

Patents are exhausted by the U.S. Supreme Court

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"*It is so ordered.*" With these simple four words, the United States Supreme Court significantly changed the way the U.S. Patent Laws affect American businesses, regardless of the size of the business and regardless of whether or not the business owns or licenses patents. There are new limitations on the enforcement of patent rights, which simultaneously create problems and new opportunities for businesses and individuals.

Whether or not you own or license a U.S. patent, this ruling affects you. If you are a patent owner, your own products sold abroad might be imported by others to compete directly against you in the U.S. If you have granted an exclusive license under your U.S. patent, you may be violating the license by selling products or licensing your patent abroad. If you are an exclusive licensee, you may now have competition in your U.S. market, and your licensor may be violating your exclusivity. The U.S. patent laws no longer prevent anyone from importing patented products sold by the patent owner abroad, and competing directly against the owner or licensee of the U.S. patent.

What Happened?

As consumers, most of us look for the lowest priced toner cartridges for our printers, which typically are remanufactured OEM cartridges, refilled and sold by non-OEM sources. Lexmark sought to control the availability of its empty patented cartridges through a two-tiered pricing structure for its new cartridge sales: At full price, the Lexmark toner cartridges were sold with no strings attached. But, under Lexmark's "Return Program," customers saved roughly 20% if they agreed to use the cartridges only once and not transfer empty cartridges to anyone except Lexmark. The Return Program did not work, and the empty cartridges continued to flow to the aftermarket. Lexmark sued many remanufacturers for patent infringement, including Impression Products, which not only refilled cartridges that were sold in the U.S. under Lexmark's Return

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Program, but also refilled cartridges that were initially sold outside of the U.S. and the U.S. patent system.

In *Impression Products, Inc. v. Lexmark International, Inc.,* the U.S. Supreme Court ruled that once a U.S. patentee sells or authorizes others to sell a patented item, that sale "exhausts" its U.S. patents rights, regardless of any post-sale restrictions the patentee has imposed and regardless of where in the world that item is sold. This decision appears to undermine the patentee's ability to segment its market and reduces the exclusivity afforded by patents.

Under this ruling, once a patented product is sold in the U.S., the patent rights in that particular product are exhausted and the patent laws cannot be used to restrict any resale or use following this "first sale." The first sale doctrine is not new; however, this ruling seems to expand its boundaries.

What is new is that exhaustion of U.S. patent rights now occurs with the first sale of a patented item anywhere in the world. As long as the U.S. patent owner authorized the sale, such as by making the sale itself or by approving another to make the sale, a U.S. patent cannot be used to prevent that foreign-sold product from being resold and used in the U.S.

What this ruling means to:

Non-Patent Owners

You are free to purchase patented products sold in foreign countries that have been sold there with the U.S. patentee's authority, and import them into the U.S. for your own use or for resale. This will reduce your cost of goods if those products are less expensive outside of the U.S. It can also allow you to enter new lines of business, such as remanufacturing or distributing products, by giving you access to products that you previously could not get in the U.S. due to a U.S. patent. You will have to make sure that there are no other U.S. laws or contractual terms that affect your importation, but at least the patent laws cannot stop you.

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The patent laws cannot prevent you from purchasing and using within in the U.S. a patented item which was previously sold to another party with the patent owner's authority. But be aware of the terms of your purchase: If you are the first purchaser buying from the patent owner or a licensee, there could be enforceable contractual limitations on your use or resale. If you are a subsequent purchaser, it is unlikely that contractual terms will limit your use or resale.

Patent Owners

You should avoid competing against yourself. Consider whether you should even sell or license your patented product in foreign countries. You cannot use your patent to prevent a patented product you sell, or authorize others to sell, in a foreign country from being imported into the U.S. without your permission. If the product is less expensive in that foreign country, the importation might undercut your U.S. prices and reduce your profit.

Consider whether you can retain title to your patented product, yet still "sell" it. You cannot use your patent to restrict subsequent sales or uses of your patented products. Any such limitations you want to impose must be done contractually with your customer, but you cannot enforce these limitations against subsequent purchasers even if your customer sells the product in a manner contrary to the contract. If you retain title to the product, even though other parties have had possession and use of the product, then your patent rights have not been exhausted and you can control the subsequent uses of your product under the U.S. Patent Laws.

Another approach is to design your patented product so it cannot be remanufactured. If your product is a single use item, design it so it cannot be reused. This is more important than before following the Supreme Court's ruling, but it remains just as difficult. Lexmark included a microchip that prevented reuse of its toner cartridges once the toner ran out, but the remanufacturers developed ways to counteract the effect of the microchips.

Patent Licensors/Licensees

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This ruling may have a significant impact on your business. The Supreme Court's decision undermines license terms relating to exclusivity, such as those based on geographic regions, channels of trade or fields of use. An exclusive license is supposed to make the licensee the only entity that can practice the patent within the specified segment. But the ruling reduces, and may preclude, the licensor's ability to offer and control such segmented exclusivity. Exclusive may no longer be exclusive.

If you are currently an exclusive licensee, the value of your license may have been compromised. Depending on the product and the market realities, the Supreme Court ruling may have no real impact on your exclusivity. But you should review your license agreement to assess whether under your license the presence of authorized imports compromises your exclusive rights and or changes your financial and other obligations under the agreement.

Licensees whose exclusivity is limited to particular market segments, e.g., specific territories, channels of trade and fields of use, have likely been negatively affected by this decision. Patents cannot keep patented products sold by other licensees within their designated segments out of your exclusive market segment. Your exclusive territory is no longer exclusive, except possibly with respect to other licensees, and your licensor is likely powerless to help you. You should review your license agreement.

If you are a licensee negotiating for exclusivity in the U.S., your license agreement should prevent the patent owner from selling or authorizing sales of the covered products anywhere. A licensee who receives from the patent owner exclusive U.S. patent rights in any U.S. segment, has no exclusivity if the patent owner is free to sell or authorize others to sell the item abroad. The Supreme Court has ruled that such patented products sold abroad with the authority of the patent owner cannot be excluded from the U.S. based on the U.S. patent.

If you are a patent licensor who has granted a license with exclusive U.S. patent rights, you may be in violation of that license if patented products you sell or authorize others to sell abroad are imported and sold in the U.S. You should review the license agreement to assess whether the importation of such authorized foreign sales is

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contrary to the agreement. Ultimately, though, we have to wait for future court decisions to tell us how this change in the law affects such foreign sales. For future licenses, you should discuss this impact of foreign sales with your licensee, and specifically address it in the license.

You may also be in violation of license terms that grant exclusivity in market segments. You should review your license to assess whether products sold by licensees within other market segments present potential problems in regard to exclusivity if those products find their way to other market segments.

Given the impact that the Supreme Court's ruling has on enforcement of patent rights in the U.S., Congress may act to overturn this decision. But until that happens, the problems, and the opportunities, remain.

For more information, please contact Ed Acheson or any other attorney in Frost Brown Todd's Intellectual Property Law and Litigation Practice Group.

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