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***Lexmark v. Impression Products*: Will (and Should) The En Banc Federal Circuit Move to International Patent Exhaustion?**

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I. INTRODUCTION

In this era of globalization, numerous companies have established licensing programs and/or filed patent infringement lawsuits to attempt to restrict the ability of foreign purchasers to import products practicing their technology into the United States. Purchasing goods outside of the U.S. and importing them back into the U.S. for resale or use – so-called "grey market" goods – have, however, become commonplace, creating increasingly complex IP exhaustion issues. In one arena, retailers have been taking advantage of price discrepancies that exist between the domestic and international markets by purchasing goods that were initially sold overseas (often sold at greater discounts than the same goods sold in the U.S.) and importing them into the U.S. for resale. As e-commerce has grown exponentially, the practice of buying and reselling grey market goods has also flourished on the Internet.

In 2013, the Supreme Court interpreted Section 109(a) of the Copyright Act to allow for international exhaustion of the copyright's holder's rights, permitting the importation and reselling of textbooks that had been lawfully sold by the copyright owner overseas. *Kirtsaeng v. John Wiley & Sons, Inc.*, 133 S. Ct. 1351 (2013). This decision conflicts with Federal Circuit precedent in the patent context, including *Jazz Photo Corp. v. ITC*, 264 F.3d 1094, 1105 (Fed. Cir. 2001), which held that a foreign sale is not "under" a U.S. patent, and that there is therefore no exhaustion of U.S. patent rights by a foreign sale.

On October 2, 2015, the en banc Federal Circuit held oral argument in *Lexmark v. Impression Products.* In *Lexmark*, the court is addressing (1) whether to overrule *Jazz Photo* and its progeny, and hold that an initial authorized sale of a patented product outside of the United States *would* exhaust the patent rights of the patent holder just as a sale within the United States would (unless the U.S. patent rights are expressly reserved at the time of sale); and (2) whether to also overrule *Mallinckrodt, Inc. v. Medipart, Inc.*, 976 F.2d 700 (Fed. Cir. 1992), in which the Federal Circuit had held that patent owners could condition sales of patented goods (for instance as "single use only") to reduce the impact of patent exhaustion.

It is likely that no matter what the Federal Circuit decides, this issue will be appealed to the Supreme Court. The decision in the *Lexmark* case could have far-ranging consequences, potentially impacting how goods are priced world-wide and disrupting the licensing practices of many companies. And, if the Federal Circuit or Supreme Court adopts international patent exhaustion, how can this be reconciled with numerous decisions holding that the scope of U.S. patent protection is limited to activities within the United States?

II. OVERVIEW OF THE PATENT EXHAUSTION DOCTRINE AND RECENT KEY DECISIONS.

The judicially created doctrine of patent exhaustion provides that the initial authorized sale of a patented item terminates all patent rights to that item. The doctrine has been applied to preclude patent holders from obtaining double recoveries from their patent rights. *See Motion Picture Patents Co. v. Universal Film Mfg. Co.*, 234 U.S. 502, 518 (1917) ("[T]he right to vend is exhausted by a single, unconditional sale, the article being sold being thereby carried outside the monopoly of the patent law and rendered free of every restriction which the vendor may attempt to put upon it."). The doctrine is not codified in the Patent Act, but has been applied by the courts since it was first enunciated by the Supreme Court in the 1850s.

Key decisions include the following.

A. *Quanta Computer, Inc. v. LG Electronics, Inc.*, 553 U.S. 617 (2008)

Facts:

LG licensed a patent portfolio to Intel under an agreement that permitted Intel to manufacture and sell microprocessors that practiced the patents. A provision of the licensing agreement specified that it extended no license to any third party to combine licensed products with products acquired from other sources. A separate "Master Agreement" between LG and Intel required Intel to give written notice of that limitation to its customers. Quanta purchased microprocessors from Intel and received the required notice. Quanta did not modify the Intel parts, but notwithstanding the written notice Intel had provided it, subsequently combined them with non-Intel parts in ways that practiced the LG patents. LG sued Quanta for infringement.

Holdings:

United States v. Univis, 316 U.S. 241 (1942), governed the case. In *Univis*, the Supreme Court held that exhaustion was triggered by the authorized sale of the products at issue "because their only reasonable and intended use was to practice the patent and because they 'embodie[d] essential features of [the] patented invention.'" Based on *Univis* and other Supreme Court precedent, the Court held that the patent exhaustion doctrine applies to method patents and that Intel's sale to Quanta exhausted LG's patent rights.

