Patent Monopoly and Doctrine of Exhaustion: Limits on Exclusive Right

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A patent is granted for an invention that is novel, non-obvious, and has an industrial application. The proprietor of the patent grant is able to exploit and control the use of patented matter. Patent as a form of personal property may be assigned, licensed, mortgaged and may devolve by operation of law. The patent exhaustion doctrine, also known as the first sale doctrine, operates to ‘exhaust,’ or extinguish, the exclusive rights of sale and use as to patented articles sold with the patent owner’s authorization. In this background, this article develops the concept of exhaustion and surveys the nature, scope and ambit of the doctrine of patent exhaustion. The relevance of doctrine and right of exclusivity is thoroughly discussed with regard to commercial transactions involving licensing, assignment, sale, disposal or offer of disposal of the patented articles. The article concludes that those conditions which are within the scope of patent monopoly act as limits on the doctrine of exhaustion of right in the sold goods. The exhaustion of right is limited to patented goods, therefore the purchaser has all rights except right to reconstruct. This article while discussing the doctrine from international and national perspective suggests rethinking of the nomenclature of doctrine of exhaustion as contained in Article 6 of the TRIPS Agreement.

Keywords: Patent, monopoly, doctrine of exhaustion

A patent is granted for an invention that is novel, non-obvious, and has an industrial application. The proprietor of the patent grant is able to exploit and control the use of patented matter. Patent as a form of personal property may be assigned, licensed, mortgaged and may devolve by operation of law. These features of a patent have made it part of commercial currency, i.e., they can be traded, exploited, and included as part of a larger commercial transaction at national and international level. The stipulations and conditions governing these transactions at pre-sale, post-sale, export-import and consequent exhaustion of the monopoly right forms the subject matter of discussion of this article.

Doctrine of Exhaustion: Meaning and Concept

The patent exhaustion doctrine, also known as the first sale doctrine, operates to ‘exhaust’, or extinguish, the exclusive rights of sale and use patented articles sold with the patent owner’s authorization. When the patented article embodies a clearly defined invention claimed by one patent, and when its sale features impose no conditions or restrictions, the patented article emerges from that sale unencumbered; the patent owner no longer has rights to exclude activities like resale, ordinary use and repair of the article. The exclusive right under the patent and transactions incidental to property right, such as, assignment, licensing, export and import creates a web of commercial interaction.

The doctrine of exhaustion is a defence against infringement of the patented articles sold with patent owner’s authorization. A defendant infringes only if he performs certain industrial or commercial activities. Since a bulk of the patents are concerned with things manufactured or process of manufacture, the prohibited acts may be broadly classified as those performed (i) during manufacture, (ii) before and (iii) after manufacture. These acts have to be related to the type of claim which the patentee has been able to obtain. In general, a claim to a product i.e., a machine, a substance, or a compound is infringed the moment a product is made which contains all essential features claimed; while a claim to a process is infringed when the completed process is carried out.
The defence against the liability for infringement under the first sale doctrine is concerned with the infringement that takes place after the manufacture. The list of infringing acts covers: disposing of, offering to dispose of, importing, and even keeping for disposal or otherwise, either the patented product or a product obtained directly by means of a patented process. Where the infringing goods pass down a chain of distributors, each of them becomes liable as keeper, then as disposer, including the ultimate recipient. Further a person who acquires or imports goods for the purpose of exporting them to sell abroad will be liable for infringement. Where the chain of distribution originates abroad, a person who completes a sale by transferring property in the product in another country does not infringe, but the subsequent importer will. This is true under English law but may vary from nation to nation depending upon the types of exhaustion policy adopted, i.e., international, regional or national. A person involved in negotiations to sell an article after the expiry of a patent is also covered under ‘offers to dispose’ of the goods, and therefore will infringe. The acts excluded from liability of infringement such as private, non-commercial and experimental use, are applicable to post manufacturing phase also, but only to protect those who perform the specified acts. These exceptions do not cover subsequent acts of resale in a business deal.

The chain of distribution of the patented goods and extent of exhaustion of right will depend upon the condition, restrictions imposed by the patentee. This is further circumscribed by the nature of the conditions or stipulation imposed by the patentee on whether it falls within the scope of patent monopoly or beyond the scope of patent monopoly. The condition or stipulations which are within the scope of patent monopoly can be imposed by the patentee who has made or authorized a sale of patented goods. The conditions of further sale or use would bind not only another contracting party but all recipients of the goods with notice of the restrictions.

