U.S. Supreme Court Holds That Post-Sale Restrictions Are Unenforceable Under Patent Law and That Foreign Sales Exhaust U.S. Patents

The U.S. Supreme Court recently issued its much-anticipated opinion in the *Impression Products*[1] patent exhaustion case. The Court held that the sale of a patented product by the patentee exhausts the patentee's U.S. patent rights in that product, regardless of any restrictions imposed on such sale by the patentee. The Court further held that the patentee's U.S. rights are exhausted regardless of whether the sale occurs domestically, or abroad.

"Patent exhaustion applies even when a sale is subject to an express, otherwise lawful restriction."

Background

Lexmark sells patented printer toner cartridges worldwide. Lexmark offers cartridges at a discount to U.S. customers who contractually agree to "single use/no resale" restrictions. Impression Products ("IMP") is a remanufacturer that acquires used Lexmark toner cartridges both in the U.S. and abroad, refills them with toner, and then resells them. Lexmark sued IMP for patent infringement, arguing that: (i) IMP's reuse and resale of discounted cartridges sold by Lexmark to U.S. customers infringed Lexmark's U.S. patents because they violated the reuse and resale restrictions Lexmark imposed as a condition of sale; and (ii) IMP's importation into the U.S. of cartridges Lexmark sold abroad infringed Lexmark's U.S. patents because Lexmark had never authorized such importation. IMP defended both claims by arguing that Lexmark's initial sale of the cartridges, whether domestically or abroad, fully exhausted Lexmark's U.S. patent rights in such cartridges. The Federal Circuit sided with Lexmark, holding that Lexmark could enforce its U.S. patent rights against products that it sold in the U.S. subject to lawful post-sale use or resale restrictions, or products that it sold abroad without restriction.

Court's Analysis

With respect to the contractual restrictions on reuse and resale of cartridges Lexmark sold in the U.S., the Court repeated its long-held view that "even when a patentee sells an item under an express restriction, the patentee does not retain patent rights in that product" (citing, among its earlier cases, *Quanta*, for the proposition that "patent exhaustion applies even when a sale is subject to an express, otherwise lawful restriction"[2]). Lexmark's sale of the discounted cartridges in the U.S. therefore put those products beyond the reach of Lexmark's patents, notwithstanding any contract terms of sale to the contrary.

The totality of the exhaustion principle articulated by the Court is further illustrated in the Court's discussion of the differences between licensing (exchanging rights, not goods) and selling (passing goods into commerce without a cloud on legal title). The Court distinguished restrictions a patentee *may* impose on its licensees from those it *may not* impose on purchasers of a patented product, including purchasers who buy patented products from licensees instead of the patentee. It is permissible for a patentee to limit a licensee's right to sell a patented product (e.g., to individuals and only for non-commercial purposes). Any sale by a licensee in compliance with such restrictions would be an authorized sale and "is treated, for purposes of patent exhaustion, as if the patentee made the sale itself" (i.e., it exhausts the patentee's patent rights in the item sold by the licensee). In such a case, and assuming no unusual circumstances that implicate the integrity of the sale (e.g., collusion between the licensee and purchaser to circumvent the license restrictions on sale), the licensor's patent rights will be exhausted as against any downstream purchaser, including one who violates the restrictions in the original license. Therefore, following any authorized sale of a patented product, whether the patentee retains any rights against its licensees or its purchasers with respect to the item sold will be a matter not for patent law, but for contract or other applicable law. If the licensee, however, violates the sales restrictions (e.g., by selling the patented product to a company for commercial use directly), that would not be an authorized sale and no patent exhaustion would occur. In such a case, the patentee could pursue patent claims against the licensee for the infringing (unlicensed) sale and downstream purchasers for any infringing acts in connection with the patented product.

Recognizing the similarity and "historic kinship between patent law and copyright law," the Court explained that there was no reason for different rules with respect to patent exhaustion by international sales, as nothing in the patent statute "confine[d] that borderless common law principle to domestic sales."

