

***Lexmark* on Conditioned Sale and Foreign Sale Patent Exhaustion: A Nutshell, A Roadmap and Some Comments**

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The Federal Circuit's February 12, 2016, en banc *Lexmark* decision on patent exhaustion as applied to conditioned sales and foreign sales is a big case, "big" not only qualitatively, that is, in importance, but also quantitatively: Judge Taranto's majority opinion is 99 pages of dense prose. Judge Dyk's dissent is not brief at 30 pages. A roadmap may be useful; this one has a few added comments about how the Circuit's ruling will play on the Big Stage (that is, before the Supreme Court).

First, a nutshell summary of the rulings. A patent owner sold printer cartridges covered by patents. The patent owner imposed a restriction on reuse and resale of the cartridges. Companies refurbished the cartridges by replacing a microchip and replenishing ink. An accused infringer bought the refurbished cartridges in the U.S. (or imported them from abroad) and resold them. The patent owner alleged infringement. The majority held that the exhaustion doctrine did *not* preclude infringement. First, as to cartridges first sold by the patent owner with the restriction, a patent owner's sale of a U.S.-patented article under a restriction on resale and reuse that was communicated to a buyer at the time of sale and that was "otherwise proper," that is, did not constitute misuse, for example through a price-fixing or tie-in restriction or an antitrust violation, did *not* exhaust its patent rights. The 1992 panel decision *Mallincrodt* so held and was not undermined by the Supreme Court's 2008 *Quanta* decision. The patent owner could charge infringement against a buyer who engaged in the restricted acts or against "downstream buyers having knowledge of the restrictions." Second, as to cartridges first sold abroad, a foreign sale of an article, made or approved by a U.S. patent owner, did *not* exhaust U.S. patent rights even though the owner did not explicitly reserve those rights at the time of the foreign sale. The 2001 panel decision *Jazz Photo* so held and was not undermined by the Supreme Court's 2013 *Kirtsaeng* international copyright exhaustion decision. The owner could lose U.S. rights by foreign sale through an express license or a licensed implied from the circumstances of the sale. In dissent, Judge Dyk argued that the majority's ruling on conditional sales was contrary to Supreme Court precedent, which clearly stated that a patent owner sale exhausted patent rights and that enforcing any contract restrictions was left to contract law. He argued that a foreign sale did not cause exhaustion under all circumstances but did so unless an authorized seller explicitly reserved United States patent rights.

The two opposing opinions' leave-no-stone-unturned approaches, addressing at length Supreme Court and other case law, scholarly sources, and various arguments and ramifications, were doubtlessly adopted with a view to persuading the Supreme Court when it addresses the questions of conditioned-sale and foreign-sale patent exhaustion in this or another case. That the Supreme Court Justices might divide along similar lines was suggested by the Court's *Kirtsaeng* decision in which opinions by three Justices took distinct positions.

The Taranto and Dyk opinions will likely continue to be significant for their detailed plumbing of patent law issues even after the Federal Circuit en banc ruling is supplanted by a Supreme Court ruling. As the Supreme Court noted in a comparable situation in *Bilski v. Kappos*, 561 U.S. 593, 600 (2010), “[s]tudents of patent law would be well advised to study these scholarly opinions.”

Now, the roadmap of the Taranto majority opinion. A skeletal outline is as follows:

1. Initial Summary of Holdings
2. Background; Three Limiting Aspects
3. Framework:
 - a. Statutory Basis for Exhaustion: Section 271(a) “Without Authority”
 - b. Keying Exhaustion to Patent Owner Consent
4. Restricted Sales
 - a. *Mallinckrodt*
 - i. Summary
 - ii. *Quanta*'s Effect
 - A. What It *Held*; Patent Owner Restricted Sale *Not* at Issue
 - B. What It *Stated*; Context
 - b. Full Analysis of Issue
 - i. Statute
 - ii. Supreme Court Precedent, Especially *General Talking Pictures*
 - iii. Common Law Anti-Alienation
 - iv. Real World Consequences
5. Foreign Sales
 - a. *Jazz Photo*
 - i. Summary
 - ii. *Kirtsaeng*'s Effect; Copyright Not Transportable to Patents
 - b. Full Analysis of Issue
 - i. Statute
 - ii. Supreme Court Precedent, Especially *Boesch*
 - iii. Trade Agreement Legislation
 - iv. Lower Court Decisions
 - v. Real World Consequences
 - vi. No Presumptive Exhaustion Subject to Express Reservation

To flesh out this skeleton:

After beginning with a summary of the two holdings, the Taranto majority opinion provided “background” on the facts and the lower court’s two rulings. Importantly, in this background, the opinion emphasized that three “aspects” of the accused infringer’s contentions in support of its exhaustion defense narrowed the court’s “focus,” that is, narrowed both of the issues.