**Patent Monopoly and Right to Exclude**

Patents have long been considered a species of property therefore securing, the patentee the exclusive right and liberty of making, constructing, using and vending an invention. In the eighteenth and nineteenth centuries, the concept of property had political and legal connotations comprising rights of possession, use, and disposition. At that time, these substantive rights constituted the essential concept of property. As the father of natural rights theory, Hugo Grotius, declared, ‘liberty in regard to actions is equivalent to dominium in material things’ a principle that Locke followed in his own ‘mixing labour’. Thus, the now familiar legal definition of property is ‘the exclusive right of possessing, enjoying, and disposing of a thing.’ The central importance of these substantive property rights is best illustrated in the patent licensing doctrines developed by nineteenth century courts, which sought to secure to patentees the essential rights of use and disposition of their property. Contrasting the essential protection of the rights of use and disposition in patented inventions as in personal privileges in English patents and the property rights in American patents; the principal difference was the right of disposition. English patents were a mere grant by the crown and thus inalienable unless power to that effect is given by the crown. American patents, however, were defined as an incorporeal chattel, which the patent impresses with all the characteristics of personal estate, including the right to dispose.

The protection of the exclusive right of intellectual property was referred to by Justice Levi Woodbury, in as early as 1845 wherein he opined that patents protect the same rights of use and disposition as do property rights in land and chattels; “[A] liberal construction is to be given to a patent, and inventors sustained . . . . and only in this way can we protect intellectual property, the labours of the mind, [which are] production and interests as much as a man’s own, and as much as the fruit of his honest industry, as the wheat he cultivates, or the flocks he rears”. Justice Woodbury went on to explain that patentees were not monopolists, as ‘the design [of the patent system] is to encourage genius in advancing the arts, through science and ingenuity, by protecting its productions of what did not before exist.’

In addition to adopting real property rhetoric, concepts, and notice requirements in patent law, nineteenth-century courts exercised substantial discretion in crafting specific doctrines to implement broad statutory declarations that a patent secured the right to use and dispose of an invention. In doing so, courts developed patent doctrines mirroring common law doctrines that secured to landowners the right to control the downstream use of their property by third parties. In patent law, such doctrines protected
patentees by allowing them to impose restrictions on manufacturing, sale, and use on their licensees. Such licence restrictions were deemed to be conceptually and doctrinally identical to a landowner’s imposition of a use restriction in conveying a limited ‘title’ to a third party. In 1874, Justice Woodruff, declared that the patentee may grant the right to use within any specified place, town, city or district, and he may make such right of use exclusive; and he further said it is no less clear that he may limit the right to manufacture for such use. It is important to recognize that the rights of use and disposition did more than provide nineteenth-century courts with a descriptive framework to explain why patentees could engage in restrictive licensing practices. The concept of property that comprised these substantive rights also explained why courts created the doctrinal limits that prevented patentees from abusing their property entitlements.  

As the US Supreme Court stated in its 1852 decision in Bloomer v McQuewan, when a patentee sells a product covered by its patent without restriction, the product passes to the hands of the purchaser, and thus it is no longer within the limits of the patent monopoly. Although the Bloomer Court’s creation of the exhaustion doctrine was initially framed in terms of limiting the patent monopoly, the subsequent evolution of this important nineteenth-century doctrine reflected the courts’ understanding that patents were conceptually equivalent to common law property entitlements in land.

The rights to use and dispose of one’s property meant that one had the freedom to restrict uses by successors-in-interest within the constraints imposed by either public policy or the police power. Such restrictions, however, had to be expressly adopted by the property owner and clearly conveyed to the purchaser. In the absence of restrictions, courts rejected landowners’ attempts to enforce alleged restrictive covenants and other servitudes given the lack of notice to successors-in-interest. The default rule in real property law was that, absent any express terms limiting an estate interest conveyed to a third party, a subsequent property owner had the same rights to possess, use, and dispose of the property as the original owner. In accordance with this default rule governing conveyances of land, nineteenth-century courts concluded that, if a patentee did not impose any express, written restrictions in a licence, then the conveyance was absolute in terms of the property right received by the purchaser.

