Impression Products v. Lexmark: Supreme Court Strengthens Doctrine of Patent Exhaustion

by David R. Todd

On May 30, 2017, the U.S. Supreme Court issued its decision in *Impression Products, Inc. v Lexmark Int'l, Inc.*, addressing two patent exhaustion issues: First, whether a patent owner can prevent application of the doctrine of patent exhaustion by selling a patented product subject to otherwise-lawful restrictions on post-sale use or resale. Second, whether a patent owner's sale of a patented product outside of the United States gives rise to patent exhaustion. In answer to the first question, the Supreme Court answered "no," overruling the Federal Circuit's 25-year-old decision in *Mallinckrodt, Inc. v. Medipart, Inc.*, 976 F.2d 700 (Fed. Cir. 1992). In answer to the second question, the Supreme Court answered "yes," overruling the Federal Circuit's decision in *Jazz Photo Corp. v. International Trade Comm'n*, 264 F.3d 1094 (Fed. Cir. 2001).

Lexmark owns a patent on toner cartridges and sells its patented toner cartridges under two alternative options. Under the "Regular Cartridge" option, customers pay full price subject to no restrictions. Under the "Return Program Cartridge" option, customers get a 20% discount if they agree to a "single use only" restriction. Lexmark sells some of the cartridges outside of the United States and others inside the United States. Impression Products, the defendant in the case, acquired used cartridges from Lexmark customers who had chosen the "Return Program Cartridge" option or who were outside the United States, refurbished them, and then sold them to consumers in the United States. Lexmark sued Impression Products for patent infringement, and Impression Products raised the doctrine of patent exhaustion as a defense.

Chief Justice Roberts, writing for the Court, held: "We conclude 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 or the location of the sale." The Court rejected the Federal Circuit's reasoning that the doctrine of patent exhaustion must be understood as an interpretation of the patent-infringement statute, which precludes infringement when a sale is made with the "authority" of the patent owner. The Court explained that the doctrine of patent exhaustion is instead a judge-made doctrine that "functions automatically," *i.e.*, is implied in law not in fact, and limits a patentee's rights independent of the infringement statute. The Court acknowledged that "[t]he single-use/no-resale restrictions in Lexmark's contracts with customers may have been clear and enforceable under contract law, but they do not entitle Lexmark to retain patent rights in an item that it has elected to sell." In other words, Lexmark might be able to sue its customers for breaching the "single use only" provision in Lexmark's sales contracts, but it cannot sue those who acquired used cartridges from those customers for patent infringement.

As a policy justification for its rule, the Court provided an illustration of "[t]he inconvenience and annoyance to the public" that the Federal Circuit's rule would entail:

> "Take a shop that restores and sells uses cars. The business works because the shop can rest assured that, so long as those bringing in the cars own them, the shop is free to repair and resell those vehicles. That smooth flow of commerce would sputter if companies that make the thousands of parts that go into a vehicle could keep their patent rights after the first sale. Those companies might, for instance, restrict resale rights and sue the shop owner for patent infringement. And even if they refrained from imposing such restrictions, the very threat of patent liability would force the shop to invest in efforts to protect itself from hidden lawsuits. Either way, extending the patent rights beyond the first sale would clog the channels of commerce, with little benefit from the extra control that the patentees retain."

Although it is true that allowing patent owners to restrict patent rights could result in problems such as these, it should be noted that the same or similar problems could arise if the "companies that make the thousands of parts that go into a vehicle" are infringers of patents other than their own. In that case, the owners of those patents could cause virtually the same problems as those posited in the Court's illustration. The Court also does not consider similar problems that could arise if the part-making companies are able to enforce post-sale restrictions against their direct customers by virtue of breach-of-contract actions. Thus, the Court's illustration appears to prove too much.

The Court next distinguished its decision in *General Talking Pictures*. In that case, the Court held that a patentee could restrict a licensee from selling within certain fields of use and that a product sold by a licensee outside of the licensee's authorized field of use was not subject to exhaustion. The Court stated that this case "does not mean that patentees can use licenses to impose post-sale restraints on purchasers" but "stands for the modest principle that, if a patentee has not given authority for a licensee to make a sale, that sale cannot exhaust the patentee's rights."

As for sales first made by Lexmark outside of the United States, the Court held: "An authorized sale outside the United States, just as one within the United States, exhausts all rights under the Patent Act." In response to Lexmark's argument that "a patentee selling in a foreign market may not be able to sell its product for the same price that it could in the United States" (particularly if it has no patent there), the Court responded that "the Patent Act does not guarantee a particular price, much less the price from selling to American consumers. Instead the right to exclude just ensures that the patentee receives one reward—of whatever amount the patentee deems to be 'satisfactory compensation'…."

The Court also addressed the United States' proposed middle-ground position in which a foreign sale would exhaust rights unless the patentee expressly reserved them. This was the rule that had been apparently adopted by the 2nd and 8th Circuits in the 1890s. The Court rejected this rule because it was based on "the likely expectations of the patentee and purchaser during a sale." The Court explained that "[e]xhaustion does not arise because of the parties' expectations about how sales transfer patent rights" but instead arises because "the patentee elects to give up title to an item in exchange for payment" and "what matters is the patentee's decision to make a sale."

On the question of exhaustion from foreign sales, Justice Ginsburg dissented. She would have held that a foreign sale does not give rise to patent exhaustion. She reasoned: "Because a sale abroad operates independently of the U.S. patent system, it makes little sense to say that such a sale exhausts an inventor's U.S. patent rights. U.S. patent protection accompanies none of a U.S. patentee's sales abroad—a competitor could sell the same patented product abroad with no U.S.-patent-law consequence. Accordingly, the foreign sale should not diminish the protections of U.S. law in the United States." Although the Court had previously held that exhaustion applies to copyrighted works sold outside of the United States in *Kirtsaeng v. John Wiley & Sons, Inc.*, 568 U.S. 519 (2013), Justice Ginsburg observed that this decision was distinguishable because “copyright protections, unlike patent protections, are harmonized across countries” and therefore “[t]he copyright protections one receives abroad are…likely to be similar to those received at home.”

The full text of the Court’s opinions can be found here:

http://www.supremecourt.gov/opinions/16pdf/15-1189_ebfj.pdf