INTERNATIONAL PATENT EXHAUSTION[*]

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I. OVERVIEW

"Patent exhaustion" is an American doctrine whereby a patentee's first sale of his product extinguishes his patent right, thus permitting the purchaser the unfettered right to further sell or use the product. "International patent exhaustion" is the doctrine where the purchaser in Country A is able to sell the product in Country B where the patentee owns a parallel patent.

While *domestic* patent exhaustion is firmly rooted in nineteenth century case law such as *Bloomer v. McQuewan,* 55 U.S. (14 How.) 539 (1852), the Supreme Court has never ruled whether international patent exhaustion applies to the United States. Now, the Court may review the question of international exhaustion in the copyright context of "Costco II", *Kirtsaeng v. John Wiley & Sons, Inc.*, *opinion below, John Wiley & Sons, Inc. v. Kirtsaeng*, __ F.3d __ (2nd Cir. 2011)(Cabranes, J.). The case may be styled as "Costco II" as it replicates issues ducked by the Court in its nonprecedential tie vote affirmance in *Costco Wholesale Corp. v. Omega, S.A.,* 131 S.Ct. 565 (2010)(per curiam without opinion), *opinion below, Omega S.A. v. Costco Wholesale Corp.*, 541 F.3d 982 (9th Cir. 2008)(Smith, Jr., J.).

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[*] The views expressed herein are solely those of the author and do not necessarily reflect the views of any colleague, organization or client thereof. This paper was first published on May 27, 2010, and has been edited to provide updated citations and to consider developments in cases after that date. For the sake of completeness, the writer acknowledges that while he had no involvement in one of the cases discussed in this paper, *Tessera, Inc. v. International Trade Com'n,* 646 F.3d 1357 (Fed. Cir. 2011), the party successfully pleading exhaustion was represented by partners of his firm.

This revision: September 24, 2011.

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While the Supreme Court has not expressed its opinion on international patent exhaustion, the same cannot be said for the Federal Circuit. In a case of first impression ten years ago, the court denied international patent exhaustion in *Jazz Photo Corp. v. Int'l Trade Comm'n,* 264 F.3d 1094 (Fed.Cir.2001)(Newman, J.), relying (mistakenly) on its view that the matter had been decided by the Supreme Court in *Boesch v. Graff,* 133 U.S. 697 (1890). *Jazz Photo* as a case of first impression is binding precedent within the Federal Circuit that must be followed by subsequent panels, even though based on an incorrect premise. The most recent case following *JazzPhoto* is *FujiFilm Corp. v. Benum,* 605 F.3d 1366 (Fed. Cir. 2010)(per curiam)(Michel, C.J., Mayer, Linn, JJ.).

"Patent exhaustion" in simple terms means that once a patentee sells his patented Framus, the purchaser holds title free and clear of the patent including the right to resell the Framus to anyone. The gist of patent exhaustion is that the patentee receives his reward by his first sale of the product, after which he has no claim to control commerce in that already-sold product.

The matter becomes more complicated when the patentee holds global patent rights through parallel patents in several countries: Does the sale of the patented Framus in Country "A" mean that the purchaser of the Country "A" Framus is free to sell that Framus anywhere in the world where the patentee holds a parallel patent? Under a theory of *international* patent exhaustion, the answer is yes: The patentee has received his reward through the first sale in Country "A"; now, he should not be able to control the resale of that same Framus in Country "B".

The Federal Circuit has said that the Supreme Court ruled on international patent exhaustion in *Boesch v. Graff,* but that clearly is not what happened in that case: The authorized first sale of the product was by *a competitor* of the patentee who was able to practice the invention free of the patent because of a prior user right.

Recently, the Court has given a broad interpretation to the scope of patent exhaustion in the domestic context of *Quanta Computer, Inc. v. LG Electronics, Inc.*, 553 U.S. 617 (2008), although international implications are found in the same matter on remand, . *LG Electronics, Inc. v. Hitachi, Ltd.*, 2009 WL 667232 (N.D.Cal. 2009)(Wilken, J.). *See* § II, *Supreme Court International Patent Exhaustion*.

While the Supreme Court has never ruled on international *patent* exhaustion, there has been activity in the area of other international intellectual property exhaustion issues in the context of copyright and trademark law. The Court granted the petition for review in *Costco v. Omega,* which could have had profound implications for international patent exhaustion but instead resulted in a 4-4 tie split (meaning that the case had no precedential value). *See* § III, **"***Costco I" Case at the Supreme Court.*

In the wake of *Quanta,* the Federal Circuit has issued opinions in *TransCore, LP v. Electronic Transaction Consultants Corp.*, 563 F.3d 1271 (2009)(Gajarsa, J.), and *Tessera, Inc. v. International Trade Com'n,* 646 F.3d 1357 (Fed. Cir. 2011)(Linn, J.).

