Lexmark, The Overruling of *Mallinckrodt* and The Future of Restraints on Alienation For Patented Goods

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Introduction

The Supreme Court in its recent *Lexmark*[1] decision ruled unanimously (with Justice Gorsuch not participating) that a patent owner could not enforce contractual restrictions on resale of patented products in domestic transactions through patent infringement suits because all patent rights were exhausted by the first sale. This decision, authored by Chief Justice Roberts, rejected the theory, articulated by the Federal Circuit in *Mallinckrodt v. Medipart, Inc.*[2]more than twenty five years ago: that a patent owner could circumvent exhaustion by conditioning a grant of its patent rights in a sales agreement as a legitimate means of obtaining compensation for the value of its invention. The Supreme Court decisively rejected the logic and the treatment of earlier precedent used in the *Mallinckrodt* opinion along lines that I had criticized at the time and others have criticized since to little avail, until now, over a quarter century later.[3]

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[1] Impression Prod., Inc. v. Lexmark Int'l., Inc.,137 S. Ct. 1523 (2017).

[2]976 F. 2d 700 (Fed. Cir. 1992), *abrogated* by Impression Prod., Inc. v. Lexmark Int'l. Inc., 137 S. Ct. 1523 (2017).

[3]*See* James B. Kobak, Jr., *Contracting Around Exhaustion: Some Thoughts About the CAFC's Mallinckrodt Decision*, 75 J. Pat. & Trademark Off. Soc'y 550 (1993). *See also* Saami Zain, *Misuse of Misuse: Princo Corp. v. International Trade Commission and the Federal Circuit's Misguided Patent Misuse Jurisprudence,* 13 N.C.J.L. & Tech., 95 (2011).

The Supreme Court, over Justice Ginsburg's dissent, also applied the exhaustion doctrine to sales made by the patent owner outside the United States even though the patent owner could have no patent rights to exhaust at

The *Lexmark* decision is carefully limited to the effect exhaustion has in denying patent law remedies against non-contracting parties. Justice Roberts' decision seemed to assume that post-sale restrictions might often be enforceable under applicable state law. But the logic and wording of the decision raise questions about future enforceability of some contractual post-sale restrictions under both state and federal law.

Lexmark will require many businesses to rethink and revamp their sales and distribution practices. Enforcement of restrictions directly against downstream purchasers or users will be difficult and often impractical in many circumstances and perhaps, in some circumstances, not achievable at all. Enforcement of certain restrictions even against some direct purchasers could be preempted by analogy to *Kimble v. Marvel Entertainment*[4] in which the Supreme Court recently reaffirmed that state law remedies for contractual royalties for expired patents are preempted. In addition, the logic and wording of *Lexmark* raise the prospect that some efforts to enforce restrictions might now be vulnerable to antitrust, patent misuse and (in some states) unfair competition law principles in a way that they have not been in several decades – in large part because of the Federal Circuit precedent built around the *Mallinckrodt* decision that has now been overruled in *Lexmark*. These possibilities pose complications and risks for patent owners seeking to control downstream sale or reuse or repair of patented goods. But first a brief synopsis of *Lexmark*.

The *Lexmark* Decision

Lexmark sold toner cartridges to consumers for use with laser printers that it also sold. Lexmark held patents covering various components of the cartridges and the manner in which they are used. It sold some cartridges at full price with no restrictions and others at a twenty per cent discount with a contractual restriction against resale or reuse. Companies such as the defendant, Impression, referred to as "remanufacturers" by the Court, repurchased and refilled the discounted cartridges (circumventing a microchip embedded to prevent refills)[5] and then resold them to printer users at a profit, but at a lower price than Lexmark's.

Lexmark sued Impression Products (and originally a number of other companies) for patent infringement. In a decision by Justice Roberts the Supreme Court held that a patent holder cannot sue for infringement after the first sale of the patented item, even if the sale contract was purportedly conditioned on the purchaser's agreement not to reuse or resell the item.[6]

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the point of sale. This decision was similar to and superficially consistent with the rule it adopted for copyrighted products under different statutory provisions in *Kirtsaeng v. John Wiley & Sons, Inc.*, 568 U.S. 519 (2013). I believe that Justice Ginsburg actually had the better of this argument, at least as a matter of theory if not practicality, since grants of rights under separate national patent laws represent separate and non-extraterritorial sovereign acts. But that debate has now been conclusively resolved and is not the principal concern of this article.

[4] 135 S. Ct. 2401 (2015).

[5] Efforts to enforce the hacked software counts under copyright law were rebuffed by the Sixth Circuit in Lexmark Int'l, Inc. v. Static Control Components, Inc. 387 F. 3d 522 (6th Cir. 2004).

[6] Lexmark, 137 S. Ct. at 1533.

The Supreme Court held that Lexmark exhausted its patent rights on the first sale of the return program cartridges.[7] Justice Roberts reasoned that while post-sale restrictions on direct purchasers might be enforced under contract law they could not be enforced through infringement suits against third party "remanufacturers."[8] The Court stressed that the exhaustion doctrine has a long history in patent law as a fundamental, if nonstatutory, limitation on the scope of the patent owner's rights, citing patent case law beginning in 1853 and culminating in the Supreme Court's application of the doctrine to method patents in the unanimous *Quanta* decision in 2008.[9]

Lexmark, Enforcement of Contractual Restrictions and Preemption

Justice Roberts mentioned near the beginning of his analysis in *Lexmark* that "[t]he single-use/no-sale restrictions in Lexmark's contracts with customers may have been clear and enforceable under contract law,"[10] but that this was irrelevant to infringement remedies. Even assuming contract rights would be enforceable, actions to enforce them would not involve the same panoply of remedies as infringement suits – and very likely would create no remedies at all against those not in privity with the patent owner. And it takes little imagination to predict the impracticality and loss of market goodwill generated if a company tried to launch a blitzkrieg of litigation directed against the activities of tens of thousands of its ultimate customers.

