

Comment on the US Supreme Court Decision “*Impression Products v. Lexmark International*”

35 U.S.C., §154(a)

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On May 30, 2017, the US Supreme Court rendered a seminal decision on the issue of exhaustion of patent rights. The decision addresses two main issues. First, whether a US patent allows the patentee to enforce post-sale restrictions through patent infringement proceedings. Second, whether the authorized first sale of a product covered by a US patent outside the United States exhausts the patentee’s rights within the United States. The Court, in a decision authored by Chief Justice Roberts, unanimously held that post-sale patent restrictions are unenforceable. The Court, by a 7-1 majority, held that an authorized first sale anywhere in the world exhausts US patent rights, including the right to prevent importation.¹

The patented products in the instant case are laser printer toner cartridges technically protected against refill and reuse, as to which the accused infringer developed and implemented circumvention technology. The patent owner sued for infringement based on violation of contractual prohibitions on refill and resale within the United States, as well as for importation of allegedly infringing products first sold abroad.² Nothing in the Supreme Court decision limits the holding to particular types or classes of patent subject matter.

On the path to the Supreme Court, the US Court of Appeals for the Federal Circuit requested the parties in this case, as well as the Department of Justice as *amicus curiae* on behalf of the Federal government, to file briefs addressing whether

¹ Justice Ginsburg dissented on the international exhaustion issue.

² *Impression Products, Inc., Petitioner v. Lexmark International, Inc.*, 581 U.S. ___ (2017), No. 15-1189, slip opinion at 2–5.

For the headnotes of the *Impression Products v. Lexmark International* decision, see this issue of IIC at doi:[10.1007/s40319-017-0640-8](https://doi.org/10.1007/s40319-017-0640-8).

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recent Supreme Court decisions required reconsideration of its precedent.³ To no one's great surprise, in the decision on certiorari (*Lexmark International v. Impression Products*, 816 F.3d 721 (Fed. Cir. 2016)) the Federal Circuit reaffirmed its own precedent on both issues, setting the stage for Supreme Court review.

1 Post-Sale Restrictions

1.1 *Mallinkrodt* Precedent

In rejecting post-sale restrictions based on patent, the Supreme Court overruled Federal Circuit precedent associated with *Mallinkrodt v. Medipart*, 976 F.2d 700 (1992). In explaining *Mallinkrodt* in its decision here on certiorari, the Federal Circuit reasoned that a patent confers a bundle of rights on its owner, and that nothing in the Patent Act prevents the patentee from transferring less than the full bundle of patent rights to a purchaser, such as by withholding the right to reuse the product. In *Quanta Computer v. LG Electronics*, 553 U.S. 617 (2008), the Supreme Court held that the sale of a patented product incorporating a method patent exhausts the rights of the patentee notwithstanding the continued practice of the patented method by the purchaser and subsequent transferees, and notwithstanding efforts by the patentee to contractually limit post-sale transfers. The Federal Circuit, in deciding that *Quanta* did not impliedly overrule *Mallinkrodt*, distinguished the Supreme Court decision principally on grounds that the subject sales in *Quanta* had been made by a patent licensee, not by the patent owner.⁴

1.2 Distinguishing Patents from Products

The Supreme Court said that the Federal Circuit made a fundamental error in its *Mallinkrodt* approach by treating the bundle of patent rights (or sticks) as the object of the sale and transfer of an invention from which a stick can be withheld. It said that the “exhaustion doctrine is not a presumption about the authority that comes along with a sale; it is instead a limit on ‘the scope of the patentee’s rights’.”⁵ Sale of the patented object divests the patentee’s exclusionary rights. “This well-established exhaustion rule marks the point where patent rights yield to the common law principle against restraints on alienation.”⁶ Once the patented product has been sold and transferred, patent rights are extinguished and the patentee may not enforce post-sale restrictions through a patent infringement action:

In sum, patent exhaustion is uniform and automatic. Once a patentee decides to sell – whether on its own or through a licensee – that sale exhausts its patent rights, regardless of any post-sale restrictions the patentee purports to impose, either directly or through a license. *Impression Products*, 581 U.S., slip opinion at 13.