The licensing agreement between Intel and LG did not restrict Intel's right to sell products that embodied the LG patents. The separate Master Agreement did require Intel to provide its customers with notice that LG had not authorized them to practice its patents, but LG did not argue that Intel breached its duty or that a breach of the Master Agreement would constitute a breach of the licensing agreement. Exhaustion "turns only on Intel's own license to sell product practicing LGE's patents."

The Court expressly stated that its decision in *Motion Picture Patents Co. v. Universal Film Mfg. Co.*, 234 U.S. 502, 518 (1917), "reiterated the rule that 'the right to vend is exhausted by a single, ***unconditional*** sale, the article being sold being thereby carried outside the monopoly of the patent law and rendered free of every restriction which the vendor may attempt to put upon it.'") (Emphasis added.) *Compare General Talking Pictures Corp. v. Western Electric*, 304 U.S. 175 (1938) (exhaustion does not apply where license limited sales for private and home use of patented amplifiers, but manufacturer sold amplifiers for commercial use because manufacturer had no authority to sell the amplifiers for commercial use, and the manufacturer "could not convey to petitioner what both knew it was not authorized to sell.").

Note: Because LG's complaint contained no breach of contract claim, the Court "express[ed] no opinion on whether contract damages might be available even though exhaustion operates to eliminate patent damages."

B. *Jazz Photo Corp. v. ITC*, 264 F.3d 1094 (Fed. Cir. 2001)

Facts:

Fuji Photo Film Co. owned several patents related to single-use cameras. After the film on these cameras is exposed, the photo processor removes the film canister by breaking open the plastic casing. Fuji intended the cameras to be used only once, but various companies, including Jazz Photo, purchased the discarded cameras and refurbished them. Some of these cameras originated overseas and were sold outside the United States. Fuji brought an action before the International Trade Commission (ITC) against 27 of these so-called "remanufacturers" for infringing its patents.

The ITC found for Fuji, determining that the refurbishment of the used cameras was prohibited reconstruction, rather than permissible repair.

Holdings:

The Federal Circuit reversed the ITC's final determination, finding instead that under Federal Circuit precedent, the acts performed by the remanufacturers (inserting new film, resetting the film counter, and resealing the broken case) was more akin to repair than reconstruction.

The patent exhaustion doctrine does not apply to products of foreign provenance—single-use cameras that were first sold outside of the United States were not immunized from infringing Fuji's patents. The Federal Circuit also held that only cameras first sold in the United States qualified for the repair exclusion under the exhaustion doctrine.

For an accused infringer "[t]o invoke the protection of the first sale doctrine, the authorized first sale must have occurred under the US patent."

C. *Fuji Photo Film Co., Ltd. v. Jazz Photo Corp.*, 394 F.3d 1368 (Fed. Cir. 2005)

Facts:

In this case, the Federal Circuit revisited the issue of whether foreign sales of single-use cameras by Fuji and its licensees could occur under Fuji's U.S. patents.

Jazz Photo imported and sold over forty million refurbished disposable cameras Fuji and sold abroad.

Holdings:

The U.S. patent system has no extraterritorial effect, so a patentee's authorization of an international first sale does not exhaust its rights in the United States. Jazz Photo did not avoid infringement liability because Fuji had authorized overseas sales of the cameras.

The affirmative defense of repair was not applicable to these disposable cameras sold overseas.

D. *LG Electronics, Inc. v. Hitachi, Ltd.*, 655 F. Supp. 2d 1036 (N.D. Cal. 2009)

Facts:

LG charged Hitachi with infringing four patents that were at issue in the *Quanta* case. Like the defendants in *Quanta*, Hitachi manufactured products that combined Intel parts subject to the license agreement with Quanta and non-Intel parts in a way that practiced the patented methods. LG attempted to distinguish *Quanta* in part by arguing that exhaustion applies only when the first authorized sale of patented items occurs in the United States.

Holdings:

LG's patent rights were exhausted by Intel's foreign sales to Hitachi overseas, which were expressly authorized by the Intel-LG licensing agreement.

The *Quanta* Court made clear its intent to prevent patentees from doing an "end-run" around the exhaustion doctrine by reaping the benefit of the patent via an authorized sale and then charging downstream purchasers with infringement.

Fuji Photo and *Jazz Photo* were inconsistent with *Quanta* because they would permit exactly the type of end-run that the Supreme Court foreclosed.

E. *Fujifilm Corp. v. Benun*, 605 F.3d 1366 (Fed. Cir. 2010)

Facts:

This appeal stemmed from the Federal Circuit's 2005 decision in *Fuji Photo Film.* Among the issues presented on appeal was whether *Quanta* overruled the Federal Circuit's holding in *Jazz Photo Corp*.