TransCore provides a broad interpretation to patent exhaustion in the setting of a domestic exhaustion fact pattern, while denying that *Quanta* compels a change in Federal Circuit law to create a doctrine of international patent exhaustion. *Tessera* concludes that there is international exhaustion in the case of sales by an *authorized* foreign licensee without territorial restrictions.

The Federal Circuit does not operate on a clean slate in its consideration of international patent exhaustion because of *Jazz Photo.* The ruling in *Jazz Photo* gives a one sentence *conclusion,* with no explanation of any kind. In lieu of an explanation for its holding, the court cites *Boesch v. Graff,* although this case is one dealing with a prior user right and has absolutely nothing to do with an authorized first sale by the patentee and *a fortiori* nothing to do with international patent exhaustion. *See* § IV, *Post-Quanta Exhaustion at the Federal Circuit.*

Whatever decision on international patent exhaustion that the Supreme Court will ultimately reach, there will be global implications as the United States during the negotiations leading up to the Marrakesh Agreement establishing the World Trade Organization and the "TRIPS" – the Trade Related Aspects of Intellectual Property – took a strong stance *against* international exhaustion. The topic remains one of great global interest. *See* § V, *The Internationally Open Question of Exhaustion.*

The Court may soon have the opportunity to break the 4-4 deadlock in *Costco,* should it grant *certiorari* in *Kirtsaeng. See* § VI, *Kirtsaeng: "Costco II" at the Supreme Court.*

II. SUPREME COURT INTERNATIONAL PATENT EXHAUSTION

Boesch v. Graff is mistakenly cited in *Jazz Photo* for the proposition that there is no international exhaustion, but the case has absolutely nothing to do with a first sale by the patentee. Thus, international patent exhaustion would involve *the patentee* selling his Framus in Country "A" (Germany) after which *the patentee's* purchaser would resell the Framus in Country "B" (the United States).

In *Boesch v. Graff* it is true that the patentee owned patents in both countries "A" (Germany) and "B" (the United States), but Framus sold in country "A" (Germany) *was not a sale by the patentee.* Rather, the seller in Country "A" was an *independent competitor* of the patentee who was able to lawfully sell the Framus in Country "A" because he had defeated a patent infringement lawsuit in Germany on the basis that he had *independently* invented the Framus prior to the critical date for establishment of a prior user right. Thus, the *independent competitor* sold *his* Framus without permission or reward from the patentee based upon the German national prior user right statute.

More recently, the Supreme Court has provided guidance on its view of exhaustion in general in *Quanta*, which involves both domestic and international exhaustion issues, although only domestic exhaustion was directly involved in the Supreme Court's decision.

The expectation that eventually the Supreme Court will review international patent exhaustion in the wake of *Quanta* immediately became apparent from the opinion. *See* Harold C. Wegner, *Post-Quanta, Post-Sale Patentee Controls*, 7 J. Marshall Rev. Intell. Prop. L. 682, 698 (2008). On remand in *Quanta* (now styled as *LG Electronics, Inc. v. Hitachi*), the *international* exhaustion issue was taken up with the trial court holding that a ruling in favor of international patent exhaustion is mandated by the Supreme Court opinion.

III. "COSTCO I" AT THE SUPREME COURT

While the Supreme Court has never dealt with international *patent* exhaustion, the Court on several occasions has dealt with international intellectual property exhaustion issues in the context of copyright and trademark law. In a case before the Court on a merits appeal during the October 2010 Term, *Costco* raised the question of international exhaustion of intellectual property rights in the context of copyright law.

The specific *Question Presented* in the petition to the Court is stated thusly:

"Under the Copyright Act's first-sale doctrine, 17 U.S.C. § 109(a), the owner of any particular copy 'lawfully made under this title' may resell that good without the authority of the copyright holder. In *Quality King Distribs., Inc. v. L'Anza Research Int'l, Inc.,* 523 U.S. 135, 138 (1998), this Court posed the question presented as 'whether the 'first sale' doctrine endorsed in § 109(a) is applicable to imported copies.' In the decision below, the Ninth Circuit held that *Quality King* (which answered that question affirmatively) is limited to its facts, which involved goods manufactured in the United States, sold abroad, and then re-imported. The question presented here is:

"Whether the Ninth Circuit correctly held that the first-sale doctrine does not apply to imported goods manufactured abroad."