³ Sua Sponte Hearing En Banc, Order of April 14, 2015, *Lexmark International v. Impression Products*, Nos. 2014-1617, 2014-1619 (Fed. Cir. 2014).

⁴ *Lexmark International v. Impression Products*, 816 F.3d 721, 737–39 (Fed. Cir. 2016).

⁵ *Impression Products*, 581 U.S., slip opinion at 10.

⁶ *Id.*, at 6.

1.3 Policy Concerns

The Supreme Court expressed significant concern about the downstream market impact of allowing post-sale patent restrictions. It illustrated with the example of a shop restoring and selling used cars that would be subject to continuing uncertainty as to whether infringement suits might be brought by patent owners that retained rights on any of the thousands of parts embodied in those cars. Even the threat of patent liability would require defensive investment by the shop owner. Advances in technology and increasingly complex supply chains magnify the potential problems created by post-sale patent restrictions.⁷ The Supreme Court put an end to them.

1.4 Enforceability of License Remains

However, while it eliminated post-sale restrictions based on patent, the Supreme Court distinguished limitations on licensees of patented technologies. A licensee is not a purchaser, and it may be subject to enforceable contractual limitations, such as regarding how a patented product is used.⁸ Nonetheless, if the licensee engages in an authorized sale of a patented product, patent rights are extinguished by operation of the exhaustion doctrine.⁹

A foreseeable consequence of the distinction drawn by the Supreme Court between sales and licenses is to encourage efforts by patent owners to characterize transactions as licenses where they intend to restrict the activities of technology users. In *Quanta*, the Supreme Court, by characterizing transfers of method inventions as sales for exhaustion purposes, had expressly sought to discourage opportunistic efforts to reframe inventive technologies as methods to prevent exhaustion of rights. Here in *Impression Products* the Supreme Court may have set itself up for revisiting the sale/license distinction once the consequences of this new decision are played out.

2 International Exhaustion

2.1 The Global Setting

Of greater interest to an international audience is the Supreme Court’s decision adopting and reaffirming a rule of international exhaustion of patents for the United States. Exhaustion doctrine was the subject of controversy during the GATT Uruguay Round (1986–1993) of trade negotiations.¹⁰ In TRIPS Agreement negotiations, the United States opposed international exhaustion, the EU was largely concerned with preserving intra-Union exhaustion, while developing

⁷ *Id.*, at 7–8.

⁸ *Id.*, at 11.

⁹ *Id.*, at 10–12.

¹⁰ Frederick M. Abbott, *First Report (Final) to the Committee on International Trade Law of the International Law Association on the Subject of Parallel Importation*, 1 *Journal of International Economic Law* 607 (1998)

countries favored international exhaustion.¹¹ The TRIPS Agreement result was to allow each WTO Member to adopt its own rule of exhaustion (across IP subject matter). Though at the time of the Uruguay Round, the weight of US judicial authority appeared to support international exhaustion of patents¹²; then and now the US Patent Act does not expressly address the question.

2.2 The South Africa Affair

The exhaustion issue became the focus of intense international controversy in the late 1990s as the government of South Africa was accused by the United States, the EU and originator pharmaceutical companies of violating its TRIPS Agreement obligations by adopting international exhaustion of patents to take advantage of medicines price differentials. This matter was resolved in favor of South Africa, including with subsequent recognition in the Doha Declaration on the TRIPS Agreement and Public Health of the right of governments to adopt their own rule on exhaustion.¹³ However, the episode intensified interest in the exhaustion question, including in subsequent negotiation of preferential trade agreements.¹⁴

2.3 *Jazz Photo* Precedent

The US Court of Appeals for the Federal Circuit stepped into the arena in 2001 rendering a decision in *Jazz Photo Corp. v. International Trade Commission*, 264 F.3d 1094 (Fed. Cir. 2001), that rejected international exhaustion of patents for the United States. In a terse and oddly worded paragraph,¹⁵ the Court answered the exhaustion question in reliance on the Supreme Court's decision in *Boesch v. Graff*, 133 U.S. 697 (1890), a decision that did not stand for the principle for which the Federal Circuit cited it, and without referencing or distinguishing contrary precedent.¹⁶

In the instant case on *certiorari*, the Federal Circuit suggested to the disputing parties that the Supreme Court's recent decision in *Kirtsaeng v. Wiley*, 133 S.Ct.