First, neither party distinguished between the patent owner’s sales to end users and its sales to resellers. Both were first authorized sales by the patent owner.

Second, the court could assume that both the first purchaser of the patent owner’s cartridges and the accused infringer as a repurchaser had adequate notice of the patent owner’s restriction on reuse of its cartridges. That left unanswered a significant question that could arise in other cases: under what circumstances, if any, would a purchaser without actual knowledge be liable for use or sale?

Third, the accused infringer did not contend that the particular restriction, to wit, a ban on reuse and resale, was a misuse, an antitrust violation or “otherwise” improper.

A fourth “aspect” limited the accused infringer’s defense with regard to the foreign sales: the accused infringer did not rely on implied license. That left unanswered another significant question: what circumstances surrounding a foreign sale would give rise to an implied license? The majority opinion at one point referred to a patent owner-authorized sale of an article at an airport or seaport as being a scenario apt to create an implied license for one who purchases the article in transit to the United States.

The majority opinion continued with three substantive parts.

The opinion’s first substantive part provided a “framework” for both the questions. It emphasized the Patent Act language on a patent owner’s rights to exclude. It keyed the exhaustion doctrine to the statutory qualification of “without authority” in Section 271(a). It distinguished the Copyright Act which, unlike the Patent Act, provided explicit authority to a buyer of a copyrighted item to resell that item without the copyright owner’s authorization. Thus, Judge Taranto for the majority repeatedly linked the exhaustion doctrine to the statutory “without authority” language and linked “authority” to patent owner consent, express or implied.

The opinion’s second substantive part addressed the restricted sales question. It reached its conclusion (no exhaustion by patent owner no-resale/no-reuse restricted sale) in two steps.

In the first step, the opinion determined that the Federal Circuit’s no-exhaustion-by-conditioned sale decision, *Mallinckrodt*, was not implicitly overruled by the Supreme Court’s statement of the exhaustion rule in *Quanta Computer, Inc. v. LG Electronics, Inc.*, 553 U.S. 617 (2008). It considered separately, first, *Quanta*’s holding on the facts and issues before the Court and, second, *Quanta*’s broad description of the patent exhaustion rule.

In the second step, the opinion undertook a full analysis and determined that the *Mallinckrodt* rule was correct. The full analysis included consideration of (1) the infringement statute (Section 271(a)), (2) Supreme Court precedent, including *Motion Picture Patents Co. v. Universal Film Mfg. Co.*, 243 U.S. 502 (1917), which imposed exhaustion on conditioned sales with unlawful restrictions, such as tie-ins and price fixing, and *General Talking Pictures Corp. v. Western Electric Co.*, 304 U.S. 175 (1938), which allowed a patent owner to restrict a licensee’s sales to a field-of-use, (3) the common law principle prohibiting anti-alienation restrictions on the sale of chattels and (4) the “likely real-world consequences.”

The opinion’s third substantive part addressed the foreign sales question. As with the second part, it reached its conclusion (no exhaustion by patent owner foreign sale even without an express reservation of U.S. rights) in two steps. First, it determined that the Federal Circuit’s no-exhaustion-by-sale-out-the-United States decision, *Jazz Photo*, was not implicitly overruled by the Supreme Court’s *Kirtsaeng v. John Wiley & Sons, Inc.*, 133 S. Ct. 1351 (2013), which found international exhaustion under the Copyright Act’s explicit statute (17 U.S.C. § 109(a)) giving an owner of a particular, lawfully made copy a right to sell that copy. There was no counterpart to Section 109(a) in the Patent Act. Second, it undertook a full analysis and determined that *Jazz Photo* was correct. The full analysis included consideration of (1) the Supreme Court’s *Boesch v. Graff*, 133 U.S. 697 (1890), decision, which emphasized that sale of an article “in the United States under a United States patent cannot be controlled by foreign laws,” (2) provisions in U.S. trade agreements, which left to “internal law—the Patent Act, as judicially interpreted—whether even a presumptive-exhaustion rule governs,” (3) lower court decisions, which found exhaustion only after assessing “the particular circumstances and language of foreign sales to determine if the U.S. patentee gave permission for importation” and (4) “likely real-world consequences.”