The great interest that at least four members of the Court have in the issue is manifested by the fact that *certiorari* was granted *despite* a negative recommendation whether to grant review by the Solicitor General, responsive to a CVSG Order from the Court last year.

The 4-4 tie split decision on the merits without opinion shows the difficult time the Court is having in resolving the issue. (A tie vote at the Supreme Court means that the decision of the Court of Appeals is affirmed, but the action of the Supreme Court has no precedential value.)

IV. POST-*QUANTA* EXHAUSTION AT THE FEDERAL CIRCUIT

A. *FujiFilm* Denial of International Patent Exhaustion

FujiFilm v. Benum represents the first post-*Quanta* confrontation at the Federal Circuit over the issue of international patent exhaustion, although the Court in *TransCore* and *Tessera* has already given *Quanta* a broad interpretation.

In *FujiFilm Corp. v. Benum,* the court continued the rule of *Jazz Photo*, denying the existence of international patent exhaustion. The Court denied the applicability to this case of *Quanta Computer, Inc. v. LG Electronics, Inc.*, 553 U.S. __, 128 S. Ct. 2109 (2008), which did not involve international exhaustion:

"Holding the case governed by *United States v. Univis Lens Co.*, 316 U.S. 241 (1942) (exhaustion occurs when the only reasonable and intended use of the products sold is to complete the patented combination), the Court [in *Quanta*] found that Intel's chips substantially embodied the patented invention and their unconditional, authorized sale by Intel thereby exhausted LG's patents. *Quanta Computer, Inc.*, 128 S. Ct. at 2122.

"Defendants assert that *Quanta* created a rule of 'strict exhaustion,' that the Court's failure to recite the territoriality requirement eliminated it. That case, however, did not involve foreign sales. Defendants rely on *Quanta's* footnote 6 because it contains the phrase '[w]hether outside the country.' [footnote omitted] This phrase, however, emphasizes that *Univis* required the product's only use be for practicing–not infringing–the patent; and a practicing use may be "outside the country," while an infringing use must occur in the country where the patent is enforceable. Read properly, the phrase defendants rely on supports, rather than undermines, the exhaustion doctrine's territoriality requirement. LGE suggests that the Intel Products would not infringe its patents if they were sold overseas, used as replacement parts, or engineered so that use with non-Intel products would disable their patented features. But *Univis* teaches that the question is whether the product is 'capable of use only in *practicing* the patent,' not whether those uses are infringing. Whether outside the country or functioning as replacement parts, the Intel Products would still be *practicing* the patent, even if not infringing it." *Quanta Computer, Inc.*, 553 U.S. at __, 128 S. Ct. at 2119 n.6 (citations omitted) (emphasis in original)".

Prior to *Quanta,* the Federal Circuit in *Jazz Photo*, a case of first impression on the issue of international exhaustion, gave no explanation at all for its one sentence holding that "[t]o invoke the protection of the first sale doctrine [of exhaustion], the authorized first sale must have occurred under the United States patent." *Jazz Photo,* 264 F.3d at 1105. Instead, the court merely gave the citation to *Boesch v. Graff* with a parenthetical statement of what it viewed as the holding of that case that "a lawful foreign purchase does not obviate the need for license from the United States patentee before importation into and sale in the United States." *Id.* (citing *Boesch v. Graff,* 133 U.S. at 701-703). While it is entirely correct that this was the holding of the case *in the context of a lawful sale by the patentee's competitor* the holding had nothing to do with international exhaustion which would have implicated a sale *by the patentee.*

With *Jazz Photo* as binding circuit precedent, there have been several pre-*Quanta* opinions reaching the same conclusion. *See Fuji Photo Film Co., Ltd. v. International Trade Com'n,* 474 F.3d 1281, 1285 (Fed. Cir. 2007)(Dyk, J.)(discussing *Jazz Photo Corp. v. United States,* 439 F.3d 1344 (Fed.Cir.2006); *Fuji Photo Film Co. v. Jazz Photo Corp.,* 394 F.3d 1368 (Fed.Cir.2005); *Fuji Photo Film Co. v. Int'l Trade Comm'n,* 386 F.3d 1095 (Fed.Cir.2004).

B. Post-*Quanta* Cases Supporting Exhaustion

In *TransCore,* a panel broadly interpreted the scope of exhaustion under *Quanta.* It stated that in *Quanta,* "the Supreme Court reiterated unequivocally that '[t]he longstanding doctrine of patent exhaustion provides that the initial authorized sale of a patented item *terminates all patent rights* to that item[.],'" *TransCore*, 563 F.3d at 1274 (quoting *Quanta,* 128 S.Ct. at 2115, 2121)(emphasis added). The court distanced itself from cases like *Boesch v. Graff* dealing with a mere lawful sale by anyone, interpreting *Quanta* as ruling that "[e]xhaustion is triggered only by a sale *authorized by the patent holder*[.]" *TransCore*, 563 F.3d at 1274 (quoting *Quanta,* 128 S.Ct. at 2115, 2121)(emphasis added).