¹¹ *Id.* at 609. The Court of Justice of the European Union recognized in the immediate aftermath of the formation of the Union that IP, including patents, might constitute an obstacle to completion of the internal market. IP may act as a form of quantitative barrier that allowed IP owners to re-partition the internal market. The multilateral trading system as embodied in the World Trade Organization has characteristics different than the EU (*e.g.*, in terms of the level of integration seeking to be achieved), but the potential for enterprises to partition the global market based on IP rights similarly raises the problem of measures equivalent to quotas.

¹² See Margreth Barrett, *The United States' Doctrine of Exhaustion: Parallel Imports of Patented Goods*, 27 N. Ky. L. Rev. 911, 945–49 (2000), reprinted in 32 *Intell. Prop. Rev.* 231 (West, 2001).

¹³ WTO, Declaration on the TRIPS Agreement and Public Health (14 November 2001), at para. 5(d), Doc. WT/MIN(01)/DEC/2 (20 November 2001).

¹⁴ Frederick M. Abbott, *Intellectual Property Provisions of Bilateral and Regional Trade Agreements in Light of U.S. Federal Law*, ICTSD-UNCTAD Project on IPRs and Sustainable Development, Issue Paper No. 12, at 12–14, 18 (Feb. 2006).

¹⁵ *Jazz Photo Corp. v. International Trade Commission*, 264 F.3d 1094, 1105 (Fed. Cir. 2001).

¹⁶ The absence of reference to precedent was recognized by a subsequent District Court decision in related infringement proceedings, *Fuji Photo v. Jazz Photo*, 249 F.Supp.2d 434, 448–50 (D.N.J. 2003).

1351 (2013) in favor of international exhaustion for copyright might require a change to its own holding in *Jazz Photo*.¹⁷ The Department of Justice as amicus on behalf of the United States proposed a presumption in favor of international exhaustion for patents, but rebuttable by express reservation of rights.¹⁸ While expanding considerably on its earlier *Jazz Photo* decision, the Federal Circuit nonetheless affirmed its earlier approach, that is, a rule of national patent exhaustion for the United States.

There was common agreement among the disputing parties, and the Federal Circuit acknowledged, that the Patent Act did not define a rule of exhaustion for the United States.¹⁹

The Federal Circuit focused on the territorial nature of patent rights for the United States, including precedent of the Supreme Court emphasizing that territorial scope. According to the Federal Circuit, a principal consequence of the geographic limitation is to provide US patent owners with the right to determine the prices at which they will sell their patented products within the United States, without concern regarding the prices that may be charged in foreign markets where economic conditions may be different.²⁰ The Federal Circuit endorsed price discrimination among markets, including by arguing that reducing the pricing power of firms within the United States would reduce R&D investment in the United States.

The Federal Circuit also referred to three free trade agreements that had been negotiated by the United States and which required the country parties to provide the means for patent owners to prevent importation of products first put on the market outside those countries.²¹ It said that a ruling in favor of international exhaustion would put the United States in breach of those agreements, even though: (a) the agreements permitted the parties to use contract enforcement as a means to block imports; (b) subsequent to the negotiation of the three agreements Congress directed that similar clauses not be included in future free trade agreements negotiated by the United States;²² and (c) pursuant to US statute, the agreements are not directly effective in US law.

2.4 The Supreme Court

The Supreme Court categorically rejected the Federal Circuit’s approach in *Jazz Photo* and in the decision here on *certiorari*.

The Court observed that the US Patent Act does not expressly address the exhaustion question.²³ The Court noted that there is long-standing Supreme Court

¹⁷ See Order *supra* note 3.