A few years later, the US Supreme Court held that if a patentee failed to use restrictive covenants in a conveyance instrument, then a licensee or end-user received an absolute and unrestricted right to use the patented invention. Since ownership meant full dominion over the property, the Court explained the absence of restrictive covenants or external legal restraints meant that a property owner had a full right to use and dispose of his possessions: land, chattels, or patented inventions. The shades of influence of common law property rights in land on nineteenth-century patent doctrine are unmistakable. Patent exhaustion doctrine was thus built on a conceptual foundation that maintained that all property owners — patentees, licensees, and end-users — had the right to use and dispose of their property, barring explicit and unequivocal restrictions as to the time, or place, or manner of using the patented article. This was the default rule designed into nineteenth-century legal doctrine governing both land and intellectual property rights. Without notice of an express restriction imposed by a grantor, courts refused to enforce restrictive covenants against patent licensees, just as they did in cases involving covenants governing the use of land. They also prevented patentees from pursuing infringement claims against innocent downstream purchasers who had no notice of a breached restriction by a licensee. On the basis of the definition of patents as property, nineteenth century courts and legislatures crafted a legal default rule that provided inventors strong licensing rights, guaranteeing that a patentee may grant licences to whom he wants, and restrict the licence as to time, territory, and purpose.

**Monopoly and Exhaustion Doctrine: Extent of Exclusivity**

The patent monopoly is granted to a patentee as a reward for his creativity and intellectual efforts. When a patent owner receives compensation for the use of his invention by the sale of a good, the purpose of patent law is fulfilled with respect to that good. Upon receiving compensation, the patent owner’s rights to exclude others are exhausted and the patent law affords no basis for restricting the use and enjoyment of the thing sold. Accordingly, a patent owner’s voluntary introduction of a patented good into commerce without restriction prevents the patent owner from exercising his right to exclude others from using or reselling that good. Procedurally, the
The patent exhaustion doctrine provides an affirmative defence to infringement claims concerning the use or sale of a patented good after the patent owner authorizes its sale. The purchase of the good from an authorized seller emancipates such article from any further subjection to the patent. An infringement remedy to exclude others from practising the patentee’s invention in the goods sold is exhausted. The right of reconstruction comprises a new making of the good, the exclusion of which is not exhausted by the authorized sale.

Mode of Exploitation of Patent and Authorized Sale

The difficulty in determining the authorized sale and extent of exhaustion arises under the following circumstances: (i) the patent owner licenses sales, (ii) the patent owner sells the article with restrictions applied to purchasers directly, and (iii) the patent owner sells one or more components of a multi-component patented good.

Licence Restriction

In order to understand an authorized sale, it is necessary to first examine the various modes of exploitation of the patent. The owner may decide to manufacture or use the patented invention himself to assign or license the interest to other party. An assignment is a transfer of ownership of the patent; once a patentee has assigned the patent he no longer has an interest in or responsibility to maintain the patent. Another mode of exploitation is through the licence. Licences may take many forms including permission, one off-permission or an exclusive licence. An exclusive licence is an agreement under which the owner of a patent not only grants the licensee permission to use the patented technology, but also refrains from granting any other licences or exploiting the technology themselves. The assignment and exclusive licence completely exhausts the right of the patentee in the licensed goods. The licences other than the exclusive licence may impose several conditions as to use of the patented goods, such as, field use restriction, no-challenge clause, and tie-in clause, duration of licence, grant back, price limitation and patent pooling. If the conditions or stipulation governing the licence agreement falls within the ambit of patent monopoly then the exhaustion doctrine shall apply, otherwise a remedy will lie under contract and competition law.