As a preliminary matter, the assumption that all restrictions would be fully unenforceable even against the party agreeing to them under state contract law merits further consideration.[11] The policy animating exhaustion is to avoid a regime that will, in Justice Roberts's words, "clog the channels of commerce"[12] with restrictions that would prevent purchasers even several levels removed from the original seller from freely reselling, reusing, or repairing items they have purchased. The Court held in *Lexmark* that patent exhaustion functions automatically once a good is sold,[13] that exhaustion operates as an "unwritten limit on the scope of the patentee's monopoly,"[14] and that the Patent Act, like the common law, incorporates "enmity" toward restraints on alienation.[15]

If restrictions violate fundamental even if nonstatutory limits on the scope of a patent, preemption may come into play. State law contractual remedies

[7] *Id.*

[8] *Id.*

[9] *Id.* at 1531-33 *citing* Bloomer v. McQuewan, 14 How. 539 (1853); Keeler v. Standard Folding Bed Co., 157 U.S. 659 (1895); Straus v. Victor Talking Mach. Co., 243 U.S. 490 (1917), and Quanta Comput., Inc. v. LG Elec., Inc., 533 U.S. 617 (2008).

[10] *Id.* at 1531.

[11] As Justice Thomas noted in *Quanta Computer, Inc. v. LG Electronics Inc.*, 553 U.S. 617, 637 n.7 (2008), the question of enforceability of such restrictions on patented products has been undecided since the Court refused to opine on it in *Keeler v. Standard Bed Co.*, 157 U.S. 659, 666 (1895), before the end of the nineteenth century.

[12] Lexmark, 137 S. Ct. at 1531.

[13] *Id.* at 1531 (slip op. at 6).

[14] *Id.* at 1536.

[15] *Id.* at 1532.

that contravene the federal patent policy against restraints on alienation could conceivably be preempted, just as state law remedies that would require royalty payments after expiration of a patent have been held to be contrary to patent policy and therefore preempted.[16] This venerable, if often criticized, feature of patent law, dating to the *Brulotte* case more than fifty years ago, was endorsed by the Supreme Court only two years ago in *Kimble v. Marvel Entertainment*.[17]

Justice Roberts did not discuss or even cite *Kimble* in *Lexmark*, but both decisions may be said to be based on a federal policy against allowing owners of patents to use contracts to extend the limits of patent protection as defined in earlier federal court precedent.[18] In *Kimble* and *Brulotte* the temporal limits of a patent were at issue. The result in both cases was that the ability to receive royalties from a party who agreed to pay them under a contract that was clear and would otherwise be enforceable under state law was extinguished by the expiration of a patent. In a case like *Lexmark*, the principle of exhaustion, which the Court regarded as a fundamental feature of patent law, also extinguishes patent rights with respect to the item sold.[19] Certainly a possible, and in the eyes of some a probable,[20] corollary is that the same type of preemption analysis ought to apply in both cases.

To be sure, the post-expiration royalty situation could be considered somewhat *sui generis.* While one would seldom agree to pay a royalty to produce an item not believed to be at least potentially eligible for some form of intellectual property protection,[21] restrictions on unpatented articles in sales agreements with an immediate purchaser are (subject to antitrust principles) a more common feature of commercial life. One might conceivably argue that the first type of agreement is inconsistent with patent policy in a more direct way than the second, though it is equally possible to argue the reverse.[22]

Whether the Supreme Court would actually be prepared to extend the *Brulotte-Kimble* doctrine to some classes of restraints on alienation remains to be seen. Three Justices dissented from continuing to apply the *Brulotte* rule even to post-expiration royalties in *Kimble;*[23] Justice Roberts' *Lexmark* opinion seems to assume that some post-sale contractual restrictions might be enforceable against the purchaser under state contract law; and Justice Gorsuch did not participate in either decision. Justice Thomas, writing for a unanimous court, also left this question open in *Quanta* in 2008.[24] But at least some of the

[16]Brulotte v. Thys Co., 379 U.S. 29, 32-33 (1964).

[17]135 S.Ct. 2401 (2015)

[18]See Quanta Comput., Inc. v. LG Elec., Inc., 553 U.S. 617, 625-27 (2008); Princo Corp. v. Int'l Trade Comm'n, 916 F. 3d 1318, 1327 (Fed. Cir. 2010).

[19]Lexmark, 137 S. Ct. at 1531.

[20]See Richard H. Stern, *Impression Products v. Lexmark: The resurgence of the US exhaustion doctrine*, Euro. Intell. Prop. Rev. 2017, 39(10), 654-56 (2017).

[21]In *Aronson v. Quick Point Pencil Co.,* 440 U.S. 257 (1976), a licensee agreed to pay a 5% royalty on sales unless a patent failed to issue in five years, at which point the royalty would continue indefinitely but was cut in half. The agreement to pay any royalty for sale of a non-patented item was held to be unenforceable.

[22]Stern, *supra* note 201, at 656 ("The balance between the competing policy claims tips far more strongly against contract law in exhaustion cases than it did in Kimble because the harm to the public is clearer and the social benefit in recognising the seller's interest in evading exhaustion is far weaker".)

[23]135 S. Ct. at 2401, 2415 (2015).

[24]*See supra* note 12.

logical underpinnings for a possible preemption analysis appear to exist in the strong language of *Lexmark*. And from that unequivocal language not a single one of the eight Justices then on the Court dissented, including any of the three who dissented in *Kimble*. That preemption might bar state law breach of contract claims against purchasers for violation of some restraints on alienation is far from a certainty, but neither is it a possibility that can be dismissed out of hand.