¹⁸ Brief for the United States as Amicus Curiae Supporting Reversal in Part and Vacatur in Part, *Impression Products v. Lexmark International*, S.Ct., No. 1189, at 22–24 (Jan. 2017).

¹⁹ *Lexmark International v. Impression Products*, 816 F.3d 721, 765 (Fed. Cir. 2016).

²⁰ *Lexmark International v. Impression Products*, 816 F.3d 721, 760–62 (Fed. Cir. 2016).

²¹ *Id.*, at 765–66.

²² Science, State, Justice, Commerce, and Related Agencies Appropriation Act, 2006, Act of Nov. 22, 2005, Pub. L. No. 109-108, §631, 119 Stat. 2344.

²³ *Impression Products, Inc., Petitioner v. Lexmark International, Inc.*, 581 U.S. __ (2017), No. 15-1189, slip opinion at 14.

jurisprudence generally establishing patent exhaustion that is rooted in common law principles disfavoring restraints on alienation of personal property. While that precedent does not expressly address geographic scope in terms of international or national exhaustion, the same policy concerns that motivated the Court to recognize international exhaustion for copyright apply with respect to patent.²⁴ The Supreme Court rejected the Federal Circuit's view that its decision in *Kirtsaeng v. Wiley* in favor of international exhaustion for copyright was necessitated by statutory language.²⁵ According to the Supreme Court, the same principles that animated its decision in in favor of international exhaustion for copyright operate in respect to patents. Many everyday products are subject to both patent and copyright protections. The Court referred again to the risks to the market imposed by allowing downstream enforcement of patents.

The Supreme Court distinguished its own holding in *Boesch v. Graff* on the basis that the US patent owner in that case had not authorized the sale of the patented products in Germany (which were lawfully made pursuant to a German prior user right).²⁶ The US Patent Act gives the patent owner the right to prevent sales that are not made under its authority. In the United States, patent exhaustion is based on the consent or authority of the patent owner.

While recognizing “the territorial limit on patent rights”, the Court said that this was not a basis for distinguishing copyright protection which also has such limit. “Exhaustion”, it said, “is a separate limit on the patent grant”.²⁷ The Court rejected the premise of the Federal Circuit that the territorial limitation of the Patent Act entitles a patent owner to recover a US price for its product. The Court said that the Patent Act is neither intended to guarantee a particular price nor a US market price.²⁸ Given the reliance placed by the Federal Circuit on the implicit guarantee of US pricing in the Patent Act, this was a key holding of the Supreme Court, and critical to the competition-enhancing implications of international exhaustion.

The Court rejected also the suggestion of the US Government through the Department of Justice that it limit its holding to establishment of a presumption in favor of international patent exhaustion that could be rebutted by contract and/or notice. The Supreme Court dismissed the Department of Justice's references to long-standing judicial doctrine supporting a presumption of international exhaustion subject to reservation of rights, saying that precedent was “sparse and inconsistent”.²⁹

The fundamental basis of the Supreme Court decision is the common law's favoring of trade, and the importance of allowing goods that are placed in commerce to move freely in commerce. The Court concludes:

²⁴ *Id.*, at 13–14.

²⁵ *Id.*, at 13–14.

²⁶ The Court said: “All that case illustrates is that a sale abroad does not exhaust a patentee's rights when the patentee had nothing to do with the transaction.” *Id.*, at 16.

²⁷ *Id.*, at 15.

²⁸ The Court said: “But the Patent Act does not guarantee a particular price, much less the price from selling to American consumers.” *Id.*, at 15.

²⁹ *Id.*, at 17.

