U.S. SUPREME COURT LIMITS RIGHTS OF PATENT OWNERS

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IP Litigation Alert

By: Patrick J. McElhinny

On May 30, 2017, the Supreme Court limited a patent owner's ability to control products after an authorized initial sale. In *Impression Products, Inc. v. Lexmark International, Inc.*[1], the Court reversed long-standing precedent and limited the ability of patent owners to control use, sale, or importation of their patented products after an authorized initial sale. The decision addressed the scope of patent "exhaustion," which is a rule that the patent owner's sale of a patented product generally extinguishes the power granted under a patent to prevent others from making, using, selling, or importing a patented invention. Prior to this decision, exceptions to that rule allowed patent owners to control the product even after selling it. Specifically, patent owners could (1) sell patented products but contractually restrict the buyer's ability to resell them or (2) sell patented products outside of the United States without extinguishing their U.S. patent rights. As a result, patent owners could bring patent infringement claims against the resellers of the patented products or anyone importing patented products that the patent owner had sold abroad.

The Court held in *Impression Products* that a patent owner's sale of a patented item exhausts all of its patent rights in the item, regardless of the location of the sale or any restrictions the patent owner imposes on its purchasers. Although the decision preserves the ability of patent owners to enforce contractual restrictions against the original purchaser of the patented products, those contractual restrictions likely will be a less-effective means of controlling resale or reuse. As a result, the decision likely will increase the availability of resold goods and will adversely affect the ability of patent owners to vary pricing in different locations.

IMPRESSION PRODUCTS V. LEXMARK

Lexmark sells patented toner cartridges for laser printers. Lexmark offered a "Return Program" through which its customers — in exchange for discounted cartridges — agreed to use their cartridges only once and refrain from transferring empty cartridges to anyone but Lexmark. Remanufacturers, including Impression Products, later acquired empty Return Program cartridges and refilled and resold them at lower prices than Lexmark's new cartridges.

Rather than suing its own customers to enforce the contractual restriction, Lexmark sued the remanufacturers for patent infringement, arguing that it retained the patent rights to prevent others from making, using, and selling (or reselling) Return Program cartridges. In other words, Lexmark argued that downstream purchasers could not have acquired a right that it never passed along to the initial purchasers. Lexmark also argued that, even absent a contractual restriction, its sale of cartridges outside of the United States did not exhaust its U.S. patent rights, so that Impression Products infringed those rights when it imported remanufactured cartridges into the United

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States. Relying upon its decisions in *Mallinckrodt, Inc. v. Medipart, Inc.*[2] and *Jazz Photo Corp. v. International Trade Commission*[3], the U.S. Court of Appeals for the Federal Circuit ruled for Lexmark on both arguments.

The Supreme Court reversed, reasoning that patent rights must "yield to the common law principle against restraints on alienation." It also analogized the patent exhaustion doctrine to the first-sale doctrine in copyright law. In copyright law, when a copyright owner sells a lawfully made copy of its work, it loses the power to restrict the purchaser's freedom to sell or otherwise dispose of that copy, regardless of the location of the initial sale. The Court also appeared to be persuaded by the practical effects of a contrary decision on the "smooth flow of commerce," citing used car sales as an example. The Court noted that, "if companies that make the thousands of parts that go into a vehicle could keep their patent rights after the first sale," the channels of commerce could be clogged by the threat of patent infringement claims against shops that restore and sell used cars. The Court indicated that "advances in technology, along with increasingly complex supply chains, magnify the problem."

Nonetheless, the Court indicated that patent owners still may restrict contractually the initial purchaser's right to reuse or resell a patented item. The remedy for failure to comply with those restrictions is a breach of contract action against the initial purchasers — not a patent infringement action against downstream purchasers. This remedy may be less effective than a patent infringement action for a variety of reasons. For example, as the *Impression Products* case illustrates, patent owners must bring the breach of contract claim against its own customers, which may have adverse business consequences. Likewise, multiple suits may be required instead of one suit against the reseller.

THE PRACTICAL CONSEQUENCES OF *IMPRESSION PRODUCTS*

Online marketplaces make it possible for third-party resellers to acquire goods meant for one jurisdiction and sell them anywhere in the world, thus undercutting manufacturers' attempts to tailor price, packaging, and technical features to a specific geographic area. Some industries will be affected more than others.

For example, *Impression Products* limits manufacturers' ability to set prices based on geography, so third-party resellers can undercut the prices of domestic retailers. Many domestic retailers have brick-and-mortar stores and other expenses that make it difficult for them to compete with Internet resellers. This potential effect on differential pricing is a particular concern for the pharmaceutical industry. Foreign sale exhaustion may prevent pharmaceutical companies from recouping their research and development costs by charging more in some countries while simultaneously providing low-cost products to poorer nations. Also, regulation may limit their ability to raise their prices in some jurisdictions. With resellers potentially undercutting prices and consequently the ability to recover research and development costs through higher prices in more affluent countries, there may be less incentive for innovators.

Medical technology companies that manufacture devices for a single use also may be affected. While reusable devices are designed to be cleaned, sterilized, and reused, single-use devices are designed to be used once and then discarded. First-sale exhaustion could implicate customer safety by permitting third-party reprocessors to collect and resell discarded single-use medical devices. This could create serious health and safety issues (and perhaps even additional product liability), but the original medical-device manufacturers may have no patent-based recourse against third-party reprocessors. On the other hand, reuse may help keep medical costs down and reduce the environmental impact of waste from medical devices.

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Regardless of industry, companies that have business models that incorporate differential international pricing or conditional sales will have to reexamine them to ensure that they still make economic sense in light of this change in the law.

Notes:

[1] No. 15-1189 (May 30, 2017).

[2] 976 F.2d 700 (Fed. Cir. 1992).

[3] 264 F.3d 1094 (Fed. Cir. 2001).

KEY CONTACTS



PATRICK J. MCELHINNY
PARTNER

PITTSBURGH
+1.412.355.6334
PATRICK.MCELHINNY@KLGATES.COM

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