Beyond Preemption: Antitrust and Patent Misuse Consequences

Lexmark's adoption of strong language and rejection of the *Mallinckrodt* rule may portend more than just future enforcement difficulties. They may also portend renewed attention to antitrust and misuse theories.

One aspect of the application of patent law to contractual restrictions in *Mallinckrodt* was that breaches of the restrictions were treated as infringements. Conditioning release of patent rights on acceptance of such restrictions was considered an inherent right of the patent owner. The notion that the ability to impose such restrictions is an inherent right of a patent owner and can give rise to patent infringement remedies if restrictions are ignored has been eliminated by *Lexmark*. As a result, some of the special ways in which these restrictions were treated in antitrust and patent cases under *Mallinckrodt* should be eliminated as well.

Now that contractual restrictions have definitively been held to be outside the scope of a patentee's rights under the patent law, restrictions on sales of patented objects should be fully subject to antitrust law[25] and the patent misuse doctrine. Before *Lexmark*, cases seeking to enforce such restrictions were treated as infringement cases within the scope of the patent; the Federal Circuit, which has exclusive jurisdiction over patent cases, held that its law, not the regional circuit law which it applies to questions of general, non-patent law, would apply to antitrust and misuse questions involving the scope of the patent.[26] In *Mallinckrodt* the Federal Circuit applied and has subsequently consistently followed a two-part misuse test for evaluating restrictions: "The appropriate criterion is whether [a] restriction is reasonably within the patent grant, or whether the patentee has ventured beyond the patent grant and into behavior having an anticompetitive effect not justifiable under the rule of reason."[27]

[25] Univis Lens Co. *v.* United States, 316 U.S. 241, 251 (1942).

[26] *See* 2 ABA Section of Antitrust Law, Antitrust Law Developments 1150-52 (8th ed. 2017) (hereinafter Antitrust Developments). The Federal Circuit applies regional circuit law to questions of antitrust policy such as market definition, market power and damages but it applies Federal Circuit precedent exclusively to questions on the scope of "immunity" conferred by patents. Nobelpharma AB v. Implant Innovations, Inc., 141 F.3d 1059, 1068 (Fed. Cir. 1998).

[27] Mallinckrodt, Inc. v. Medipart, Inc., 976 F. 2d 700, 708 (Fed. Cir. 1992), *abrogated by* Impression Prod., Inc. v. Lexmark Int'l, Inc., 137 S. Ct. 1523 (2017) at 708, *following* Windsurfing Int'l. v. AMF, Inc. 782 F. 2d 995 (Fed. Cir. 1986). Accord, Princo v. Int'l Trade Comm'n, 616 F.3d 1318, 1328 (Fed. Cir. 2010); C.R. Bard, Inc. v. M3 Systems, Inc., 157 F.3d 134, 1372 (Fed. Cir. 1998); Virginia Panel Corp. v. MAC Panel Co., 133 F.3d 860, 868 (Fed. Cir. 1997); B. Braun Med. Inc. v. Abbott Labs., 124 F. 3d 1419, 1426 (Fed. Cir. 1997). District courts have followed the

In this way, and through its choice of law rules, the Federal Circuit arrogated to itself the application of misuse and antitrust principles to virtually all sales, licensing and enforcement activities involving patented technology. The misuse test it created conflated misuse and antitrust principles, making the relationship between a restriction and the scope of a patent an often dispositive part of the analysis.[28]

The Supreme Court has now determined that activities after sale are beyond the scope of a patent, not part of a patent owner's legitimate reward, and in fact are inimical to an important, if not statutorily codified, principle of the patent laws. It should follow that, since restrictions are outside the scope of the patent grant or the legitimate reward of the patent, normal rules of contract interpretation and defenses should be applied to them.[29] Restrictions, whether imposed by a seller or its licensee, can no longer be considered "within the patent grant" once a sale has taken place. And with no special patent overlay, all issues involving the interpretation, enforcement and legality of these provisions should presumably now be determined in accordance with applicable regional federal circuit law (and even in some cases state unfair competition law).

Not only should the misuse and antitrust rules applied to restrictions on sales of patented goods no longer be the exclusive province of the Federal Circuit, as has been the case for many years, but also, in misuse cases, the part of the test that stresses conduct or contract provisions "reasonably within the patent grant" should no longer suffice to justify or even be relevant to a resale restriction. The Supreme Court has confirmed in *Lexmark* that such restrictions are beyond the scope of the patent grant because of the longstanding "enmity" between patent and other law toward restraints on alienation, and that the power to impose them is not part of a patentee's legitimate bundle of rights.

Lexmark and Licensing

Exhaustion does not apply to licenses of patent rights. The Patent Act specifically permits patentees to license all or less than all of the rights conferred by the patent, including rights to grant licenses to "the whole or any specified part of the United States."[30] The Federal Circuit had deemed it illogical for exhaustion to apply to sales transaction but not licenses, but Justice Roberts explained in *Lexmark* that the Federal Circuit's reasoning was faulty.

The key to this aspect of the decision is interpretation of the Supreme Court's ambiguous eighty year old decision in *General Talking Pictures Corp.*

Federal Circuit's lead. See Texas Instruments, Inc. v. Hyundai Elecs. Indus., Co., 49 F. Supp. 2d 893, 907 (E.D. Tex. 1999); PSC Inc. v. Symbol Techs., Inc., 26 F. Supp. 2d 505, 508-09 (W.D.N.Y. 1998).

[28] *See* Princo, 616 F. 3d. at 1318, 1327-29, 1334 (holding alleged agreement to suppress technology not misuse).