Post-sale Restrictions

The courts held that an authorized, unconditional sale prevented patent owners from enforcing patent rights as to the good sold. Consequently, patent owners began placing conditions directly onto goods in the form of notices. In cases challenging these notices as beyond the scope of the patent grant, courts focused on the traditional disfavour to contracts of adhesion, restrictions on transfer of personal property and restraints on trade. The courts held that certain notice restrictions did not prohibit application of the exhaustion doctrine to the sold good, for example, resale price restrictions and restrictions to use with non-patented articles. In these cases, patent owners commonly argued that restrictions partially withholding rights are within the patent grant monopoly because their exclusive rights permitted them to withhold the patented good altogether. The US Supreme Court characterized this argument as defective on the grounds that it failed to distinguish between the patent owner’s right to exclude, which may be asserted against all through infringement suits, and private ordering through contract, which is subject to general contract law principles. In General Talking Pictures, the Court hinted that notice restrictions on field of use may be enforceable as to downstream purchasers. In 1992, the Federal Circuit approved the use of post-sale restrictions in Mallinckrodt Inc v Medipart Inc. Mallinckrodt presumed that non-exhaustion for goods sold with post-sale restrictions was reasonably within the patent grant. Under this rationale, any restriction on use is reasonably within the patent grant. Of course, this makes it difficult for courts to analyse whether a condition is enforceable through a patent infringement action.

Patented Combination

The patent exhaustion doctrine also applies to incomplete articles that have no substantial use other than to be manufactured into a separate patented and allegedly infringing article. When a patent owner or his licensee sells a component or unfinished article embodying the essential features of his patented invention and he intends that the purchaser complete the article consistent with the patent, he has sold his invention so far as it is or may be embodied in that
particular article and the patent exhaustion doctrine applies. Requiring components to comprise essential features of the patented invention is part of the effort to ensure that the patent owner does not collect more than one reward for his patented invention.13

Precedent in USA: Doctrine of Exhaustion in the light of Quanta v LGE

After United States v Univis Lens Co12, it was only in 2008 that the US Supreme Court discussed patent exhaustion in Quanta Computer Inc v LG Electronics Inc.14 The doctrine of patent exhaustion provides that the initial authorized sale of a patented item terminates all patent rights to that item. Patent exhaustion, also known as the first-sale doctrine, requires a sale, either from a patent owner to the purchaser or from a licensee to a purchaser. If the sale of the patented item is authorized, then the patent owner gives up the statutory rights of exclusion with respect to that item.15

Quanta reinforced the rule from Univis Lens that a component that embodies a patent can trigger exhaustion if it satisfies two requirements. First, the component’s only reasonable and intended use must be to practice the patent, such that it has no infringing use. Second, the component must embody essential features of the patented invention by including all the inventive aspects of the patented invention. To understand this test, it is useful to explain the facts of two cases that elucidate the reasoning behind this application of patent exhaustion. This is especially relevant since the Supreme Court based so much of its Quanta opinion on the analysis in Univis Lens and did not discuss Cyrix Corp v Intel Corp16 which was merely a district court ruling, but had a fact pattern nearly identical to that of Quanta.

In Univis Lens,12 Univis Corporation granted Univis Lens Company a licence to make lens blanks for US$ 0.50 each, and to sell those lens blanks at US$ 4.00 to licensed finishing retailers and US$ 3.25 to licensed wholesalers. Under the first option, the finishing retailers would grind and polish the lens blanks into finished lenses, which they would sell directly to customers at a set price of US$ 16. Under the second option, wholesalers would grind and polish the lens blanks into finished lenses, which they would sell at a set price of US$ 7 to licensed prescription retailers, who would then resell it to customers at a set price of US$ 16.15. All of these prices were set by the Univis Corporation through its multi-tiered licensing scheme. The Supreme Court in this case found that when the Lens Company sold the lens blanks to wholesalers and finishing retailers, those lens blanks exhausted the eight product patents. Therefore, only the Corporation’s licence to the Lens Company was within its patent rights; the Corporation’s attempt to license the finishing retailers, wholesalers, and prescription retailers to fix prices was an antitrust violation.

The lens blanks passed the exhaustion test for components. Under the reasonable and intended use test ‘it is plain that . . . the only use to which the lens blank could be put and the only object of the sale is to enable the [finisher] to grind and polish it for use as a lens by the prospective wearer.’ As for the essential features prong, the Court reiterated that ‘each blank . . . embodies essential features of the patented device and is without utility until it is ground and polished as the finished lens of the patent.’ The Court emphasized that ‘merely because the licensee takes the final step . . . it does not follow that the patentee can control the price at which the finished lens is sold.’12

In the district court case of Cyrix15, Intel entered into cross-licences with SGS-Thomson (ST) and Texas Instruments (TI). Under the cross-licence, ST and TI made microprocessors which were covered by one of the claims in an Intel patent under the cross-license for Cyrix. Cyrix combined these microprocessors with external memory; a combination which infringed different claims of the same Intel patent. When Intel sued Cyrix for patent infringement, the Eastern District of Texas found that the sale of the microprocessors exhausted the Intel patent. The Court compared the case to Univis Lens; the combination claims were exhausted because the microprocessors cannot be used for any purpose without external memory. Cyrix’s microprocessors, although complete in and of themselves, were unfinished in the sense that they need to be combined with external memory to be used. Cyrix’s microprocessors were thus compared to the lens blanks of Univis Lens.

