

## US Supreme Court Says No to Post-Sale Restrictions Under Patent Law

***The Court also holds that patent exhaustion applies to both foreign and domestic sales in a historic decision.***

### Key Points:

- Patent rights are exhausted by sale even if the patentee purports to impose post-sale restrictions
- Sales by licensees exhaust rights if the sales are authorized by the patentee
- Foreign sales are subject to exhaustion in the same manner as domestic sales

The Supreme Court's recent decision in *Impression Products, Inc. v. Lexmark International, Inc.* reversed years of Federal Circuit precedent by holding that once a patentee decides to sell a product, the sale exhausts the patentee's patent rights, regardless of any post-sale restrictions the patentee purports to impose on such products or the location of the sale. See 137 S. Ct. 1523 (2017). Specifically, the Supreme Court ruled on the permissibility of post-sale restrictions under patent law; however, questions remain about whether and how similar restrictions may be available under other regimes, such as contract.

Lexmark manufactures and sells printer toner cartridges for laser printers. Because printer cartridges are very expensive in comparison to the toner contained inside, and the toner cartridges can be refilled with toner and used again, a market developed to refill and resell Lexmark's printer cartridges. In response to this market, Lexmark offered two types of cartridges: one type was sold at a discounted price, which Lexmark specified must be returned to Lexmark when empty (the "Return Program" cartridges), whereas the other type, which was otherwise identical and sold at a higher price, did not include such a restriction. Despite the restriction, companies still refilled and resold the Return Program cartridges on their own, rather than returning the cartridges to Lexmark. Lexmark sued some of these companies for patent infringement, claiming that Lexmark did not grant the right to refill and resell such cartridges to the purchasers of Return Program cartridges, and by extension, to the sellers of refilled cartridges. In addition to reselling Return Program cartridges bought in the United States, companies imported and resold cartridges originally sold abroad. Lexmark's suit also challenged the sales of the cartridges originally sold abroad, with Lexmark claiming that sales abroad do not exhaust patent rights in the United States.

In 2016, the Federal Circuit ruled in Lexmark's favor on each issue. It held, *en banc*, that Lexmark could sue for patent infringement based on the resales of both domestic and foreign cartridges because the

restrictions were reasonably communicated to purchasers and that sales abroad, which otherwise would not infringe a US patent, do not exhaust a patentee's rights in the United States.

The Supreme Court then faced two questions:

- May a patentee, after selling a good, enforce post-sale restrictions on the good under patent law?
- May a patentee, after selling a good abroad, sue for patent infringement based on downstream sales or use of the product in the United States?

To both questions, the Supreme Court responded — emphatically — no.

## History

Several recent cases set the stage for this historic decision.

In 2008, the Supreme Court decided *Quanta Computer, Inc. v. LG Electronics, Inc.*<sup>1</sup> The Court considered whether a patentee could impose post-sale restrictions on products purchased from manufacturing licensees. In this particular instance, LG had licensed to Intel the right to make and sell certain computer chips employing technology covered by LG patents, but the license granted to Intel purported to withhold from downstream purchasers, such as Quanta, any right to combine those chips with other standard components to form a computer. The Supreme Court held that because the license gave Intel authority to sell chips that fully embodied LG's invention, the sales authorized under that license exhausted LG's patent rights and gave Quanta the right to use those chips in computers — which was the only commercially reasonable use of those chips. Accordingly, LG did not have a patent infringement claim against Quanta.

In 2013, the Supreme Court decided *Kirtsaeng v. John Wiley & Sons, Inc.*<sup>2</sup> In *Kirtsaeng*, the Supreme Court considered whether a copyright holder could sell copyrighted goods abroad but still sue for copyright infringement in the United States based on the importation and subsequent resale of those goods in the United States. Mr. Kirtsaeng's family in Thailand purchased textbooks sold by Wiley, which Mr. Kirtsaeng then imported into the United States and resold at a significant markup. The Supreme Court held that because Wiley authorized the sales in Thailand, the sales exhausted any copyright claim in the United States over the textbooks. Accordingly, Wiley did not have a copyright infringement claim against Mr. Kirtsaeng.

## Decision

The Supreme Court, reversing the Federal Circuit, effectively held that a sale is a sale is a sale. If a patentee authorizes a sale of a good, regardless of the country of sale, it can no longer restrict the use or resale of the good through a claim of patent infringement. In doing so, the Court looked to the common law's strong disfavor of restrictions on alienation — limitations on the use and sale of goods. Accordingly, if a patentee sells a good or authorizes the sale of a good through a licensee, the patentee can no longer exert patent rights over the good.

The Supreme Court noted that the exhaustion rule is “well-established” and “marks the point where patent rights yield to the common law principle against restraints on alienation.”<sup>3</sup> The Court confirmed that once the patent holder sells or authorizes the sale of a good, the patent holder's patent rights are exhausted as to that good. At that point, the traditional restrictions on alienation of goods take over. The Supreme Court further argued that extending any patent rights past the first sale would clog the channels of commerce, with little benefit to the patentee.