[29] *See* Quanta Comput., Inc. v. LG Elecs., Inc., 553 U.S. 617, 637 n. 7 (2008) (*quoting* Keeler v. Standard Folding Bed Co., 157 U.S. 659, 665 (1895) ("It is, however, obvious that such a question would arise as a question of contract, and not as one under the inherent meaning and effect of the patent laws.")

[30] 35 U.S.C. §261.

v. Western Electric Co.[31] In that case the patent owner had licensed an entity to manufacture so-called amplifiers for non-commercial use.[32] The licensee, however, knowingly entered into contracts and essentially conspired with a purchaser that intended all along to acquire the amplifiers for prohibited commercial use in movie theaters. The *General Talking Pictures* Court allowed the patentee to sue both the licensee and the purchaser for infringement. The Supreme Court explained in *Lexmark* that the suit against the licensee's purchaser had been sustained in *General Talking Pictures* "only because the purchaser participated"[33] in the licensee's knowing and deliberate infringement. Justice Roberts then added – confusingly, if taken out of context – that *General Talking* Pictures "stands for the modest principle that, if a patentee has not given authority for a licensee to make a sale, that sale cannot exhaust the patentee's rights."[34]

Standing alone, this is not at all a modest proposition. What makes it so is the immediately preceding discussion in the opinion describing what the Court plainly considered the more typical situation: a company that licenses its product to a manufacturer that is not known to be intending all along to breach its contract to make devices such as computers only for non-commercial use by individuals. The Court concluded that the patentee could sue the licensee for infringement if it knowingly sold the computer for commercial use outside the license. But if the licensee sold the computer in a normal, non-collusive, commercial transaction, that sale is subject to exhaustion "as if the patentee made the sale itself."[35] If the patent owner required the licensee to place restrictions on the sale of the item mirroring the intent of the license, the sale would nevertheless exhaust the patent right and the restrictions could not be enforceable through infringement suits by either patentee or licensee.[36]

This gloss on *General Talking Pictures* goes an important step beyond Justice Thomas' decision in *Quanta* nearly ten years before. There the Supreme Court held that exhaustion from sale of a computer representing a substantial embodiment of a method of use patent precluded enforcement by way of a patent infringement suit of restrictive notice provisions that the patent owner required manufacturing licensees to convey to their purchasers.[37] The Court held that, notwithstanding the notice provision, "no conditions [in the actual terms of the license] limited [the licensee's] authority to sell products substantially embodying the patents."[38] The sales for use with a third party's products could therefore not be said to be unauthorized within the meaning of *General Talking Pictures*. The *Lexmark* Court did not cite or discuss this aspect of *Quanta* in its discussion of the limits of *General Talking Pictures*.

I said earlier that revising licensing and distribution systems to ameliorate the effects of *Lexmark* would not be easy. Licensing may give some patent own-

[31] 304 U.S. 175, *aff'd on reh'g*. 305 U.S. 124 (1938).
[32] Actually nothing more than off the shelf vacuum tubes according to Justice Black's dissent. General Talking Pictures, 305 U.S. at 130 & n.5.
[33] Impression Prod., Inc. v. Lexmark Int'l. Inc., 137 S. Ct. 1523, 1535 (2017).
[34] *Id*.
[35] *Id*.
[36] *Id*. at 1534-35.
[37] Quanta Comput., Inc. v. LG Elecs., Inc., 553 U.S. 617 (2008).
[38] *Id*. at 637.

ers some ability to channel initial distribution of their patented products. But it will do so only at a significant cost in terms of turning over manufacturing, responsibility for sale, and enforcement of limitations (to the extent enforcement is possible) to third parties.

And in the extent of enforcement lies the rub. If enforcement of a post-sale restriction might be preempted by the logic of *Brulotte* and *Kimble* when imposed by a patentee, so too might it be preempted when imposed by a manufacturer licensed under the patent. According to the unanimous *Lexmark* opinion the licensee steps into the patent owner's shoes for purposes of exhaustion and enforcement of restrictions.[39]

For misuse and antitrust purposes, simple license limitations such as territorial restrictions unaccompanied by requirements that a licensee place restrictions on purchasers should continue to be analyzed under the existing Federal Circuit test pronounced in *Mallinckrodt* and should continue to be subject to Federal Circuit law. But post-sale restrictions imposed unilaterally by the patent licensee should no longer be subject to the special *Mallinckrodt* rules because all patent rights will by definition have been exhausted at the point of sale.[40]

Lexmark and Antitrust

Restrictions on sale of patented goods should receive no special antitrust treatment after *Lexmark.* This means that patented products will simply stand on the same footing as other products. Vertical sales restrictions are now subject to rule of reason treatment under antitrust law, whether goods are patented or not. With two possible exceptions *Lexmark* is not likely to change that analysis significantly in most cases.

The first possible exception might be post-sale restrictions on sale, use, or repair of a patented product that enjoys a substantial, near-monopoly position in a relevant market, possibly in part due to patent protection or to special circumstances such as those producing lock-in effects.[41] The effect of restrictions in stymying intrabrand competition and preventing free movement or repair of goods could be quite severe with a near monopoly product because of the absence of interbrand competition. Restrictions that suppress this remaining competition, and the innovations and improvements competition may spawn, might be deemed unreasonably anticompetitive under standard rule of reason analysis.

[39] Lexmark, 137 S. Ct. at 1535.

[40] For misuse purposes, a restriction imposed unilaterally by the licensee might be unenforceable, but it should probably not bring into play the *Morton Salt* rule of unenforceability of the patent against all comers discussed below at least outside the licensee's territory or authorized field. *See* text at notes 50-52 *infra*. If the patent owner dictates or actively supports imposition of the provision, however, a finding of misuse barring enforcement of the patent might be possible for some restrictions. The discussion of antitrust and misuse considerations that follows will, unless otherwise noted, assume that post-sale restrictions have either been imposed directly by the patentee in a sale or required by a patentee of its licensees.