In *Tessera,* a case factually based upon *Quanta,* the Federal Circuit considered foreign sales by an *authorized* licensee without geographical restrictions on its activities:

"'The longstanding doctrine of patent exhaustion provides that the initial authorized sale of a patented item terminates all patent rights to that item.' *Quanta,* 553 U.S. at 625. At issue here, as in *Quanta,* is whether the patentee has authorized certain sales of products embodying the asserted patent. *Id.* at 636. In *Quanta,* patent holder LG licensed a portfolio of patents to Intel. *Id.* at 623. Under the License Agreement, Intel could sell its own products practicing the LG patents. *Id.* The License Agreement did not, however, grant Intel the right to practice the patents in conjunction with non-Intel products. *Id.* Quanta purchased, from Intel, products substantially embodying the LG patents and combined them with non-Intel products to practice the licensed patents. *Id.*

"The Supreme Court held that LG's patent rights were exhausted upon Intel's authorized sale to Quanta. Although Intel was not licensed to practice the patents using non-Intel parts, '[n]othing in the License Agreement restricts Intel's *right to sell* its microprocessors and chipsets to purchasers who intend to combine them with non-Intel parts.' *Id.* at 636 (emphasis added). Rather, the agreement 'broadly permit[ted]' Intel to make, use, or sell products free of LG's patent claims. *Id.* Indeed, the agreement 'authorized Intel to sell products that practiced the [asserted patents]. No conditions limited Intel's *authority to sell* products substantially embodying the patents.' *Id.* at 637 (emphasis added). Because Intel was authorized to sell its products to Quanta, the doctrine of patent exhaustion prevented LG from further asserting its patent rights against those products purchased from Intel. *Id.*

"Here, as in *Quanta,* Tessera's licensees were authorized to sell the accused products. Nothing in the TCC Licenses limited the licensee's ability to sell the accused products. Each of the TCC License agreements contains an unconditional grant of a license 'to sell ... and/or offer for sale' the accused products." *Tessera,* 646 F.3d at 1369-70.

The Court concludes its analysis of exhaustion by quoting nineteenth century Supreme Court precedent that "when the machine passes to the hands of the purchaser, it is no longer within the limits of the monopoly". *Tessera,* 646 at 1370 (quoting *Bloomer v. McQuewan,* 55 U.S. (14 How.) at 549).

V. THE INTERNATIONALLY OPEN QUESTION OF EXHAUSTION

International exhaustion is one of the most contentious points of international patent trade discussions. While many developing countries have adopted international patent exhaustion, there has also been adoption of international patent exhaustion within the developed countries of the world. Within the European Union, there is now a doctrine of international patent exhaustion for a first sale in a member state so that, for example, the purchaser of pharmaceuticals on the open market in the United Kingdom is able to export the thus-purchased products to Germany and Holland free from patent infringement. Japan has adopted international patent exhaustion with the exception that there is no exhaustion where the purchaser in Country "A" is on notice of the patent right.

In the negotiations leading up to the 1994 Marrakesh Agreement establishing the TRIPS, the United States was able to lead a coalition of developed countries to striking victories to establish minimum standards of patent protection that favored strong patent rights. The one area where victory could not be achieved was the establishment of a standard *denying* international patent exhaustion. To avoid any possibility that future panels of the World Trade Organization deciding disputes under the TRIPS could reach this decision, the developing countries insisted upon an express provision in the TRIPS that makes it clear that international exhaustion was *not* a topic of agreement. Hence, the express statement is found in the Marakesh Treaty itself that "[f]or the purposes of dispute settlement under this Agreement, subject to the provisions of [TRIPS] Articles 3 [providing for national treatment] and 4 [providing most-favored-nation treatment,] nothing in this [TRIPS] Agreement shall be used to address the issue of the exhaustion of intellectual property rights." TRIPS, Article 6.

VI. *KIRTSAENG*: "COSTCO II" AT THE SUPREME COURT

While the Court split 4-4 in its nonprecedential affirmance in *Costco,* the Court again has the opportunity to consider the issue of international copyright exhaustion in what is expected to be a *Kirtsaeng* petition for certiorari from the divided panel decision of the Second Circuit in *John Wiley & Sons v. Kirtsaeng*. (The petition for *certiorari* is due November 13, 2011.).