In Quanta, unlike in Cyrix, Intel entered into a cross-licence with LG Electronics (LGE). This time, under the cross-licence, Intel made microprocessors which were covered by a number of LGE patents under the cross-licence, for Quanta. Quanta combined these microprocessors with external memory and buses; this combination then infringed three different patents under the cross-licence. The Federal Circuit
held that there was no exhaustion in this case, and oddly enough, failed to mention either Univis Lens or Cyrix, which the Federal Circuit had affirmed. It also failed to make any mention of the ‘reasonable and intended use’ and ‘essential features’ test in its opinion. The US Supreme Court rightly overturned the Federal Circuit and, following Univis Lens, found that the sale of the microprocessors did exhaust the three LGE system and method patents. Under the reasonable and intended use prong, ‘[a] microprocessor or chipset cannot function until it is connected to buses and memory. And here, as in Univis, the only apparent object of Intel’s sales to Quanta was to permit Quanta to incorporate the Intel products into computers that would practice the patents.’ As for the essential features test, it was also pointed out that everything inventive about each LGE patent was embodied in the microprocessors. The Quanta case, however, emphasizes exactly this ‘heart of the invention’ requirement. The language of the exhaustion cases indicates that in order for a component to be an essential feature, the other parts of the patented invention must be uninformative: grinding and polishing the lens blanks in Univis Lens, and adding memory and buses to the microprocessors in Quanta. If there are two essential features, then patent exhaustion may well not apply. This is a much higher threshold than that required in inventorship determinations. Along with its holding on components that embody essential features, the Quanta Court reasoned that ‘[i]t is true that a patented method may not be sold in the same way as an article or device, but methods nonetheless may be ‘embodied’ in a product, the sale of which exhausts patent rights.’

Restrictions within the Scope of Patent Monopoly

After Quanta, there is still substantial uncertainty about the extent to which parties may contract around exhaustion. Cases leading up to Quanta indicate that licence restrictions that are within the scope of patent rights have always been allowed; when those restrictions are valid and properly written into the licence, contracting around exhaustion can be effective. Licence restrictions that are not within the scope of patent rights are considered patent misuse and are not allowed; when this is so, attempts to contract around exhaustion are ineffective, and the default rules of patent exhaustion apply. Similar to the ‘bundle of sticks’ concept in property law, patent owners may choose to give out certain sticks and keep others for themselves. The cases of nineteenth century recognized and embraced this concept; the right to manufacture, the right to sell, and the right to use are each a substantive right, and may be granted or conferred separately by the patentee. Cases in the twentieth century expanded this concept by explaining that patent owners grant licences to manufacture, use or sell upon conditions not inconsistent with the scope of the monopoly. The US Supreme Court has held that restrictions on duration, location, and field of use are within the grant of patent rights. In the cases that follow, the Court found that the licence restrictions were validly within the grant of patent rights. When these restrictions are valid, exhaustion turns on whether the sale of an item is expressly conditioned on these restrictions. In Adams v Burke, and Keeler v Standard Folding Bed Co, the Court ruled that exhaustion still took place because even though the licence restriction was valid, the sales themselves were not explicitly restricted and were therefore authorized. But in Mitchell v Hawley and General Talking Pictures Corp v Western Electric Co, the Court ruled that a valid licence restriction and explicitly conditional sale were sufficient to prevent exhaustion from occurring.

Restrictions not within the Scope of Patent Monopoly

The US Supreme Court has held that certain licence restrictions fall outside the scope of patent rights. The cases that follow involve issues like tying and price-fixing, in which the patentee impermissibly attempts to expand his patent monopoly. In 1912, the US Supreme Court upheld a tying restriction in Henry v A B Dick Co. Over the next several years, the Court narrowed the A B Dick holding and eventually overturned it completely.