[41] Eastman Kodak Co. v. Image Tech. Serv., Inc., 504 U.S. 451 (1992).

The second possible exception would involve provisions such as direct tie-outs, quantity limitations, or exclusive or nearly exclusive purchase requirements, whether direct or indirect. To the extent these provisions have the effect of restricting purchasers' access to competitive suppliers of goods or services and inhibiting effective entry or expansion of competition in markets for unpatented goods or services, they may have significant anticompetitive effects. Antitrust law is now well-developed for express tie-ins. It is less settled with respect to arrangements such as bundled discounts, which different circuits analyze differently.[42] These differences could now come to the fore in a way they generally would not when the Federal Circuit applied its precedent exclusively to address patent-related issues arising as antitrust defenses or counterclaims to infringement actions.[43]

Lexmark and the Possible Revival of a Robust Misuse Defense

The effect of *Lexmark* on the misuse doctrine could be more pronounced. That doctrine could pose a significant potential danger for patent owners and potential unexpected benefits for infringers.

Misuse is not an antitrust doctrine. It arose from concerns that use of the exclusionary value of a patent grant might confer on a patent owner the ability to impose restrictions beyond the claims of a patent itself.[44] This patent-extending conduct, whether accomplished through contract or otherwise, may be considered anticompetitive, but, more importantly for purposes of misuse, this conduct was also deemed inconsistent with the Patent Act's limitations on patent rights and remedies and the system of awarding patent rights only on the basis of defined claims examined and approved by the Patent Office.[45]

The clearest examples of patent-extending provisions are tie-ins that require use of non-patented products or terms that require royalty payments to continue after the expiration of the term of the patent. Tie-ins are now governed by statute.[46] Challenges to the enforceability of post-expiration royalty provisions usually arise in practice after the patent has expired or close to the time it will expire. Several cases have found misuse on a *per se* basis but only to the extent

[42] *See* Collins Inkjet Corp. v. Eastman Kodak Co., 781 F.3d 264 (6th Cir. 2015); ZF Meritor LLC v. Eaton Corp., 696 F.3d 254 (3d Cir. 2012); Cascade Health Sols. v. PeaceHealth, 515 F.3d 883 (9th Cir. 2008); Ortho Diagnostic Sys. v. Abbott Labs., Inc., 920 F. Supp. 455 (S.D.N.Y. 1996). For a summary see Richard Steuer, *Musthavedness*, 81 Antitrust L.J. 447, 467-70 (2017).

[43] The *Lexmark* rule of exhaustion might also create antitrust and misuse issues if sale of a key patented component of a multi-component product is used as the basis for royalties or pricing, specifically if it is based on the price or value of the entire product, rather than that of the patented component. This issue has in fact arisen in the Qualcomm/Apple litigation involving royalties for products covered by standard essential patents and is already the subject of detailed discussion in another article to which the reader is referred. Richard Stern, *Who Should Own The Benefit of Standardization and the Value it Creates*, 19 Minn. J.L. Sci. & Tech. 1, 3-4, 93-99 (forthcoming January 2018).

[44] *See* Princo Corp. v. Int'l. Trade Comm'n, 616 F. 3d 1318, 1326-28 (Fed. Cir. 2010).

[45] *See* ABA Section Antitrust Law, Intellectual Property Misuse: Licensing and Litigation, 1-33 (2000) ("IP Misuse Book"); Marshall Leaffer, *Patent Misuse and Innovation*, 10 J. High Tech L. 142 (2010).

[46] 35 U.S.C. §271(d). *See* text following note 53 *infra*.

of finding payment provisions unenforceable for the post-expiration period.[47] Post-expiration royalties were condemned on a per se basis in *Brulotte v. Thys Co.*,[48] and that approach was reaffirmed by the Supreme Court two years ago in *Kimble.*[49] *Kimble*, however, like many other post-*Brulotte* decisions, refused to enforce a contractual provision but did not otherwise address enforceability of the patent against third parties prior to expiration.

Historically, apart from the *Brulotte* context, the effect of a finding of misuse could be extreme. Under the Supreme Court's *Morton Salt* decision,[50] a misused patent was unenforceable until the practice constituting misuse was deemed to have been purged – an uncertain standard with few precedents for guidance.[51]

In the possibly lengthy interval before purgation could be achieved, the patent was potentially unenforceable against all actual or potential infringers. In *Morton Salt* the defendant was not a contracting party, or even a third party like those in *Lexmark* and *Mallinckrodt,* that failed to abide by contractual restrictions. Rather, the defendant who succeeded in using misuse as a complete defense to an infringement suit was a direct infringer who copied and used the plaintiff's patented invention and, in fact, engaged in the same tying practice which was held to be misuse as practiced by the patent owner.[52]

Morton Salt and classic misuse cases, though concerned in part with effects on competition, did not rely on antitrust principles or require detailed market power findings to establish misuse. *Morton Salt* affirmed a grant of summary judgment dismissing the infringement case on the basis of a contractual restriction (a tying clause requiring use of salt purchased from the patentee's subsidiary as a condition to leasing a patented canning machine) in contracts between the patent owner and non-parties to the suit. The Supreme Court specifically rejected any necessity of proof of further market impact or competitive effects.