Holdings:

Quanta did not eliminate the territoriality requirement for patent exhaustion announced in *Jazz Photo Corp.*

Quanta did not involve foreign sales, and its only reference to "outside the country" addressed the distinction between a practicing use and an infringing one: while a practicing use may be "outside the country," an infringing use must occur in the United States.

F. *Mallinckrodt, Inc. v. Medipart, Inc.,* 976 F.2d 700 (Fed. Cir. 1992)

Facts:

Mallinckrodt owned a patent on a device for dispensing radioactive mist during diagnostic lung X-Rays. Mallinckrodt sold these devices to hospitals with a "single use only" notice.

After the initial use of the devices, hospitals would send the medical device to Medipart for servicing that enabled the hospitals to use the devices again.

Holding:

The Federal Circuit observed that patent owners could condition sales of patented goods to reduce the impact of patent exhaustion. The court held Mallinckrodt's single use restriction was enforceable, and that the doctrine of patent exhaustion does not turn a conditional sale into an unconditional one.

G. *San Disk Corp. v. Round Rock Research LLC*, 2014 WL 2700583 (N.D. Cal. June 13, 2014)

Facts:

SanDisk designs, manufactures, and sells a variety of flash memory devices. The infringement claims here arose partly from SanDisk's use of semiconductor memory devices purchased from Toshiba entities. Those Toshiba memory devices had been made under licenses granted by Round Rock's predecessor patent owner allowing Toshiba to make, use, and sell the inventions of the patents world-wide.

SanDisk sought declaratory relief that (a) its product did not infringe patents held by Round Rock, and/or (b) that the patents were invalid. Both parties brought partial summary judgment motions. Most relevant, SanDisk sought a determination that patent exhaustion barred the infringement claim arising from Toshiba memory.

Holdings:

> The court held that patent exhaustion barred the infringement claims arising from Toshiba memory devices. Foreign sale exhausts patent rights where the patent holder had granted a world-wide license "to make, have made, use, sell, offer for sale, ***import*** or otherwise dispose of licensed products and to use any methods covered by" its patents.
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> "The fact that the products were sold under the authority of a world-wide license agreement renders [*Jazz Photo*] distinguishable…. [W]hile the mere purchase of an item overseas that embodies a U.S. patent may not give the purchaser a right to import it into the United States, here Toshiba had such a right under the parties' negotiated license agreement…."
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> Round Rock had effectively already exercised its rights under U.S. Patent law by granting a license to Toshiba, for consideration, to import patented technology into the United States, if it so chose, as provided for in the language of the license.

III. ***KIRTSAENG V. JOHN WILEY & SONS*** **– THE SUPREME COURT FINDS INTERNATIONAL EXHAUSTION IN THE COPYRIGHT CONTEXT.**

As codified at 17 U.S.C. § 109(a), the first sale doctrine entitles "the owner of a particular copy . . . lawfully made under this title" to sell that copy without the copyright owner's authorization. Though a copyright case relating to statutory copyright exhaustion, the reasoning of *Kirtsaeng* is relevant to the analysis of common law patent exhaustion.

In *Kirtsaeng*, John Wiley & Sons, Inc. published English-language textbooks for distribution in the United States as well as publishing the same textbooks for distribution abroad through a wholly-owned subsidiary. The Asian editions of Wiley's books read in part: "'This book is authorized for sale in Europe, Asia, Africa, and the Middle East only and may be not [*sic*] exported out of these territories.'" All copies of Wiley's books printed and sold abroad state that they are not to be taken without permission into the United States.

Supap Kirtsaeng, a Thai national who moved to the United States in 1997 to obtain a math undergraduate degree and PhD, asked his friends and family in Thailand to buy copies of foreign edition English-language textbooks at Thai book shops and mail them to him in the United States. Because these books were sold at low prices in Thailand, Kirtsaeng could pay his friends and family the cost of purchase and shipping, and make a profit by selling the books at a higher price in the United States.

Wiley brought suit against Kirtsaeng for copyright infringement, claiming violation of his exclusive right to distribute the works under 17 U.S.C. § 106(3). Kirtsaeng argued that 17 U.S.C. § 109(a)'s first sale doctrine permitted him to resell the books first sold in Thailand without the owner's permission.

The district court held Kirtsaeng could not assert the first sale defense because that doctrine was inapplicable to foreign-manufactured goods (even those made abroad with the copyright owner's permission, as here) and awarded statutory damages to plaintiff Wiley, which defendant Kirtsaeng appealed. The Second Circuit affirmed.

