Contractual and Geographic Limitations on Patent Exhaustion

December 9, 2016

Winslow Taub
Agenda

- Background
  - Legal standard
  - Common fact patterns
  - Historical exceptions
- *Lexmark v. Impression Products*
  - What's at stake?
  - Federal Circuit *en banc*
  - Supreme Court (*cert.* granted)
- Implications
Background
Legal Standard for Exhaustion

“The authorized sale of an article that substantially embodies a patent exhausts the patent holder’s rights and prevents the patent holder from invoking patent law to control postsale use of the article.”

*Quanta v. LG Elecs.*, 553 U.S. 617, 638 (2008)

- Common-law rule
- Applies only to sales
- Applies only to patent rights
- Article need only “substantially embody” a patent
Common Fact Patterns

- Mismatch between the item sold (or its price) and the scope of rights exhausted by the sale
  - Product sold is only a component of a more valuable device covered by the patent claims (*Quanta*)
  - Exhaustion asserted by entities other than the purchaser or subsequent acquirer of the product (*Helferich*)
  - Sale is made in a market where monopoly pricing is unavailable (*Jazz Photo*)
- Method claim exhaustion by sale of a product
  - Where device embodies similar apparatus claims (*Keurig*)
  - Where device performs the “essential” steps of method, or where performing the method is the intended use (*LifeScan*)
- License grants vs. sales (*General Talking Pictures*)
  - A restriction in license grant can preserve an infringement claim
Historical Exceptions

- Clearly communicated, lawful restriction on post-sale use or resale
  - Mallinckrodt, Inc. v. Medipart, Inc. 976 F.2d 700 (Fed. Cir. 1992)
  - Exception applies to a sale “validly conditioned under the applicable law such as the law governing sales and licenses,” where the “restriction on reuse was within the scope of the patent grant or otherwise justified.” Id. at 709

- Foreign sales
  - Jazz Photo Corp. v. ITC, 264 F.3d 1094 (Fed. Cir. 2001)
  - “To invoke the protection of the first sale doctrine, the authorized first sale must have occurred under the United States patent. . . . a lawful foreign purchase does not obviate the need for license from the United States patentee before importation into and sale in the United States.” Id. at 1105
Lexmark v. Impression Products
Lexmark v. Impression Products

- Toner cartridges sold in the United States and abroad
- Two pricing options

<table>
<thead>
<tr>
<th>Unrestricted Cartridge</th>
<th>Single-Use Cartridge</th>
</tr>
</thead>
<tbody>
<tr>
<td>Do not need to return cartridge</td>
<td>After using, must return empty cartridge to Lexmark</td>
</tr>
<tr>
<td>Free to resell to refurbishers</td>
<td>Agree not to resell/reuse cartridge</td>
</tr>
<tr>
<td>Full price</td>
<td>20% discount</td>
</tr>
</tbody>
</table>

- Impression Products bought second-hand single-use cartridges in the United States and both single-use and unrestricted cartridges abroad
- It refurbished the cartridges and resold them in the United States
Lexmark: What’s at Stake?

For patentee
- Ability to price discriminate / make most efficient use of IP
  - Pricing for single-use vs. unrestricted cartridges
- Ability to maintain monopoly pricing in United States
  - Competition with imported refurbished cartridges
- Ability to bring any claim against sellers of refurbished goods
  - Contract law remedies still available
  - But no privity as to Impression Products

For accused infringer / the public
- Ability of patentee to double recover
- Uncertainty regarding rights following authorized sale
- Threat to development of markets for second-hand goods
Lexmark Federal Circuit Decision

- Federal Circuit reaffirmed both exceptions

- The court’s defense of the Mallinckrodt resale limitation exception:
  It has long been a familiar feature of our legal landscape that property rights in a particular thing—like the separate interests in making, selling, using, etc., an invention—are viewed as a “bundle” of rights (or sticks) that can generally be transferred separately.

- The court’s defense of the Jazz Photo foreign sale exception:
  [Section 271] gives patentees the reward available from American markets. A patentee cannot reasonably be treated as receiving that reward from sales in foreign markets, and exhaustion has long been keyed to the idea that the patentee has received its U.S. reward.

- The Supreme Court just granted cert. on both questions
  - Supported by Solicitor General
On Cert.: Post-Sale Restrictions

- **Petitioner**
  - All authorized sales result in complete exhaustion—restrictions in licenses, but not sales, have been upheld by Supreme Court
  - Only remedy following an authorized sale is via contract law
- **Respondent**
  - A patentholder may “authorize” a purchaser as to all or some patent rights
  - No reason to distinguish between restrictions on a sale and restrictions in a license
  - Restrictions are only disallowed when otherwise unlawful
- **Solicitor General**
  - Any sale that is not “conditional”—i.e., that has no condition precedent—fully exhausts patent rights
On Cert.: Foreign Sales

- **Petitioner**
  - *Kirtsaeng* controls, and compels a finding that all foreign sales conclusively exhaust patent rights

- **Respondent**
  - *Kirtsaeng* is not controlling because copyright law has a statutory first-sale limitation (17 U.S.C. § 109(a)) that is not present in the patent statute

- **Solicitor General**
  - Foreign sales presumptively exhaust patent rights
  - But the seller may expressly reserve U.S. patent rights
Implications
Implications

- Licensing, rather than selling, components that can be refurbished and resold
  - But must license both the manufacture and the sale?
  - Careful limitations on authorized sales by the license (*Cascade*)
- Including non-exhaustion clauses in foreign sale agreements
  - If Solicitor General’s position is accepted
- Improved technological limitations on reuse
  - Lexmark attempted this, but was unsuccessful