This is not to say that misuse is likely to be restored post-*Lexmark* in all its pre-*Mallinckrodt* vigor. Over time, even before the Federal Circuit largely occupied the field, some courts added a measure of market-based analysis to the *Morton Salt* approach for any practice not held to have been per se illegal by the Supreme Court. Judge Posner and the Seventh Circuit, as well as the Federal Circuit, have been leading proponents of this approach.[53] Congress also stepped in twice, first in 1952 (35 U.S.C. §271 (d)(1)-(3)), and again in 1988 (35 U.S.C. §271(d)(4)-(5)), to narrow the scope of misuse for tying, the conduct at issue in *Morton Salt*. The statute now requires a showing of market power in the

[47] *See* Antitrust Developments, *supra* note 26, at 1103-05; Daryl Lim, *Revisiting the Misuse Doctrine.* The Innovation Society and Intellectual Property, Edward Elgar Publishing (forthcoming), https://ssrn.com/abstract=2667094.

[48] 379 U.S. 29 (1964).

[49] 135 S. Ct. 2401 (2015).

[50] Morton Salt Co. v. G.S. Suppiger Co., 314 U.S. 488 (1942).

[51] Antitrust Developments, *supra* note 26, at 1136 & nn. 591-97; IP Misuse Book, *supra* note 45, at 30-33.

[52] The Federal Circuit majority misdescribed this important aspect of *Morton Salt* in *Princo*, although it was not material to its analysis. Princo Corp. v. Intl Trade Comm'n, 616 F. 3d 1318, 1327 (Fed. Cir. 2010).

[53] USM Corp. v. SPS Techs., Inc., 694 F.2d 505, 511 (7th Cir. 1982); County Materials Co. v. Allan Block Co., 502 F. 3d 730, 734-37 (7th Cir. 2007). *See Princo*, 616 F. 3d at 1329-30 & n.2, citing USM Corp., 694 F. 2d at 511 and Mark A. Lemley, *The Economic Irrationality of the Patent Misuse Doctrine*, 78 Cal. L. Rev. 1599, 1614-20 (1990).

tying product or technology (which may not be presumed from the existence of the patent) as well as conditioning and other factors before misuse may be found.

Given all these developments, it is unlikely that many restrictions will be condemned as misuse on a strict per se basis. It is also possible that courts finding misuse may temper the doctrine of unenforceability until purge.[54] But this does not mean the potential for revival of a newly robust misuse doctrine can be safely ignored. Misuse may still be found on the basis of showing of patent extension requiring far less proof than an antitrust case, and its effect on enforcement of a patent could be severe. Misuse also poses a potent potential defense that may be exploited by innovative defense counsel to complicate otherwise straightforward infringement cases. The very process of exploiting this defense could lead to extensive and undoubtedly unwelcome discovery about a patent owner's marketing and licensing practices.

To What Practices Might a Revived Misuse Rule Apply?

One may hazard a few educated guesses about how a post-*Lexmark* misuse doctrine might apply to various types of restrictions in practice.

1. Post-expiration payments. The *Brulotte* rule and the courts' application of it to various sales and licensing schemes should continue to apply after *Kimble*. Whether these patent-extending practices could be considered misuse rendering a patent unenforceable prior to expiration has never been conclusively established.

2. Tie-Ins. As noted in the previous section, tie-ins are now governed by statute. Their analysis should not be affected by *Lexmark's* rejection of *Mallinckrodt*.

3. Tie-outs; quantity limitations; volume discounts. Both copyright and older patent misuse cases have condemned provisions that act to keep customers from dealing with competitive providers of sources or improvements.[55] The theory is that such provisions extend the IP right in a manner that is inconsistent with the ultimate purpose of IP laws to stimulate innovation. Provisions of this nature might therefore be likely

[54] For suggestions on refining the elements of misuse and establishing some nexus between the conduct constituting misuse and harm to the party asserting the defense, see the IP Misuse Book, *supra* note 45, at 216-27. *See also* Richard Stern, *Heightening Tension between the Exhaustion Doctrine and Field-of-Use Licensing in Information Technology Tests the Limit of each Doctrine (Part I)*, Eur. Intell. Prop. Rev. 2016, 38, 339-43 (2016) (generally pro-exhaustion commentator suggests approaches based on equitable estoppel/reasonable expectations principles or use of presumptions); Herbert Hovenkamp, *Resasonable Patent Exhaustion*, 34 (2017) (more skeptical commentator suggests "development of a federal common law of post-sale patent restraints that is more nuanced than reflected in existing Supreme Court doctrine, but that reaches further than antitrust"), http://scholarship.law.upenn.edu/faculty_scholarship/1790.

[55] M. Eagles Tool Warehouse, Inc. v. Fisher Tooling Co., Civil Action No. 97-1568-(JAG), 2007 U.S. Dist. LEXIS 23636, at *63-64 (D.N.J. March 30, 2007); IP Misuse Book, *supra* note 45, at 45-48. *See* Lasercomb Am., Inc. v. Reynolds, 911 F.2d 970, 978 (4th Cir. 1990); Omega S.A. v. Costco Wholesale Corp., 776 F.3d 692, 699-700 (9th Cir. 2015) (citing Apple Inc. v. Psystar Corp., 658 F.3d 1150, 1157 (9th Cir. 2011) and Lasercomb, 911 F.2d 970) (Wardlaw, C.J. concurring).

candidates for a resurgent patent misuse doctrine. A few district court cases have found tie-outs in patent cases, like tie-ins, to be governed by 35 U.S.C. §271(d),[56] though such a conclusion is contrary to the language and legislative history of the statute and other courts have rejected it.[57] The outcome in some cases might depend on the precise nature and wording of the restriction.

