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ALERT MEMORANDUM

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The Federal Circuit Reaffirms The Strength of U.S. Patent Rights by Reaffirming Its Prior Rulings Against Finding Patent Exhaustion Based On Overseas Sales And In Favor Of Post-Sale Restrictions On Patented Products

In its much anticipated *en banc* decision in Lexmark International v. Impression Products, the U.S. Court of Appeals for the Federal Circuit earlier this month reaffirmed its prior rulings that (1) overseas sales of a product do not exhaust a patent owner's patent rights under U.S. law and within the U.S., and (2) the sale of a patented article, when made under a restriction that is otherwise lawful and within the scope of the patent grant, does not give rise to patent exhaustion.[1] On the first issue, the Federal Circuit rejected arguments that, based on the Supreme Court's decision concerning exhaustion in the copyright context in Kirtsaeng v. John Wiley,[2] it should overrule its earlier decision in Jazz Photo Corp. v. International Trade Commission,[3] which held that the sale of a patented item outside the U.S. never gives rise to patent exhaustion under U.S. law. Similarly, on the second issue, the Federal Circuit rejected arguments that the Supreme Court's decision in Quanta Computer v. LG Electronics[4] should lead it to overrule its prior decision in Mallinckrodt v. Medipart[5] to uphold post-sale restrictions on patented products.

Background

Lexmark International makes and sells printer ink cartridges for which it holds U.S. patents. It gives customers the option to purchase ink cartridges at a discount, subject to the requirement that the customers return the cartridge to Lexmark and refrain from reselling or transferring the cartridge to anyone else. Cartridges subject to this requirement were sold in both the U.S. and abroad. Impression Products acquired used Lexmark cartridges, refilled them with ink and resold them in the United States. Lexmark sued Impression for patent infringement on the basis of (1) the reuse of cartridges that were subject to the return requirement, and (2) the resale within the U.S. of cartridges initially sold outside the United States. Impression argued that it did not infringe Lexmark's U.S. patents because Lexmark's prior sales of the cartridges had exhausted its U.S. patent rights in those cartridges. Those arguments set the stage for the Federal Circuit to revisit whether U.S. patent rights are exhausted by an authorized sale outside the U.S. or by a sale of a patented item subject to post-sale restrictions.[6]

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[1] 2016 WL 559042 (Fed. Cir. Feb. 12, 2016).
[2] 133 S. Ct. 1351 (2013).
[3] 264 F. 3d 1094 (Fed. Cir. 2001).
[4] 553 U.S. 617 (2008).
[5] 976 F. 2d 700 (Fed. Cir. 1992).
[6] Lexmark Int'l, Inc. v. Impression Prods., Inc., 785 F.3d 565, 566 (Fed. Cir. 2015) (granting *en banc* review of these issues).

Foreign Sales

In its 2001 decision in Jazz Photo, the Federal Circuit ruled that "United States patent rights are not exhausted by products of foreign provenance," and accordingly such products "are not immunized from infringement of United States patents."[7] More recently, the Supreme Court addressed related issues in the context of copyright law in Kirtsaeng and reached a different result: it ruled that the "first sale" doctrine of U.S. copyright law applies to copyrighted works lawfully made and first sold outside the U.S., such that purchasers of copyrighted works that were lawfully made abroad, and first sold abroad, have the right to resell or otherwise transfer ownership of those works within the United States.[8]

In Lexmark, the Federal Circuit distinguished Kirtsaeng from the patent context. It emphasized that "[p]atent law is especially territorial, and laws vary considerably from country to country." It noted that the Supreme Court has consistently ruled that U.S. patent laws "do not, and were not intended to, operate beyond the limits of the United States."[9] Thus, a U.S. patent cannot "cover foreign conduct."[10] Correspondingly, the "guaranteed reward" that a U.S. patent confers on its owner is directed to the U.S. market, not to foreign markets: a U.S. patent "secure[s] to the inventor a just remuneration from those who derive a profit or advantage, within the United States, from his genius and mental labors."[11]