The Supreme Court granted certiorari, interpreting statutory copyright exhaustion doctrine as codified at 17 U.S.C. § 109(a). In its 6-3 decision, the Supreme Court found that Section 109(a) allowed Kirtsaeng to import and resell textbooks that had been lawfully made and sold by the copyright holder abroad. The Court held that "first sale" doctrine applies not only to copies of a copyrighted work lawfully made in the United States but also to those lawfully made abroad. In so holding, the Court found Section 109(a) contains no express geographic limitations.

In reaching its decision, the majority noted not only the common law's general refusal to permit restraints on the alienation of chattels, but also that "common-law doctrine makes no geographical distinctions," and focused on whether Wiley, as the U.S. copyright holder, had authorized an unrestricted sale of the copyrighted work, rather than focusing on the geographic location of the sale: "In our view, § 109(a)'s language, its context, and the common-law history of the "first sale" doctrine, taken together, favor a non-geographical interpretation. We also doubt that Congress would have intended to create the practical copyright-related harms with which a geographical interpretation would threaten ordinary scholarly, artistic, commercial, and consumer activities. … We consequently conclude that Kirtsaeng's nongeographical reading is the better reading of the Act."

Of Note: Justice Ginsburg dissented, with Justice Kennedy joining and Justice Scalia joining excepts as to Parts III and V-B-1. The Dissent views the majority's holding to be "an interpretation of the Copyright Act at odds with Congress' aim to protect copyright owners against the unauthorized importation of low-priced, foreign-made copies of their copyrighted works."

IV. THE *LEXMARK* CASE AND ITS POTENTIAL IMPLICATIONS

A. Factual Background of *Lexmark*

In large part, the facts presented on appeal are undisputed. Lexmark is a leading developer and manufacturer of imaging and information management products and services including laser printers and toner cartridges, the products at issue in this case. In 2010, Lexmark filed patent infringement cases against a number of companies seeking to prevent the use in Lexmark-brand printers of printer toner cartridges originally sold by Lexmark and then refurbished by third parties. One such third party remanufacturing and selling these cartridges was Impression Products.

Lexmark sold two types of replacement toner cartridges for its printers: "Regular Cartridge" full price cartridges which customers could purchase without any use limitation, and "Return Program" cartridges which were sold for roughly 20% in exchange for customers' agreeing to use the cartridges only once and then return them to Lexmark for remanufacturing or recycling. Cartridges sold as part of the return program had, in relevant part, the following use restriction displayed on their packaging: "Following this initial use, you agree to return the empty cartridge only to Lexmark for recycling." The same lengthy restriction also appeared on

Lexmark's website. The return program cartridge agreement has been ruled an enforceable agreement in multiple cases and courts.

The District Court judge entered final judgment on June 24, 2014 as follows: (1) infringement against the remanufactured cartridges that were originally sold abroad, because an initial authorized sale of a patented product outside of the US would not exhaust the patent holder's rights following *Jazz Photo*, and (2) non-infringement against the remanufactured cartridges that were originally sold in the US, because Lexmark's patent infringement claims were barred by the doctrine of patent exhaustion. Impression Products appealed the judgment of infringement as to the cartridges originally sold abroad, and Lexmark cross-appealed as to the cartridges originally sold in the US.

After briefing, a three judge panel heard oral argument on March 6, 2015. On April 14, 2015, the Federal Circuit sua sponte ordered that the case be heard en banc to address the continued viability of *Jazz Photo* in light of *Kirtsaeng*, and the continued viability of *Mallinckrodt* in light of *Quanta*. In addition to the parties, over thirty amici curiae submitted briefs. On October 2, 2015 the Federal Circuit heard oral argument en banc.

B. Questions for En Banc Review

The en banc order presents the following two questions:

(a) The case involves certain sales, made abroad, of articles patented in the United States. In light of *Kirtsaeng v. John Wiley & Sons, Inc*., ––– U.S. ––––, 133 S.Ct. 1351, 185 L.Ed.2d 392 (2013), should this court overrule *Jazz Photo Corp. v. International Trade Commission*, 264 F.3d 1094 (Fed.Cir.2001), to the extent it ruled that a sale of a patented item outside the United States never gives rise to United States patent exhaustion?

