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Federal Circuit Report

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Federal Circuit Reaffirms Its Longstanding Patent Exhaustion Rules

On February 12, 2016, the Federal Circuit issued a 10–2 *en banc* decision in *Lexmark International, Inc. v. Impression Products, Inc.*, declining to reverse its precedential rulings on two principles of patent exhaustion. The majority opinion, authored by Judge Taranto, reaffirmed the holdings in *Jazz Photo Corp. v. International Trade Comm’n* [264 F.3d 1094 (Fed. Cir. 2001)], that a foreign sale of a patented item does not exhaust the patentee’s US patent rights, and in *Mallinckrodt, Inc. v. Medipart, Inc.* [976 F.2d 700 (Fed. Cir. 1992)] that sale of a patented item under otherwise lawful and clearly communicated post-sale restrictions on resale and use, does not exhaust the patentee’s 35 U.S.C. § 271 rights to charge a buyer with patent infringement if the buyer engages in the restricted acts. In a decision that could be reviewed by the Supreme Court, the full Federal Circuit found that the patent exhaustion rules in *Jazz Photo* and *Mallinckrodt* remain sound in light of recent Supreme Court decisions in *Kirtsaeng v. John Wiley & Sons, Inc.* [133 S. Ct. 1351 (2013)], and *Quanta Computer, Inc. v. LG Electronics, Inc.* [533 U.S. 617 (2008)]. The decision underscores the ongoing importance of explicit restrictions on the resale of patented products, and suggests that contracting parties to international sales and licensing agreements should delineate clearly the terms permitting or restricting the import of patented articles into the United States.

Lexmark makes and sells toner cartridges for its printers and owns a number of patents that cover the toner cartridges and their use. Lexmark offers buyers a choice to purchase a “Regular Cartridge” at full price without any restrictions on use, or a “Return Program Cartridge” sold at a discount, but subject to the restriction that the customer will only use the cartridge once and will return the used cartridge only to Lexmark. Lexmark sued Impression Products for patent infringement, alleging that Impression Products: (1) imported into the United States cartridges purchased from Lexmark outside of the United States without permission from Lexmark to do so; and (2) acquired and sold in the United States spent “Return Program Cartridges” which were subject to the restriction on resale and use. Impression Products did not dispute that its actions infringed Lexmark’s US patents, but argued that Lexmark’s US patent rights had been exhausted with respect to all such cartridges.

On the issue of foreign sales, Impression Products argued that Lexmark’s sales abroad precluded Lexmark from suing for infringement of its US patents when those cartridges were imported into the United States. Impression Products acknowledged that its position contradicted the Court’s ruling in *Jazz Photo*, but argued that *Jazz Photo* was implicitly overruled by the Supreme Court’s decision in *Kirtsaeng*, which held that foreign-made copies of a copyrighted work are subject to the first sale doctrine, and therefore can be resold within the United States without the copyright owner’s permission under Section 602(a)(1) and Section 109(a) of the Copyright Act.

In rejecting Impression’s arguments, the Court found that *Kirtsaeng* was not controlling for patent exhaustion analysis, underscoring the different scope and application of the Copyright Act and the Patent Act. The Court noted that while the Copyright Act explicitly makes the rights of the copyright holder subservient to the first sale doctrine codified in 17 U.S.C. § 109(a) (which the Supreme Court in *Kirtsaeng* determined to be extraterritorially applicable), the Patent Act contains no such corresponding language. The Court stated that “[t]he Patent Act does not contain a congressionally prescribed exhaustion rule, let alone a provision that makes the express definition of infringement and rights to exclude subservient to any congressionally expressed exhaustion rule,” and, therefore, the Supreme Court’s opinion in *Kirtsaeng* is not precedential on the foreign exhaustion question presented under the Patent Act.

The Court also observed that a long-recognized basis for exhaustion is a patentee’s receipt of the inherent market reward from sale of a patented article made available from the statutory right to exclude. “The guarantee is the reward from sales in American markets, not from sales in foreign markets. A sale in a foreign market therefore does not furnish ‘the basis for’ exhaustion.” The Court further emphasized that patent law is notably territorial in nature, and that patent laws vary considerably from country to country, thus reinforcing the conclusion that “foreign markets are not the predictable equivalent of the American markets in which the US patentee is given a right to exclude and the rewards from that exclusivity.”

On the issue of post-sale restrictions, Impression Products argued that Lexmark’s patent rights were exhausted upon sale of the cartridges, despite the express contractual restrictions under the “Return Program.” Impression Products acknowledged that its position contradicted the

Court's ruling in *Mallinckrodt*, but argued that *Mallinckrodt* was implicitly overruled by the Supreme Court's decision in *Quanta*, which held that LG Electronics' patent rights were exhausted with respect to downstream customers as a result of the unrestricted sale of patented products by Intel (LG's licensee) to the downstream customers. In rejecting Impression's arguments, the Court held that *Quanta* did not require overturning the *Mallinckrodt* decision because in *Quanta* "the Court did not have before it or address a patentee sale at all, let alone one made subject to a restriction."

After finding that *Mallinckrodt*'s principles remain sound after *Quanta*, the Court focused on the Supreme Court's 1938 decision in *General Talking Pictures Corp. v. Western Electric Co.* [304 U.S. 175, opinion on rehearing at 305 U.S. 124 (1938)], which held that a patentee may prevent exhaustion of its patent rights by imposing restrictions when licensing others to make and sell patented articles. The Court reemphasized the prior reasoning in *Mallinckrodt* that there is no legal difference between the licensee sale of *General Talking Pictures* and a patentee-sale like that of Lexmark, stating "there is no sound reason, and no Supreme Court precedent, requiring a distinction that gives less control to a practicing-entity patentee that makes and sells its own product than to a non-practicing

entity patentee that licenses others to make and sell the product." The Court recognized that a patentee already may preserve its patent rights by licensing others to make and sell its products and concluded that "the law does not forbid the patentee to do the same when making and selling the articles itself."

Judge Dyk authored a dissenting opinion in which he agreed that mere foreign sales should not exhaust US patent rights in all circumstances, but argued that *Kirtsaeng* required a "presumptive exhaustion rule" where any failure to explicitly reserve its US patent rights would result in exhaustion of the patentee's US patent rights. With respect to the post-sale restrictions, Judge Dyk argued that the majority's opinion could not be reconciled with the *Quanta* decision and admonished the majority for "refusing to follow Supreme Court authority establishing the exhaustion rule" and for "misconceiv[ing] our role as a subordinate court."

In confirming that (1) there is no legal rule that US patent rights are exhausted simply by virtue of a foreign sale, even when no reservation of US rights accompanies the sale and (2) a patentee may prevent exhaustion of US patent rights when itself selling a patented article, through clearly communicated, otherwise-lawful restrictions, the Federal Circuit has reaffirmed its existing patent exhaustion rules. However, a Supreme Court cert

petition is probable given Lexmark's contrast with *Kirtsaeng* and *Quanta*, and the Supreme Court's recent focus on Federal Circuit decisions that create rules applicable only to patent cases.

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