The Supreme Court referred to several of its own holdings, which uniformly favor exhaustion, including *Boston Store of Chicago v. American Graphophone Co.* In *Boston Store*, the Supreme Court considered whether a manufacturer could use the patent law to enforce resale price restrictions and held:

[T]here was “no room for controversy” about the result: By selling the item, the manufacturer placed it “beyond the confines of the patent law, [and] could not, by qualifying restrictions as to use, keep [it] under the patent monopoly.”<sup>4</sup>

The Court also looked to *United States v. Univis Lens Co.*, in which the patentee authorized an agent to sell unfinished eyeglass lens blanks, but attempted to impose restrictions on the purchaser’s authority to grind those blanks into finished lenses.<sup>5</sup> In that case, the Supreme Court took an equally clear stance when it held:

[T]he initial sales “relinquish[ed] ... the patent monopoly with respect to the article[s] sold,” so the “stipulation ... fixing resale prices derive[d] no support from the patent and must stand on the same footing” as restrictions on unpatented goods.<sup>6</sup>

In the Supreme Court’s view, the Federal Circuit was approaching the problem the wrong way: “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.’”<sup>7</sup> A patent grants exclusive rights to make, use, and sell products embodying certain inventions, but a patent does not give the patent owner the power to alter the consequences of a sale — which the general law of property governs. The exhaustion doctrine sits between the two, acknowledging that after the patentee sells (or, by its authorization, a licensee sells), the buyer obtains full ownership of the goods and the patentee has no further rights over the goods. Accordingly, a patentee cannot enforce restrictions on patent rights after a sale.<sup>8</sup>

The Supreme Court clarified that the same analysis applies to licensees. A patentee can enforce limitations on its licensees by using contractual provisions. As the Court indicated with reference to *General Talking Pictures*, a patentee could limit its licensee to sell only to certain customers. If a licensee sold to unauthorized customers, then the patent right is not exhausted. But, so long as a licensee complies with the restrictions in its contract with the patentee, an authorized sale by the licensee “nonetheless exhausts all patent rights in the item sold.”<sup>9</sup>

The Supreme Court noted that patent exhaustion through foreign sales is just as straightforward as copyright exhaustion through foreign sales, following *Kirtsaeng*.<sup>10</sup> The Court noted that the patentee is entitled to exclude others from making, using, or selling a patented invention in the United States; however, if a patentee decides to sell a product anywhere in the world, that decision exhausts the patentee’s rights in that item. Therefore, Lexmark’s sales, wherever they occurred, exhausted all of Lexmark’s patent rights over the products once sold.

## Impact

*Impression Products* leaves a number of practical questions unanswered for interpreting current contracts and drafting future agreements. Some of the more prominent questions include whether corporate structure may be used to avoid exhaustion, what contract language constitutes “authorization” of a licensee, and whether leasing goods can avoid exhaustion.

Although the Court’s decision in *Impression Products* clearly prohibits reserving post-sale rights under the patent law, it does not prohibit enforcing similar restrictions on a purchaser’s right to sell or use through contract. Thus, patent holders may need to rely more heavily upon contractual provisions to try enforcing

post-sale restrictions. If supply chains are involved, patent holders may wish to consider implementing a series of contracts that bind downstream purchasers to restrictions that may be enforceable under contract law even though they are no longer enforceable under patent law (although patent holders should note that the Court did not address whether such restrictions would be enforceable under contract law). Further, patent holders may want to incorporate arbitration provisions into their agreements to reduce the burden of potential future litigation and enforce restrictions on foreign activity.

Likewise, patent holders may want to consider changes to their sales models or move to leasing models. For example, if goods are sold at a premium in the United States compared to foreign markets, patent holders may want to reconsider pricing strategies now that goods sold abroad can be imported to the United States and resold at any price.

Patent holders may also want to consider other avenues for restricting the importation, sale, and use of goods. For example, patent holders, particularly in regulated industries, may want to review more closely legislation that restricts importing certain goods sold abroad.

Exhaustion has proven to be a hot-button issue among companies and in the courts over the last few years. This trend will likely continue in the near future as the rules of *Impression Products* are put into play and tested.

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## Endnotes

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<sup>1</sup> Latham — including then-partner Maureen Mahoney and current partners Scott Ballenger, Melissa Arbus Sherry, and Anne Robinson — represented Quanta Computer, Inc., Quanta Computer USA, Inc., and Q-Lity Computer, Inc. in *Quanta*.

<sup>2</sup> In her previous position as Assistant to the Solicitor General, current Latham partner Melissa Arbus Sherry represented the United States as *amicus curiae* in *Kirtsaeng*.

<sup>3</sup> *Impression Prods.*, 137 S. Ct. at 1531.

<sup>4</sup> *Id.* at 1533 (quoting *Boston Store*, 246 U.S. 8, 20, 25 (1918)).

<sup>5</sup> *Id.*

<sup>6</sup> *Id.* (quoting *Univis*, 316 U.S. 241, 249-51 (1942)).

<sup>7</sup> *Id.* at 1534 (quoting *United States v. Gen. Elec. Co.*, 272 U.S. 476, 489 (1926)).

<sup>8</sup> In certain cases, however, a patent holder may still be able to assert infringement against downstream purchasers for practicing patented methods, if the method is not fully embodied in, or essential to the only reasonable use of, the thing sold.

<sup>9</sup> *Id.* at 1535.

<sup>10</sup> *Id.* at 1536.