

For the second question, the Supreme Court also concluded that "[a]n authorized sale outside the United States, just as one within the United States, exhausts all rights under the Patent Act." *Id.* at *13. For this, the Court relied heavily on its prior decision in *Kirtsaeng*, finding that patent exhaustion, like the copyright first sale doctrine, had roots in common law principles that disfavored restraints on alienation. *Id.* at *14. Thus, an authorized sale anywhere exhausted U.S. patent rights.

Kirtsaeng affirmatively answered the territoriality question for copyright law, but did not address whether post-sale restrictions were enforceable under copyright law. Since the Supreme Court quoted *Kirtsaeng* and relied upon "common law" principles in answering the first question, the first holding of *Lexmark* likely will apply to Copyright's First Sale Doctrine as well.

It remains to be seen whether the remanufacturers will be liable under other theories beyond patent law, such as traditional tort law. The Supreme Court seemed to acknowledge that the original purchaser of the "Resale Program" cartridges might be liable under contract law. *Id.* at *9, 12. The remanufacturers admittedly knew of these contracts, potentially giving rise to a tort claim, such as interference with contractual relationships.

This case also leaves open more questions than answers, particularly as to the line between a license restriction and a restriction on a sale. The Supreme Court distinguished licenses from post-sale restrictions noting, "[b]ecause the patentee is exchanging rights, not goods, it is free to relinquish only a portion of its bundle of patent protections." *Id.* at *11. The Court focused on the situation where a patentee licenses the right to a manufacturer to make and sell a good. What happens when the licensee only licenses the right to use a product/good, though? For example, had Lexmark's "Resale Program" been contracted as a one-time use license, instead of a sale, would the outcome have been different? The Court noted that the title of the cartridges passed to the users, so this distinction could be significant.

Even for the licensed manufacturer example, questions remain. The Supreme Court seemed to imply that where a manufacturer/licensee made sales outside of the license, "the patentee could sue both the licensee



and the purchaser—who knew about the breach—for infringement." *Id.* At 12. This leaves the question of what constitutes noncompliance with the terms of the license, sufficient that the downstream purchaser is liable for infringement? If the licensee simply did not pay what it owed, would the downstream purchaser be liable for infringement? What if the downstream purchaser was in the U.S., but the licensee was only authorized to sell outside of the U.S.?

Further, does the Supreme Court's language about the purchaser "who knew about the breach," create a knowledge requirement? *Id.* at 12; see *also*, at *11 ("a patentee can *also* sue for infringement those purchasers who knowingly violate the restrictions") (emphasis in original). For example, if a manufacturer is licensed to sell only in one state, but sells to someone else in another state, is that purchaser only liable if he or she knew the manufacturer was breaching the license? What if the downstream purchaser was wholly unaware of the license in the first place?

In short, the Supreme Court expanded the doctrine of patent exhaustion (and arguably of copyright's first sale doctrine), but left application of many significant issues open to future interpretation.

If you have questions regarding this alert, please contact your Lathrop Gage attorney or the attorneys listed above.