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IP Frontiers

Supreme Court makes an impression on patent holders

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A common feeling shared by what I would venture to guess is most readers of this article is a special frustration with printer manufacturers. Specifically, it's the negative feeling we experience when it comes time to replenish the ink or toner in our printer (after a suspiciously short amount of time—was the cartridge full to begin with?), only to find that the replenishment costs more than the printer itself. Good news: the U.S. Supreme Court is looking out for you in its recent decision, *Impression Products, Inc. v. Lexmark International, Inc.,* 581 U.S. ___ (2017).

To be fair, companies across many different industries follow this approach of pairing a non-consumable good with a complimentary consumable good. This model has existed for years, the most famous example of its use being in the shaving industry where manufacturers sell the razor (non-consumable) for a low price, perhaps lower than the cost to produce, and sell the blades (complimentary consumable) at a substantial markup over cost. The model is widely known across all industries as the "razor and blade model."

Obviously, the benefit to the original manufacturers comes when customers recurrently purchase the consumable item after the initial purchase. The revenues from such follow-on sales are potentially very large. Because others might enter the market and either sell their own version of the consumable or refresh the original consumable (e.g. refill with toner/ink), original manufactures sometimes take creative steps to keep their customers loyal to them.

Lexmark, a well-known printer manufacturer, introduced a "Return Program" in which customers could purchase patented printer toner cartridges at a discount if they signed a contract agreeing to use the cartridge only once and to refrain from transferring the cartridge to anyone but Lexmark. After purchasers transferred the cartridges to a third-party company that refilled and resold the cartridges, Lexmark sued these "remanufacturers" alleging patent infringement.

The suit concerned remanufacturer resale of two groups of cartridges: (i) Return Program cartridges sold within the U.S., and (ii) cartridges (not just those sold under the Return Program) sold originally overseas that were imported into the U.S. The case ultimately made its way to the U.S. Supreme Court.

The issue in the case was whether Lexmark "exhausts" its patent rights in a patented cartridge once it sells that cartridge to a customer, despite Lexmark putting lawful restrictions on the customer's post-sale activities. The Patent Act grants patent owners the right to exclude others from making, using, offering for sale, or selling their inventions. A resold Lexmark cartridge that incorporates the patented features seemingly fits within that scope.

But the court held that the doctrine of "exhaustion" applies. This well-established doctrine states that when a patentee sells an item, that product is no longer within the limits of the patent monopoly. The doctrine is rooted in the common law principle against "restraint on alienation"—the undue restraint on the downstream sale/transfer of property.

Thus, with respect to the remanufacturers—and even though Lexmark has potential remedies under contract law against its customers who made promises under their contract with Lexmark—Lexmark has no patent rights in the remanufactured cartridges that the remanufacturers sell. This applies to both categories of cartridges: those sold by Lexmark in the United States under the Return Program, and those sold overseas by Lexmark and imported into the United States by the remanufacturers.

In short, the court held that once the patented item is sold, it passes outside of the patent monopoly and the patent

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owner has no patent rights that it could use to control what the first-purchaser does with the patented item. This is the case even if the restrictions in a contract that may exist between the patent owner and first-purchaser are clear and enforceable under contract law against the first-purchaser.

The consequences of this decision are potentially significant. Although the manufacturer might reserve contractual remedies against first-purchasers, no recourse, either against first purchasers or secondary purchasers, arises under patent law, and consequently some advantages afforded by patent-related remedies and the statutory backing of patent law are lost.

Furthermore, grey markets are affected by this decision because of its applicability to foreign sales. It is common for multinational companies to sell the same product at different prices in different countries depending on the local market. Grey markets form when purchasers at the lower price in one locale undercut manufacturers in a more expensive locale (e.g., the United States) by selling at an in-between price.

Manufacturers handle this by contractually prohibiting purchasers from importing the product into the United States. After the Impression decision, manufacturers will not be able to assert patent infringement against importers of the product sold overseas. And though contractual obligations of the overseas first-purchaser may exist, it seems the first-purchaser may potentially get around their contractual restrictions by first selling to an overseas third-party strawman who then imports the product.

There are also consequences for consumers like us who experience the pain of expensive toner. The diminished ability for an original manufacturer to restrict the secondary market will promote competition in that secondary market. This competition will exert downward pressure on prices of items in the secondary market and, as a result, items sold by the original manufacturer in competing with that secondary market.

On the other hand, manufacturers might respond with product redesigns aimed at keeping their customers tied to the original products—for instance by incorporating product aspects that are consumable but irreplaceable or otherwise very difficult for others to replace because of trade secret or other advantages held by the manufacturer. An additional approach that manufacturers might take—although the viability of this option may not be there—is to grant purchasers a mere license to possess and use the product, while the manufacture retains legal ownership of the product and therefore control over its sale.

Supporters of the so called "right to tinker" also cheer the Impression decision as a win for consumers because it bolsters the right for a first-purchaser to tinker with—modify, inspect, breakdown, sell, etc.—his or her possessions without running afoul of patent rights. This negatively impacts companies who leverage patent litigation against customers who adversely affect the company business by tinkering with the product, for instance by reverse-engineering or repurposing it for their own revenue stream.

As with many court decisions, it remains to be seen just how drastic an effect this decision will have over time. The impact of this case is worth watching at least because it presents a problem to patent owners—a group that, by definition, finds innovative ways to solve the problems they face.

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