In Motion Picture Patents Co v Universal Film Manufacturing Co, the patent owner granted the Precision Machine Company a licence to make and sell patented motion picture exhibiting machines. The licence agreement required Precision to use the machine only to show films covered under a separately licensed patent (which expired two years after the agreement), to agree that the patentee could change the terms of the licence at its discretion, and to include an identification plate on the machines stating these restrictions. The licensee sold a machine under those same licence terms to the Seventy-second Street Amusement Company, which in turn leased space to the defendants, who proceeded to show non-patentee films. The Court rejected the covenant requiring that the machine only be used with films under the expired
patent as impermissible because such a film is obviously not any part of the invention of the patent in suit; because it is an attempt, without statutory warrant, to continue the patent monopoly in this particular character of film after it has expired, and because to enforce it would be to create a monopoly in the manufacture and use of moving picture films, wholly outside of the patent in suit and of the patent law. The Court also rejected the covenant that the patentee could change the terms of the licence at its discretion because it was a ’restriction which would give to the plaintiff such a potential power for evil . . . wholly without the scope and purpose of our patent laws.’

Restrictions on Sale and Post-sale Use

Though Bloomer v McQuewan was not a case about patent exhaustion, it set up in dicta, the distinction between the grant of the right to make and vend the machine, and the grant of the right to use it. ‘When [the patentee] sells the exclusive privilege of making or vending [the thing patented] for use in a particular place, the purchaser buys a portion of the franchise which the patent confers . . . the interest he acquires necessarily terminates at the time limited for its continuance by the law which created it . . . But the purchaser of the implement or machine for the purpose of using it in the ordinary pursuits of life stands on different ground. In using it, he exercises no rights created by the act of Congress, nor does he derive title to it by virtue of the franchise or exclusive privilege granted to the patentee . . . And when the machine passes to the hands of the purchaser, it is no longer within the limits of the monopoly . . . And if his right to the implement or machine is infringed, he must seek redress in the courts of the State . . . and not . . . under the law of Congress granting the patent.’

The Quanta Court seemed to echo this distinction by referring to the licence restrictions in A B Dick, Bauer & Cie, and Motion Picture Patents as impermissible ‘post sale restrictions’ on purchasers. The Quanta Court also characterized Adams v Burke as a patent holder’s suit alleging that a licensee had violated post-sale restrictions on where patented coffin-lids could be used. In Adams, the licensee was restricted to making and selling the coffin-lids within a ten-mile circle of Boston, but the Court did not mentioned restrictions on the purchaser’s subsequent use. Likewise, in Keeler, the assignee was restricted to making and selling the folding beds in Michigan, but again the Court mentioned no restrictions on the purchaser’s use. In both cases, exhaustion seemed to turn on the fact that the sellers had complied with their geographic restrictions and therefore the sales were authorized, rather than the impermissible nature of post-sale restrictions.

It is not at all clear that there is really a bright-line distinction between restrictions on sale and restrictions on use. For example, restriction on sales into a specific field of use (a restriction on a sale for use) straddles the line between the two types of restrictions. If, for example, the licensee in General Talking Pictures had been authorized to sell amplifiers only to the extent that the purchaser contractually agreed to use the amplifiers in the private field, it would be difficult to place the restriction unequivocally into only one category. Caught in the midst of this inquiry is the Federal Circuit ruling in Mallinckrodt Inc v Medipart Inc. Mallinckrodt, the patent owner, sold its medical devices to hospitals with a ‘single use only’ restriction. Instead of disposing of the devices after the first use, however, the hospitals sent them to Medipart for re-sterilization. The Federal Circuit held that the sale of the device to the hospitals did not exhaust the patent and that violation of the restriction was actionable as patent infringement as long as the sale ‘was validly conditioned under the applicable law such as the law governing sales and licenses, and . . . the restriction on reuse was within the scope of the patent grant or otherwise justified.’

For the purposes of patent exhaustion, it seems unfair that a patentee would be disadvantaged when it sells directly to customers as opposed to indirectly through a licensee. All other things being equal, a blanket statement like that would encourage companies like Mallinckrodt to operate through licensees to avoid the effects of patent exhaustion. Again, though, it is important to point out that the problem in such cases was not merely that there were restrictions on post-sale use of the patented items, but that those restrictions fell far outside the scope of patent rights, and strayed into the realm of patent misuse, involving impermissible tying and price-fixing.

