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Impression Products, Inc. v. Lexmark Inc.: Will International Patent Exhaustion Bring Free Trade in Patented Goods?

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Impression Products, Inc. v. Lexmark Inc.: will International Patent Exhaustion bring Free Trade in Patented Goods?

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Guest post by Professor Sarah R. Wasserman Rajec*

In *Impression Products, Inc. v. Lexmark Inc.*, decided Tuesday, the Supreme Court held that the authorized sale of a patented product, anywhere in the world, exhausts the patent-holder's rights in that product. The Court overturned Federal Circuit case law holding that post-sale restrictions and foreign sales preserve a U.S. patent-holder's right to sue for infringement. As a result, Impression Products was not liable for patent infringement when it bought used Lexmark toner cartridges abroad from lawful purchasers, refilled them, and then imported and sold them in the United States, nor did the post-sale restrictions Lexmark placed on its goods give rise to patent infringement liability. Jason Rantanen has written about the decision's impact on post-sale use restrictions. I will focus on the ruling as regards international patent exhaustion.

The decision that an authorized sale anywhere in the world exhausts a patentee's rights brings patent law doctrine in line with copyright law and the Court's 2013 decision in *Kirtsaeng v. John Wiley & Sons, Inc.*. In that case, the Court held that textbooks lawfully made and sold in Thailand could be imported and sold in the United States without infringing U.S. copyright. *Kirtsaeng* was not controlling because it involved statutory interpretation as opposed to the purely doctrinal nature of exhaustion in patent law, but many of the policy arguments for copyright apply in the patent context, and many goods are covered by both types of protection. The greater impact of an international patent exhaustion rule, as I have previously argued, is that it makes

U.S. patent law more consistent with free trade principles and is likely to increase competition by lowering barriers to trade in patented goods. Companies will no longer be able to use patent rights (without further strategizing, see below) to engage in geographic price discrimination between U.S. and foreign markets, and supply-chain-participants, resellers, and consumers will not be subject to the information costs associated with determining the provenance and travels of all articles of commerce they purchase. These Court makes clear that the third party benefits that ease the flow of commerce were important in coming to its decision, colorfully explaining that:

> *More is at stake when it comes to patents than simply the dealings between the parties, which can be addressed through contract law. Instead, 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.*

Even after looking up "remora," the opinion leaves open some questions about international trade in patented goods. Some are legal and will likely spur further litigation (*e.g.*, whose authorization is required for an "authorized sale abroad" to occur?) while others are empirical and still speculative (*e.g.*, with geographic price discrimination off the table, what other methods will businesses pursue for price discrimination and control of downstream sales? And, what will the effect of this ruling be on access to medicine?).

First, the legal question: *What is an authorized sale abroad?*

Who needs to authorize the sale? Will companies be able to get around exhaustion by structuring businesses so that foreign sales are not authorized by the U.S. patent holder?

In its opinion, the Court stated that "a patentee's decision to sell a product exhausts all of its patent rights in that item, regardless of any restrictions the patentee purports to impose on the location of the sale." And, more to the point, "[a]n authorized sale outside the United States, just as one within the United States, exhausts all rights under the Patent Act." However, an authorized sale is not the same as a lawful sale—it requires an entity capable of authorization in the United States, and requires that this entity grants authorization in the foreign market. The Court addressed the issue of what will count as an authorized sale in its discussion of *Boesch v. Graff*, an 1890 case in which the Court ruled that U.S. patent rights were not exhausted by lawful manufacture and sale in Germany. However, in that case, the manufacturer was entitled to make and sell the products under a prior user right in the German patent law which allowed those who were

preparing to produce a patented article at the time the patent was filed to do so without authorization. Thus, the Court in *Impression Products* explained that *Boesch* merely illustrates "that a sale abroad does not exhaust a patentee's rights when the patentee had nothing to do with the transaction."

However, there is a lot of room between *Boesch*, where the patentee had "nothing to do with" the manufacture and sales and *Impression Products*, where Lexmark had patent rights in multiple countries and authorized sales abroad. The question remains whether a company structured such that subsidiaries in different countries own the various patent rights will be subject to exhaustion of its U.S. patents for foreign sales made by a foreign subsidiary. The Court seems to imply not, explaining that "only the patentee can decide whether to make a sale that exhausts its patent rights in an item," and later, "what matters is the patentee's decision to make a sale." Yet if it is really the case that only authorization by the U.S. patent-holder will result in exhaustion through foreign sales, the Court has left open a way for patent holders to opt out of international exhaustion. And while courts may interpret "authorized sale" more broadly, to include sales by related entities, the contours of any rule will take some time to be settled.