Now for the comments (with a view to Supreme Court review).

On both issues, in the “framework” discussion and throughout the majority opinion, Judge Taranto repeatedly linked the exhaustion to the statutory “without authority” language and linked “authority” to patent owner consent, express or implied. The Supreme Court may find missing from this position sufficient consideration of the following argument. Congress added the “without authority” language in the 1952 Act and could be presumed to have taken account of the exhaustion doctrine already settled by case law. In other words, “authority” in Section 271(a) could be deemed to come from the exhaustion principle as well as from patent owner consent. That Congress assumed the existence of a “common law” exhaustion principle that provided “authority” and did not necessarily depend on even implied patent owner consent is suggested by the 1999 amendment to the Patent Act, which added a prior user right (Section 273), and referred to “exhaustion” without defining it. It is also suggested by the Supreme Court’s indication in *Quanta* that patent exhaustion was distinct from implied license.

On the domestic, conditioned sale issue, the majority, per Judge Taranto, relied heavily on the Supreme Court’s 1938 *General Talking Pictures* decision, which found no exhaustion when a licensee made a sale in violation of a field-of-use restriction. The majority repeatedly argued that it made no sense to distinguish patent-owner restricted sales and licensee sales. Why give a “practicing” patent owner who makes and sell a patented article fewer rights to impose restrictions and conditions than a “nonpracticing” patent owner who, under *General Talking Pictures*, can impose those restrictions and conditions on a licensee? On that basis, the majority distinguished Supreme Court cases stating the rule on exhaustion broadly and limited cases finding exhaustion despite violation of restrictions to particular, “improper” restrictions, to wit, tying and price fixing.

As an intermediate appellate court, the Federal Circuit was bound by *General Talking Pictures*. But the Supreme Court has greater freedom to resolve tensions and inconsistencies between and among its precedents. For example, the Court might agree that it was inconsistent to treat patent-owner sales and licensee sales differently but go on to find that it was also inconsistent to distinguish reuse and resale restrictions from resale price restrictions. It could then resolve both inconsistencies by both limiting and expanding *General Talking Pictures*. It might, for example, distinguish the field-of-use restriction in *General Talking Pictures* from the resale/reuse restriction in this case (and

Mallincrodt). It could then impose exhaustion on an authorized, reuse/resale restricted sale but not on an authorized, field-of-use restricted sale, in neither instance distinguishing patent owner sales from restricted licensee sales.

On the foreign sale issue, the majority explores deeply the Supreme Court *Kirtsaeng* decision and dismisses it as copyright-specific. To an extent, Judge Dyk in dissent agrees. But the Supreme Court may find relevance in its *Kirtsaeng* ruling in a manner not fully explored by either Judge Taranto or Judge Dyk. In *Kirtsaeng*, the majority, concurring, and dissenting justices all agreed that there was a common law doctrine of first sale or exhaustion in copyright and, importantly, that the common law doctrine had no geographic limitation. They also agreed that Congress had, to some extent, superseded the common law doctrine by enacting a specific copyright statute. They disagreed on the interpretation of that statute. The Justices' discussions of the copyright "first sale" statute were not pertinent to patent exhaustion, but their references to the common law doctrine arguably were. For patent law, the argument will be that Congress has not enacted a specific patent exhaustion statute, leaving the common law rule in place. But a counter argument will be that the patent common law doctrine was not necessarily the same in scope as that for copyright and, therefore, might be not similarly geographically neutral. For a discussion of these points, see Chisum on Patents § 16.05[3][a][iv][B].

A final point. It would seem amazing that these two basic questions about exhaustion would be in such a state of uncertainty in 2016 after more than two centuries of patent law development. But so it is.