The Federal Circuit further observed that American markets differ substantially from foreign markets, due to wealth disparities and differing government policies.[12] Given these differences, sales in a foreign market may not yield market returns comparable to the returns contemplated by U.S. patent law.[13] The Federal Circuit noted that these considerations differ in the copyright context, where copyrights "spring into being without government approval," and where standards for obtaining a copyright are substantially similar across markets.[14] Because copyright holders receive global copyright protection pursuant to the Berne Convention, there is not the same concern that copyright holders will not enjoy the same protections and rewards abroad as they do in the United States.[15]

In addition, the Federal Circuit noted that Kirtsaeng relied heavily on a textual analysis of Section 109(a) of the Copyright Act, which says nothing about geographic limits.[16] By contrast, Section 261 of the Patent Act reflects the territorial limit of patents to the U.S., providing that a patentee may assign its rights "to the whole or any specified part of the United States."[17] Thus, the Federal Circuit reasoned, extending Kirtsaeng's analysis to controversies rooted in different statutory provisions would be inappropriate.

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[7] 264 F. 3d 1094, 1105 (Fed. Cir. 2001).
[8] 133 S. Ct. 1351, 1371 (2013).
[9] 2016 WL 559042 at *37 (quoting Brown v. Duchesne, 60 U.S. 183, 195 (1856)).
[10] Id.
[11] Id. (quoting Brown v. Duchesne, 60 U.S. 183, 195 (1856)).
[12] Id. at *35.
[13] Id. at *36.
[14] Id. at *35.
[15] Id.
[16] Id. at *31.
[17] Id. at *33.

Based on these differences between patent law and patent rights on the one hand, and copyright law and the rights afforded to copyright holders on the other, the Federal Circuit declined to overrule Jazz Photo based on the Supreme Court's decision in Kirtsaeng.

Post-sale Restrictions

The Federal Circuit had previously upheld post-sale restrictions on patented products in Mallinckrodt v. Medipart,[18] holding that such restrictions did not exhaust U.S. patent rights. However, that ruling was called into question following the Supreme Court's 2008 decision in Quanta Computer v. LG Electronics.[19] In Quanta, the Supreme Court ruled that patent rights were exhausted where a licensing agreement authorized the sale of patented products, even though the license imposed certain contractual obligations on the licensee, such as requiring notice to the licensee's customers about limits on their ability to use the products.

The district court in Lexmark found Quanta controlling, holding that it effectively overruled Mallinckrodt. The Federal Circuit disagreed, distinguishing Quanta on its facts. It pointed out that Quanta concerned the sale of a patented product by a licensee, while Lexmark concerned a sale by the patent holder itself. Further, the Federal Circuit characterized the restrictions in Quanta to be "contractual obligations" on the licensee and not post-sale restrictions on usage. Because Quanta did not involve patentee sales and did not involve restrictions on sales made by the licensee, the Federal Circuit concluded that it was "at least two steps removed" from the circumstances presented in Lexmark.[20] On this basis, the Federal Circuit upheld Mallinckrodt and reaffirmed its central holding, that patent owners can lawfully impose post-sale restrictions on patented products, such as the restriction in Lexmark to use a product only once and return it to the seller. So long as these restrictions are lawful, within the scope of the patent rights and clearly communicated to buyers, they do not exhaust patent rights.[21]

[18] 976 F. 2d 700 (Fed. Cir. 1992).
[19] 553 U.S. 617 (2008).
[20] 2016 WL 559042 at *12.
[21] Id. at *10.

Implications

Lexmark is likely headed for review by the Supreme Court, given the importance of the issues it raises and the question of whether it comports with the Supreme Court's rulings in Kirtsaeng and Quanta. But for now, the Federal Circuit has reaffirmed the valuable rights its prior rulings have afforded to owners of U.S. patent rights: the ability to sell (or authorize the sale) of a patented product overseas while retaining the right to exclude the product from entering the U.S., and the ability to impose post-sale restrictions on the use and disposition of a patented product.

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