(b) The case involves (i) sales of patented articles to end users under a restriction that they use the articles once and then return them and (ii) sales of the same patented articles to resellers under a restriction that resales take place under the single-use-and-return restriction. Do any of those sales give rise to patent exhaustion? In light of *Quanta Computer, Inc. v. LG Electronics, Inc.*, 553 U.S. 617, 128 S.Ct. 2109, 170 L.Ed.2d 996 (2008), should this court overrule *Mallinckrodt, Inc. v. Medipart, Inc*., 976 F.2d 700 (Fed.Cir.1992), to the extent it ruled that a sale of a patented article, when the sale is made under a restriction that is otherwise lawful and within the scope of the patent grant, does not give rise to patent exhaustion?

Discussion topics:

- How will (and should) the Federal Circuit rule?
- How will this impact patent holders? Consumers?

- What can patent holders do to protect themselves?

V. CAN INTERNATIONAL EXHAUSTION BE RECONCILED WITH THE SCOPE OF U.S. PATENT RIGHTS IN OTHER CONTEXTS?

It is well-settled that U.S. Patent rights are limited to acts within the United States. Courts are, however, clearly struggling with how to apply U.S. patent law in an era where corporations and their manufacturing and sales capabilities are scattered all over the globe. The en banc opinion in *Lexmark* will be yet another example of this in the patent exhaustion context. As Lexmark states in its appellate brief:

> Impression and its *amici* contend that international exhaustion does not entail extraterritorial application of U.S. law, but merely recognizes that an overseas sale occurred. This is wrong: treating foreign sales as the basis for domestic exhaustion would treat an extraterritorial sale as an exchange involving U.S. patent rights. ***And because Impression and its amici insist that foreign sales must involve an exchange of U.S. patent rights as a matter of U.S. patent law, there is no getting around the fact that their rule applies U.S. patent law to foreign transactions***. For this reason, rejecting international exhaustion is "the logical and perhaps inescapable corollary of the rule… that the operation of the United States patent laws is as a general matter limited by this nation's boundaries." *Griffin*, 453 F. Supp at 1286. *Cf. Deepsouth*, 406 U.S. at 531 ("Our patent system makes no claim to extraterritorial effect," and "we correspondingly reject the claims of others to such control over our markets.") (*citing* Boesch, 133 U.S. at 703).

Id. at 18-19 (emphasis added).

Below are some of the key cases addressing the issue of extraterritoriality in various contexts, and their holdings:

- *Deepsouth Packaging Co. v. Laitram Corp.*, 92 S. Ct. 1700 (1972) – finding exporting of parts of a shrimp deveining machine did not violate U.S. patent law, even when those parts could and predictably would be combined to form the whole machine; "Our patent system makes no claim to extraterritorial effect; these acts of Congress do not, and were not intended to, operate beyond the limits of the United States, and we correspondingly reject the claims of others to such control over our markets."
    - This decision led to the enactment of 35 U.S.C. § 271(f), which provides an exception to the general rule against extraterritoriality that infringement does

occur when one supplies a patented invention's components from the United States for "combination" abroad.

- *Microsoft Corp. v. AT&T Corp.*, 127 S. Ct. 1746 (2007) – finding that Section 271(f) did not prohibit Microsoft's exporting of a master version of Windows software to foreign manufacturers; "The presumption that United States law governs domestically but does not rule the world applies with particular force in patent law…. [F]oreign law alone, not United States law, currently governs the manufacture and sale of components of patented inventions in foreign countries. If AT&T desires to prevent copying in foreign countries, its remedy today lies in obtaining and enforcing foreign patents."

- *Halo Electronics, Inc. v. Pulse Electronics, Inc.*, 769 F.3d 1371 (Fed. Cir. 2014) – despite facts that pricing negotiations, contracting activities and decisions occurred and were made in U.S., affirming grant of summary judgment of noninfringement with respect to "foreign" sales and offers to sell products abroad even if offer to sell was made within the U.S.

- *Power Integrations, Inc. v. Fairchild Semiconductor Int'l, Inc.*, 711 F.3d 1348 (Fed. Cir. 2013) – rejecting argument that U.S.-based infringement could lead to recovery of lost profits based on Fairchild's worldwide sales; "[T]he entirely extraterritorial production, use, or sale of an invention patented in the United States is an independent, intervening act that, under almost all circumstances, cuts off the chain of causation initiated by an act of domestic infringement."

- *Carnegie Mellon University v. Marvell Technology Group, Ltd.*, 2015 WL 4639309 (Fed. Cir. August 4, 2015) – following $1.5 billion judgment, affirming damages award with respect to chips that were made, used, sold ***or*** imported into the U.S., but remanding for new trial to determine where chips that were not imported into U.S. were "sold."