With respect to patent exhaustion in connection with Lexmark's sales outside the U.S., the Court noted that it had addressed the question of international exhaustion in its recent *Kirtsaeng*[3] decision, holding that the first sale rule applied to copyrighted works sold outside the U.S. In *Kirtsaeng*, the Court found in favor of international exhaustion because the first sale doctrine was a common-law doctrine that made no geographical distinctions and there was nothing in the copyright statute that restricted application of the first sale doctrine to the U.S. only. Recognizing the similarity and "historic kinship between patent law and copyright law," the Court explained that there was no reason for different rules with respect to patent exhaustion by international sales, as nothing in the patent statute "confine[d] that borderless common law principle to domestic sales." The Court held that Lexmark's foreign sales of cartridges exhausted Lexmark's U.S. patents in the same way as Lexmark's domestic sales.

Take-aways and Practice Tips

In reversing the Federal Circuit with respect to both domestic and international exhaustion in *Impression Products*, the Court also expressly rejected the Federal Circuit's reliance on earlier Federal Circuit decisions in *Mallinckrodt*[4] (post-sale use or resale restrictions that condition a sale may be enforced under patent law) and *Jazz Photo Corp.*[5] (foreign sales do not exhaust U.S. patents). Following *Impression Products*, neither *Mallinkrodt* nor *Jazz Photo Corp.* can be considered good law on these patent exhaustion concepts.

In *Impression Products*, the Court held that patentees cannot rely on patent law to enforce post-sale restrictions or prohibitions on importing patented products sold by them (or their licensees, although arguably this statement by the Court is only *dicta*, as the facts of the case did not involve sales by licensees). Patentees will likely continue to seek exceptions to the Court's holding, whether in future case law or as a matter of commercial practice. But in the short term, at least, patentees who rely on their patents to enforce post-sale restrictions do so at their own risk. The Court directs patentees instead to the protections afforded by contract law. However, patentees must keep in mind both the limitations of contract law and the practical commercial constraints in imposing such terms (for example, holding distributors liable for end user behavior or pursuing individual purchasers may not be commercially or legally practical). Patentees must also remain careful that such restrictions and prohibitions do not violate other laws, such as antitrust, or create conditions that would support claims of patent misuse (e.g., "double-royalties"), or prove unenforceable as contrary to public policy or common law principles (e.g., an impermissible restraint on the alienation of chattels). Another significant hurdle in this regard may be the difference in remedies available under contract law as compared to patent law (e.g., a contractual restriction is less likely to result in injunctive relief banning infringing activity (or an ITC exclusion order banning importation into the U.S. of products sold abroad)).

Patentees may also want to consider alternative transaction structures to avoid a sale or license that would result in exhaustion, or otherwise mitigate its consequences. Such alternatives might include the example given by the Court of licensing to an intermediary (e.g., a distributor or reseller) that can be required to impose post-sale restrictions on end users, and that can be sued for patent infringement if it fails to do so (although, a patentee would not have any direct recourse against an end user that violated the restrictions except, possibly, as an express third-party beneficiary of the sales agreement). Instead of licensing third party sellers, patentees may offer "covenants-to-sue-last" (whereby the patentee, instead of licensing the sale, promises to first fully exhaust its litigation options against purchasers before it pursues the seller of the patented product) in order to prevent exhausting sales. Another alternative might be to lease, rather than sell, products.

In the aftermath of *Impression Products,* patentees will need to think strategically about structuring transactions in the future to maximize patent rights, and may want to review existing agreements for opportunities to restructure any that are adversely affected by this decision.

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1 *Impression Products, Inc. v. Lexmark Int'l, Inc.* _______ U.S. ________ (May 30, 2017).

2 *Quanta Computer, Inc. v. LG Electronics, Inc.*, 553 U.S., 617 (2008). IMP conceded that Lexmark's contractual restrictions on its customers did not violate any laws.

3 *Kirtsaeng v. John Wiley & Sons, Inc.*, 568 U. S. 519 (2013).

4 *Mallinckrodt, Inc. v. Medipart, Inc.*, 976 F. 2d 700 (Fed. Circ., 1992).

5 *Jazz Photo Corp. v. International Trade Commission*, 264 F. 3d 1094 (Fed. Circ., 2001).

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