With geographic price discrimination off the table, what other methods will businesses pursue for price discrimination and control of downstream sales?

I have previously discussed the economic argument for price discrimination, explaining that

> *The standard economic argument against international exhaustion draws on the potential gains to patent holders and to consumers in low-income countries from geographic price discrimination. This argument describes the current rule as allowing patent holders to market goods worldwide, adjusting prices for countries with lower purchasing power while continuing to reap rewards in high-income countries. An international exhaustion regime, according to this view, will push patent holders either to restrict sales to high-income markets or to offer goods at a globally uniform price, to the detriment of consumers in low-income countries. However, geographical price discrimination is but one of many options for identifying and marketing to populations with differing abilities to pay; many goods, regardless of patent protection, are available in different versions at different prices worldwide. Geographic price discrimination is desirable to firms because of its effectiveness at preventing arbitrage and*

> *because enforcement costs are shared by states through customs enforcement. It may not be the most desirable form of price discrimination for consumers, however, because it is imprecise in identifying differing demand curves. This is particularly true for countries with large or growing income disparities. A shift to international exhaustion would likely result in changes in how firms market goods, but would not necessarily entail the wholesale welfare losses that the standard argument suggests, because that argument compares geographic price discrimination with no price discrimination at all.*

In other words, the useful comparison is not between geographic price discrimination and no price discrimination, but between geographic price discrimination and the other methods that companies will increasingly turn to following this ruling. If instead of choosing not to sell abroad under the new rule, a company chooses to sell a costly and a cheaper version of a good, the availability of that cheaper version may be a boon to consumers inside the United States that otherwise could not afford the costly version.

Many have suggested that this ruling will lead to more licensing and fewer sales and I generally agree, where that is technologically possible and privity can be maintained. However, one thought I've had is that this move towards licensing goods when possible is not isolated to the patent context in any way. That is, licensing of goods may allow companies to price discriminate and control (or stop) downstream sales, and it generally runs counter to the law's abhorrence for restraints on alienation, but it was on the rise before this case and would be just as desirable (to companies and some consumers) or undesirable (to other consumers and resellers) for goods not covered by patents as for those that are. So while I agree that we'll see more action in this area as a result of the case, and that the dividing line between licenses and sales is incredibly important to our understanding of ownership and use of modern and emerging technologies, it is not an issue of patent law *qua* patent law.

What will the effect of this ruling be on access to medicine?

International patent exhaustion presents particular concerns for the advocates of global access to medicines and for the pharmaceutical industry. Because versioning or licensing do not easily apply to the sale of drugs, there is a concern that pharmaceutical companies will refuse to sell medicines at low prices in lower-income markets because of a fear of arbitrage. As a result, patients in lower-income countries would suffer without access to medicine and pharmaceutical companies may reap lower profits to invest back into research and development of new drugs. There are reasons, however, to think that

the immediate effect on the pharmaceutical industry and patients worldwide will not and need not be so dire. There are also solid policy reasons to expand the regulatory means of curbing parallel imports in this industry.

Currently, the Food & Drug Administration must approve drugs before they are sold in the United States—both the chemical composition of the drug and its manufacture. The registration of drugs and approval of production processes mean that the FDA serves as a gatekeeper for all who wish to sell drugs in the U.S. market, and an expansion in this role to exclude drugs first sold in least developed countries would not exceed the scope of the agency's current expertise. And while generally there are good reasons to apply patent law equally to different technology areas, the drug industry may be appropriate for special treatment because it is subject to price controls in so many countries. Thus, while a patent-holding pharmaceutical company may have a choice whether to sell its drug in foreign markets, they have less control over the price than in the United States, which does not have a single-payer system allowing for the strong bargaining power that many countries have. In addition, because the WTO agreement on Intellectual Property, the TRIPS Agreement, allows for countries to issue a compulsory license for patented goods in certain circumstances, drug companies may face foreign sales that they have not authorized. Under these circumstances, the free trade concerns that drive some of the arguments for international exhaustion simply do not apply in that industry. Combined with the highly-regulated nature of drug sales in the United States, this provides a strong argument for treating drugs differently in order to maintain access for foreign patient populations.

Concluding thoughts

Despite the Court's suggestion that a rule of international exhaustion is consistent with prior doctrine, it is a change in the law as announced by the Federal Circuit and as understood by practitioners and academics. (The historical claim has been challenged for both copyrights and patents.) On the domestic side, we can expect to see even more attempts to structure transactions as licenses rather than sales, while on the international side, I expect that the question of patent-holder authorization will dominate in the near future.

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