4. Territorial, customer and price restrictions in sales transactions. These restrictions can no longer be enforced through infringement suits against downstream purchasers, but they are unlikely to be considered misuse on a per se or quasi-per se basis absent aggressive enforcement efforts. All of these restrictions are now subject to rule of reason treatment under the antitrust laws when enforced against the purchaser, and their effect in general seems no different for patented goods (except that in some cases the patented product may have substantial market power). Thus, though the logic of the original misuse cases might condemn such restriction as patent misuse, the courts may not be persuaded to go so far in many cases. But by analogy to the tie-out cases discussed in the immediately preceding point, some restrictions might be condemned as misuse when they can be proved to be a means to keep products away from repairers, or from those who could provide improvements or add-ons, or where the restrictions may confine potential innovators to narrow fields of use.

5. Restrictions on imports from abroad. Though they are similar to domestic restrictions, courts might more readily apply a per se or nearly per se approach to restrictions on imports from abroad for three reasons: first, the strength of the *Lexmark* holding that they are inimical to the unwritten limits on the scope of patent rights under the Patent Act and the decision's rejection of the territoriality and separate nature of national patents; second, the likelihood that such restrictions may be suspect or illegal in many countries where they are imposed; and third, the likelihood that such restrictions may have significant and very visible effects in stymying access to innovative or lower-priced imports.[58]

6. Single-use only restrictions; restrictions on repair. An outright restriction on reuse, repair or possibly replication (in the case of self-replicating products) would seem to be a prime candidate for a finding of misuse on a per se or quasi-per se basis under *Lexmark*. This possibility could have major implications for many products, including genetically engineered ones.

Interestingly, the imposition of the restriction at issue in *Lexmark* itself might pose a closer question. Customers there had a choice between buying a cartridge outright with no restrictions on reuse or buying one at a 20% discount

[56] *See* In re Recombitant DNA Tech. Patent & Contract Litig., 850 F. Supp. 769 (S.D. Ind. 1994); Texas Instruments, Inc. v. Hyundai Elecs. Indus. Co., 49 F. Supp. 2d 893 (E.D. Tex. 1999).

[57] *See* Nat'l Lockwasher Co. v. George K. Garrett Co., 137 F2d 255 (3d Cir. 1943).

[58] *See* Omega, 776 F.2d at 699-700.

with a reuse restriction. (Customers had no such choice in *Mallinckrodt*). This situation is not exactly a tie-in, but courts might apply a similar approach and find the practice reasonable if the price differential gives customers a *bona fide* economic choice, rather than being coercive, and does not unreasonably stifle third party participation. Absence of coercion and mutual convenience of the parties were touchstones for avoiding misuse in tying and other contexts even when the doctrine of misuse was in its heyday.[59]

It has also been suggested that Lexmark might have avoided the restraint on alienation issue by simply conditioning sale of copies or use only with its original cartridges and placing notices on both the machine and the cartridges under 35 U.S.C. §271 (d)(4). This section provides that a patent owner shall not be deemed guilty of misuse or denied relief in an infringement suit because it engaged in tying – i.e., conditioning sale of a patented product on purchase of a separate product – unless the patent owner has market power over the tying product (which cannot be presumed from the existence of the patent and which Lexmark with a small market share may not have had).[60] A party reusing a spent cartridge bearing the notice might then be sued as a contributory infringer assuming the reused toner cartridge is a material part of the "invention" embodied in the relevant patents and had no substantial non-infringing uses.

Although this solution might work in some situations, it is not the arrangement Lexmark had with its purchasers. Nor is it a solution every patent owner could employ. Such a solution requires the patent owner to have obtained patents on the use or combination of the tied product with the patented product in a manner that constitutes a material part of the invention and also requires that the tied item qualify as a non-staple with no substantial non-infringing use.

And even then an unanswered question for some products is whether the restraint on alienation rule might not still apply once the patent owner sold the first tied item (the cartridge in *Lexmark*). The activity of a purchaser or third party that simply refilled a container with a staple product might not be deemed the reconstruction of a patented invention but rather normal reuse or repair of a patented item protected by the exhaustion doctrine as a normal incident of ownership.[61]

Lexmark and the Self-Replicating Product

The implications of *Lexmark* and the rule of absolute exhaustion on products that self-replicate in whole or in part are especially intriguing. In *Bowman v. Monsanto Co.*,[62] the Supreme Court dealt with a farmer who purchased and

[59] *E.g.* Zenith Radio Corp. v. Hazeltine Research, Inc., 395 U.S. 100, 138 (1969). *See* Richard Steuer, *Mustahavedness*, 81 Antitrust L.J. 447, 468-69 (2017). Lexmark had a very small market share, making coercion less likely and customer convenience a possible explanation – subject, of course, to the possibility of lock-in effects.

[60] Again, subject to the possibility of lock-in effects that could create market power over some groups of customers.

[61] See Aro Mfg. Co. v. Convertible Top Replacement Co., 377 U.S. 476 (1964); Wilbur-Ellis Co. v. Kuther, 377 U.S. 422 (1964); Aro Mfg. Corp. v. Convertible Top Replacement Co., 365 U.S. 336 (1965).