... exhaustion occurs because, in a sale, the patentee elects to give up title to an item in exchange for payment. Allowing patent rights to stick remora-like to that item as it flows through the market would violate the principle against restraints on alienation. Exhaustion does not depend on whether the patentee receives a premium for selling in the United States, or the type of rights that buyers expect to receive. As a result, restrictions and location are irrelevant; what matters is the patentee’s decision to make a sale.³⁰

2.5 What was Unsaid

The Supreme Court refers to several business sectors in its opinion, including automobile repair shops, semiconductor manufacturers and general retailers. Not once does the Court refer to the pharmaceutical sector. The originator pharmaceutical industry in the United States has been perhaps the most vocal opponent of international exhaustion, pharmaceutical industry groups submitted amicus briefs to the Supreme Court,³¹ the Federal Circuit addressed questions to counsel during oral hearings concerning pharmaceuticals and referenced the sector in its opinion.³² Cutting through the noise, the basic argument of the pharmaceutical originator industry was that international exhaustion and parallel imports would result in lower prices in the United States, which would adversely affect R&D investments by the companies, which would adversely affect the American public.³³ By this logic, any effort to control pharmaceutical prices is a negative.

This author submitted an amicus brief to the Supreme Court favoring international exhaustion and predominantly addressing pharmaceutical sector issues, though with a different perspective than the originator industry groups.³⁴ Allowing the originator companies to protect the US market against their own products sold more cheaply in foreign markets imposes a burden on US consumers. The interests of low and middle-income countries in pharmaceuticals provided under differential pricing programs can be protected in WTO-legitimate ways.³⁵

The Supreme Court Justices were without doubt aware that the pharmaceutical industry in the United States was keenly interested in this case. The Justices knew that the industry finds the idea of price competition from parallel imports anathema. The case before the Court involved toner cartridges, and the Court did not need to

³⁰ *Id.*, at 18.

³¹ See, e.g., Brief for Pharmaceutical Research and Manufacturers of America as Amicus Curiae in Support of Respondent, S.Ct., No. 15-1189 (2017) (“PhRMA Brief”); Brief of Amici Curiae Biotechnology Innovation Organization and Croplife International in Support of Respondent, S.Ct., No. 15-1189 (Feb. 23, 2017) (“BIO Brief”).

³² *Lexmark International v. Impression Products*, 816 F.3d 721, 772 (Fed. Cir. 2016).

³³ See, e.g., PhRMA Brief at 9–19; BIO Brief at 24.

³⁴ Brief of Amicus Curiae (Frederick M. Abbott) in Support of Petitioner in *Impression Products v. Lexmark International*, US Supreme Court, No. 15-1189, filed January 20, 2017. Available at SSRN: <https://ssrn.com/abstract=2906967>.

³⁵ *Id.*, and; Frederick M. Abbott, Parallel Trade in Pharmaceuticals: Trade Therapy for Market Distortions, in: I. Calboli and E. Lee (eds.) *Research Handbook on Intellectual Property Exhaustion and Parallel Imports*, 145–65, (Edward Elgar Pub. 2016).

venture into the pros and cons of parallel imported medicines. As the law stands following the Supreme Court's decision, parallel import of patented medicines into the United States is permitted, subject to compliance with FDA rules. Such medicines must be manufactured in facilities that have been inspected and approved by the FDA, and must be approved for marketing in the United States. The originator pharmaceutical industry will be lobbying for amendment to the Patent Act and/or the laws implemented by the FDA. Whether Congress will stand with the Supreme Court and the vast majority of US citizens for exerting downward pressure on domestic pharmaceutical prices, or will join with the pharmaceutical lobbyists, is an open question.

The Supreme Court ignored the Federal Circuit's references to avoiding contravention of free trade agreements. However, the fact that the Federal Circuit pursued this line of reasoning gives another reason for caution regarding the commitments made in such agreements.

3 Final Note

The US Supreme Court is looked to by judges and lawyers around the world as a source of sound jurisprudence. The decision in *Impression Products* stands as a strong affirmation of the right of WTO Members to adopt international exhaustion of patents. It confirms the stand taken by the government of South Africa in the late 1990s. It supports the free movement of goods in commerce, including those protected by intellectual property rights.

Of course, the decision still leaves some open questions regarding patent exhaustion. There are always open questions. For this moment, however, we can take the time to appreciate the categorical stance of the US Supreme Court in favor of international patent exhaustion and non-enforcement of post-sale patent restrictions.