

3 Takeaways From The High Court's Patent Exhaustion Ruling

By Ryan Davis

Law360, New York (May 30, 2017, 10:10 PM EDT) -- The U.S. Supreme Court on Tuesday discarded rules that had allowed patents to be enforced even after an item is sold, dealing a blow to patent owners and likely forcing many companies to re-evaluate their license agreements and pricing policies.

The high court held that the Federal Circuit misinterpreted the doctrine of patent exhaustion, a defense to infringement that holds that patent owners lose their rights after an authorized sale, when it held that U.S. patent rights are not exhausted if a product is sold in another country and that patent owners can restrict how patented items can be used or sold following a sale.

The justices ruled that selling a patented item exhausts all rights in the patent, regardless of where the sale takes place or any restrictions the patentee purports to impose. The decision will require companies to rewrite licenses that relied on post-sale restrictions and could lead them to charge higher prices to maximize revenue from the initial sale, attorneys say.



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Here, Law360 takes a look at the possible fallout from the ruling.

The Ruling Will Shake Up Licenses and Litigation

Since the Federal Circuit had long held that imposing limits on how patented items are used or sold could prevent patent exhaustion after a sale, many companies included such restrictions in license agreements to hold on to their rights. The Supreme Court's holding that such restrictions exhaust patents will leave those companies scrambling to adjust.

"If companies don't want to have their rights exhausted, they're going to have to recraft their license agreement in a fairly expedient and rapid manner so that they don't have post-sale restrictions," said Blair Jacobs of Paul Hastings LLP.

That is going to create a lot of work for attorneys who write license agreements, since limits on what purchasers can do with patented goods have become widespread.

"I think this impacts almost every license drafted in the last 10 to 20 years. There are restrictions in almost every agreement," Jacobs said.

At the same time, the ruling could upend patent litigation that is currently underway by creating an opportunity for accused infringers to argue that they can't be held liable for infringement because the patents are exhausted under theories that were not available prior to Tuesday.

The ruling is "another arrow in the quiver of defenses," said Ahmed Davis of Fish & Richardson PC. Cases in which the patented item was first sold with restrictions or outside the U.S. could go away altogether or have the potential damages seriously limited, he noted.

"Cases that looked viable may not be viable anymore," Davis said.

Patent Owners Will Rethink Product Pricing

The strategies established by the Federal Circuit to let patent owners prevent patent exhaustion led many companies to set the price of their products based on an assumption that they could generate revenue from multiple sales. After the Supreme Court's ruling, that option is no longer available and patent owners may respond by increasing prices.

For instance, the patent owner in the case the Supreme Court decided, printer cartridge maker Lexmark International Inc., charged a lower price for its products if customers agreed to use them only once and then returned them to the company to be resold. The impact of the decision will be particularly felt by other makers of other reusable or refillable products.

Since the Supreme Court held that patent exhaustion is "uniform and automatic" upon the first authorized sale of an item, that is where patentees will have to focus their pricing policies.

"It's a blow for patent owners. It will require them to obtain the full value of their IP from the first person they sell to or license to," said Michael Q. Lee of Sterne Kessler Goldstein & Fox PLLC.

Since the Supreme Court limited the ability to generate revenue from a patented product after an initial sale, "patentees are going to try to recover that by increasing their licensing rates," Davis said.

The high court's decision that sales outside of the U.S. exhaust patent rights could also disrupt pricing systems where the same product is sold at different prices in different countries, often at lower prices in less wealthy parts of the world.

Under the ruling, there is nothing in patent law to stop people from buying lower-cost products in foreign countries and shipping them to the U.S. to be resold at a price that undercuts the U.S. market. That could cause companies to reconsider charging lower prices abroad.

"The unintended effect could be higher prices outside of the U.S.," Lee said.

It's More Bad News for Patent Owners

Over the past several years, most Supreme Court patent rulings have been a setback for patent owners and favorable to accused infringers, and Tuesday's decision continues that trend.

"The Supreme Court is taking a fairly significant hatchet to patent owners these days," Jacobs said.

The patent exhaustion came just over a week after the high court imposed new limits on where patent owners can file infringement suits. It follows numerous recent rulings that have put limits on patent eligibility, the damages in infringement cases and the ability to secure injunctions for patent cases, often unanimous rulings reversing the Federal Circuit.

At this point, it is not difficult to guess that when the Supreme Court agrees to hear a patent case, the justices are likely to issue a ruling that is favorable to defendants, Jacobs said.

"This is not a pro-patent ruling in any sense, which is a trend we've been seeing," he said.

Before the Supreme Court started hearing a sizable number of patent cases about a decade ago, the trajectory of patent law tended to favor patent owners, but Tuesday's ruling makes clear that those days are over.

"This is another case where the pendulum for patents is swinging in a direction away from patent owners," Lee said.

The case is *Impression Products Inc. v. Lexmark International Inc.*, case number 15-1189, in the Supreme Court of the United States.

--Editing by Katherine Rautenberg and Catherine Sum.