SELLING PRODUCTS OVERSEAS JUST BECAME VERY RISKY

May 30, 2017

In an opinion handed down on May 30, 2017 in a case titled Impression Products, Inc. v. Lexmark International, Inc., the Supreme Court overruled previous lower court decisions relating to "exhaustion" of patent rights. The impact of this ruling on big companies will be minimal over the long term; the impact on small companies and independent inventors will be devastating.

The first question was whether a patentee could sell a product in the United States with a contractual requirement that the buyer is prohibited from reselling that product to a third party. The court held that a sale in the United States immediately exhausts all patent rights in the sold product, and while a breach of contract suit is possible, a patent infringement suit is not. This is not a surprising holding, because the sale of a product covered by a United States patent within the United States can be made under monopoly conditions, and at the maximum price a consumer is willing to pay as opposed to at a market price.

The second question was more complex: Lexmark sold cartridges in other countries, and Impression Products purchased them used, refilled them, and imported them into the United States. The Supreme Court (over the well reasoned dissent of Justice Ginsberg) held that a sale of a product by the patentee anywhere in the world exhausted all patent rights in that product in the United States. This is where the Supreme Court's blindness to practical considerations facing small companies and individuals becomes truly punishing.

Lexmark can afford to file for a patent in every country in the world — a task that can easily cost $250,000 or more. If they have patent protection in most or all nations, then they can sell at a monopoly price everywhere, allowing the inventor to recoup the costs of invention. Under such circumstances, it might make sense that a sale by the inventor anywhere exhausts patent rights globally.

Compare this to an individual inventor. A good example of the financial limits on inventors is found in Robert Kearns, featured in the biographical film "Flash of Genius". Kearns invented the intermittent windshield wiper and filed for a patent in the United

States. He tried to license the invention to Ford, but Ford instead simply used the invention without paying. Kearns was unable to afford to keep paying lawyers to enforce his patent rights, and won improbable victories in infringement suits without much legal assistance.

Kearns was a very typical individual inventor — a person with a great idea and not a lot of money. The same is true of small companies. They must choose between making payroll and paying patent lawyers. Until the ruling in Impression Products, that small company could get some patent protection by filing in the United States and perhaps a few other nations, and under the rules as they existed, they could also sell the product globally, even in nations where they could not afford to file for patent protection. Presumably there would be competitors in the nations where they did not have patent protection, so in those nations they would sell at a market price, far lower than in nations where they had a patent monopoly. They could recoup the cost of their investment in the nations where they had patent protection, while making some money in other nations.

Under the ruling in Impression Products, such a strategy is no longer viable. Imagine that Kearns refused to license the intermittent wiper, but instead created a company that manufactured and installed them as an aftermarket upgrade. The company had patent protection in the United States only. Prior to Impression Products, they could sell the wiper at a higher price in the United States (because of the patent) but still participate in a market priced sale in other nations. After Impression Products, they would be forced to choose between selling at a market price in the United States and the world, or selling in the United States only, ceding foreign markets to competitors.

This result flows from the Supreme Court's new rule that a sale by the inventor anywhere in the world exhausts all rights in the United States. If the wipers were sold at a market price of 5% over cost in India because the lack of an Indian patent forced competitive pricing, a competitor could buy millions of them in India and resell them in the United States at an additional 5% above the cost of acquisition. This would create a market pricing situation even in the United States — despite the existence of a U.S. patent. Kearns would have been forced to choose between selling in the United States at a price sufficient to cover his R&D and legal costs, or selling globally and hoping he could survive against the automotive giants who would presumably start competing with him in those unpatented, foreign markets.

One solution — and I strongly advise getting legal advice as to implementing this — is to file a “PCT Application”. This filing, under the Patent Cooperation Treaty, gives an inventor time (typically 30 months) to seek patent protection in any member nation. If the stars align and the inventor can get sufficient financial backing before the 30 month mark, the inventor could then cover the cost of filing in all major markets (and then refuse to sell in other markets).

A cheaper and more global solution to both prongs of the Impression Products ruling may be simple — but the Supreme Court has proven very hostile to patentees of late, and it should be understood that this proposed work-around might not be sufficient to overcome that hostility. My proposed solution is that patentees refrain from selling products at all. Rather, they should lease the products, preferably for a limited time. It is commonly understood that copyrighted materials may be rented without exhausting the author’s rights. For example, if I rent a movie (whether a physical copy of it or a digital, streaming copy), I do not get permanent rights to view that movie. Rather, the rights expire on a set date. By contrast, if I purchase a movie, the rights to that copy of that movie are exhausted and I can resell my copy.

The Impression Products case involved ink cartridges that were sold with the requirement that they be returned only to Lexmark after they have been used. That sounds a lot like how Amazon and Apple rent digital movies — you have 30 days to start watching, and once you start watching, you have 48 hours to complete watching, after which all rights revert to the owner. However, while Lexmark’s policy looks very similar to the Apple/Amazon rental policy, Lexmark called it a sale. Lexmark also did not tie the reversion of rights to a time limit. As a result, Lexmark’s sales were considered, well, sales, and triggered the exhaustion of patent rights.

Imagine if Lexmark instead said: “We are selling you the ink, and renting you cartridge. You must start using the ink within one year of purchasing the ink, and the rental of the cartridge terminates one year after you start using the ink.” On page 4 of the slip opinion in the Impression Products v. Lexmark case, the Supreme Court held that “Differentiating
between the patent exhaustion and copyright first sale doctrines
would also make little theoretical or practical sense: The two
share a “strong similarity . . . and identity of purpose…“. This leaves the Supreme Court in a bind with regard to rentals or leases of products — in order to apply the same rule in copyright and patent cases, it would either need to rule that movies cannot be

rented because even a rental exhausts all copyright rights, or that patent rentals do not exhaust all patent rights.

This is where the current court's hostility to inventors comes into play. I believe there is a significant chance that the Supreme Court would find the case of rentals of products to somehow fall outside of the Impression Products holding that different rules for patent and copyright exhaustion make little sense. I do not think there is a common law or statutory basis for such a holding, but there was also no statutory basis for the limitations on subject matter eligibility most recently applied in Alice Corp v. CLS Bank.

This work-around also fails in cases where time-limited leases are not feasible. Returning to the intermittent wiper and Mr. Kearns, it is difficult to imaging any consumer agreeing to a time limited rental of permanently installed aftermarket wipers. There may be a way to structure it so that the lease is tied to a specific vehicle (for example, the lease expires after a year and the wiper must be returned immediately upon removal from the vehicle), but this is likely to put off consumers as well. An alternative structure may be to have a large portion of the purchase price deferred until the item is removed — for example, the wiper costs $500 up front and $500 per year, but the yearly payments are deferred until the device is removed from the vehicle (although caution needs to be taken to structure this in one of the ways suggested in the Marvel case).