[62] 569 U.S. 278 (2013).

planted patented seeds to grow crops containing pesticide-resistant qualities. The farmer then used the seeds produced by the crops to produce subsequent generations of crops with the same resistant qualities without authority from the patent owner to do so. A unanimous Court in an opinion by Justice Kagan (the author of the majority opinion in *Kimble*) held that the sale of the seeds exhausted patent rights in the seeds themselves as articles of commerce but that exhaustion did not authorize using the seeds to make a new generation of patented products:

"Under the doctrine of patent exhaustion, the authorized sale of a patented article gives the purchaser or any subsequent owner, a right to use or resell that article. Such a sale, however, does not allow the purchaser to make new copies of the patented invention."[63]

The farmer, in short, could resell or use the purchased patented seeds for any normal commercial purpose other than to make additional copies of the patented seeds even though reproducing itself was an inherent property of the plant that the seed would produce and something that farmers have done with seeds for ten or twelve thousand years, since the very dawn of farming.[64] Drawing the line between where the right to reuse, repair or adapt a purchased product ends and the making of a new patented product begins will not always be as intuitive as it may have seemed to the Supreme Court on the facts as presented in *Bowman*. Justice Kagan concluded *Bowman* by noting that "our holding today is limited to addressing the situation before us, rather than every one involving a self-replicating product" and that "such inventions are becoming ever more prevalent, complex, and diverse."[65] A line may still be drawn, for self-replicating products as for others, between impermissible copying or reconstruction of purchased items on the one hand and permissible repair and reuse on the other. *Lexmark* clearly considered reuse or repair of a purchased item a normal incident of ownership protected by the exhaustion doctrine. (Interestingly enough, the parties such as Impression who refilled and resold the toner containers were referred to by the parties and the Court as "remanufacturers" rather than repairers.) The Justice Roberts opinion, however, did not discuss or even cite the *Bowman* decision, just as it did not discuss or cite Justice Kagan's majority decision in *Kimble*.

Agencies, Leases and Other Non-Sale Transactions

It may be expected that some patent owners will characterize transactions involving durable products as leases rather than sales, and that other patent owners may try to treat distributors or merchants who formerly purchased the product as agents, consignees, or licensees in an effort to avoid a patent-exhausting sale.[66] Bona fide transactions of this kind might avoid the exhaus-

[63] *Id.* at 280.

[64] *See* Richard Stern, *Bowman v. Monsanto*: *Exhaustion Versus Making*, Eur. Intell. Prop. Rev., 2014, 36(4), 255 (2014).

[65] *Bowman*, 569 U.S. 289.

[66] A bona fide lease or agency should avoid exhausting the patent under *Lexmark* and therefore negate the rationale for a finding of misuse, but the transaction must have all the characteristics of a bona fide lease or

tion doctrine, at least until the first sale, but they have financial, accounting, liability, and insurance consequences. Purported lease or agency transactions that are effectively disguised sales, with risk of loss passing to the transferee, will probably not avoid the exhaustion doctrine, just as such efforts failed to avoid the per se rule that formerly applied to vertical sales restrictions under the antitrust laws.[67] Purporting to withhold licenses for minor steps in finishing a patented product or completing a patented method of use substantially embodied in a product should also be unlikely to avoid exhaustion or a potential finding of misuse.[68]

Conclusion

Lexmark poses constraints on patent owners' abilities to use patent law to control distribution or reuse of products embodying their inventions. Some outright restrictions on resale may be preempted by patent policy and unenforceable even as a matter of state contract law. Misuse and to some extent antitrust and even unfair competition law may pose additional constraints. At the very least these bodies of law will pose risks for efforts to revamp distribution and licensing schemes in the wake of *Lexmark*. In *Lexmark* and *Kimble*, the Supreme Court hewed to its own precedent (including the unanimous *Quanta* decision in 2008) and followed absolutist approaches to what it deemed bedrock premises of patent law such as exhaustion from sale and the limited duration of royalties for use of a patented technology.[69] It rejected the supposedly more economically sophisticated and patent-friendly glosses of the Federal Circuit and many commentators.

It has been many decades since the Court last decided a patent misuse case. Three Supreme Court decisions in the last four years – *Bowman*, *Kimble*, and *Lexmark* – and another decision (*Quanta*) decided a few years before have addressed the point at which patent rights do or do not terminate, either temporally or upon sale. But each decision was consciously limited to the precise question presented and did not purport to anticipate possible implications for issues not before the Court. *Lexmark* did not cite either *Kimble* or *Bowman* or discuss the interrelationship between the three decisions and their approach to the scope of patent rights or the application of preemption, let alone doctrines such as misuse. It cited *Quanta* only for the proposition that sale of a

agency. *See* Simpson v. Union Oil Co., 377 U.S. 13 (1964); Valuepest.com of Charlotte, Inc. v. Bayer Corp., 561 F.3d 282 (4th Cir. 2009); Antitrust Law Developments, *supra* note 26, 1142-43 & n. 908. *See also* Straus v. Victor Talking Mach. Co., 243 U.S. 490 (1917); United States v. Masonite Corp., 316 U.S. 265 (1942).

[67] The burden of proof on the correct characterization of a transaction for exhaustion purposes is likely ultimately to fall on the intellectual property holder. *See* Adobe Sys., Inc., v. Christenson, 809 F.3d 1071, 1079 (9th Cir. 2015) ("To the extent that the copyright holder claims that the alleged infringer could not acquire title or ownership, because the software was never sold, only licensed, the burden shifts back to the copyright holder to establish such a license or the absence of a sale.")

[68] Univis Lens Co. v. United States, 316 U.S. 241 (1942); Quanta Comput., Inc. v. LG Elecs., Inc., 553 U.S. 617 (2008).

[69] Admittedly, however, the Court seemed to disregard a most basic feature of patent law in its treatment of international exhaustion: that rights under each national patent are granted and determined based on separate and potentially differing acts of sovereignty of separate nations.

patented item "terminates all patent rights to that item"[70] but did not address *Quanta's* discussion of licenses and notice provisions. Thus, there is little authoritative guidance for assessing the new possibilities that *Lexmark* now raises, and long-dormant arguments and approaches may find new life. In the meantime, well-counseled clients and their advisors will have to proceed with renewed caution.

[70] Impression Prod., Inc. v. Lexmark Int'l., Inc., 137 S. Ct. 1523, 1531 (2017) (quoting *Quanta*, 553 U.S. at 625).