Restrictions on Sale vs Restrictions on Use

The stance post-Quanta is that if there really is a clear distinction between restrictions on sale and restrictions on use, then it seems to follow that while restrictions on sale may be remedied by patent law, restrictions on use may only be remedied through contract law unless those restrictions run up against patent misuse or antitrust principles. Whether or not
there is a fine distinction between restrictions on use versus sale, after Quanta, and in keeping with the prior case law, it may make the most sense to set the following rules: First, if a licence restriction is validly within the scope of patent rights, and the sale of the patented item or component of the patented item is validly restricted, then one can contract around exhaustion and get remedies for patent infringement. Second, if the patent owner fails to reserve his patent infringement remedies would mean that he was not successful in contracting around exhaustion but can still sue for breach of contract; a category that the Quanta case most likely falls into. Finally, if the licence restriction is one that would fall outside the scope of patent rights altogether, then the patent owner cannot contract around exhaustion because it would be patent misuse and there would be no remedies in either patent or contract law.

Patent Monopoly and Doctrine of Exhaustion: International Perspective

Patent rights, like other intellectual property rights, are territorial in nature, which means that each patent provides its owner the exclusive right of exploiting the invention within the limits of the country or countries where the patent was granted. Thus, one single invention could be the object of patent protection in several countries, creating rights that are independent from each other. Article 28 of the TRIPS when read with the Article 6 of the TRIPS Agreement allows each WTO Member to determine its own regime on exhaustion (whether national, regional or international), subject to the national treatment and most favoured nation (MFN) provisions of Articles 3 and 4, respectively, of the Agreement. This means that parallel importation of goods into a country will not be permitted where that country’s legislation provides for national exhaustion. Such importation will be permitted into a country with a regional system of exhaustion in so far as the goods are released in a country of the region by the owner of the patent or with his consent. In a country applying a system of international exhaustion, patented products put on the market by the owner of the patent or with his consent in any country may be imported into that country without constituting an infringement of the patent. It includes among them the ‘right of importation’ because the exclusive right derived from a patent could be affected by the importation of the patented product from another country. Article 28 of the TRIPS Agreement contains a footnote regarding the right to prevent importation, stating that this right, ‘like all other rights conferred under this Agreement in respect of the use, sale, importation or other distribution of goods, is subject to the provisions of Article 6’. This means that the possibility of enforcing the exclusive rights of patents against the importation of legitimate products varies according to the level of exhaustion of rights adopted by the country where the importation takes place.

Exhaustion of Patents: Indian Perspective

The Indian patent regime recognizes international exhaustion; a literal reading of the section suggests that it does not provide for ‘national’ exhaustion. Although the term exhaustion has not been expressly used in the Patents Act, it finds mention in the Statement of Objects and Reasons appended to the Patents (Second Amendment) Bill, 1999, which became the Patents (Amendment) Act, 2002. Further, from the various Parliamentary debates preceding the passage of the Patents (Amendment) Act, 2005 as well as from official press releases in relation thereto, it is clear that Section 107A(b) was aimed at permitting parallel imports and endorsing the principle of international exhaustion. The exhaustion regime in India is developed in terms of territorial limits, it therefore covers trade between nations and is concerned with import and export. Although there are precedents on sale, use and disposal as mode of exploitation of patent monopoly through licensing and assignment, precedent on exhaustion on such issue is wanting.

India applied the doctrine of implied licence to the patent rights pursuant to the Patents Act, 1970. Accordingly, patent rights are exhausted when a patented product is first put on the market outside of India by or with the consent of the Indian patentee, absent some express notice of geographical restriction on sale or export from the market other than India. Unencumbered sale confers on the purchasers of the patented product the right of the unrestricted use and the sale including the right to import the products into India. Prior to the 2002 amendment, there were no express provisions addressing the issue of the exhaustion. The Doha Declaration and the TRIPS Agreement brought the issue of international exhaustion of patent rights and parallel imports into centre stage in the context of availability of affordable medicines.
The underlying theme of the Doha Declaration is reflected in Section 83 of the newly substituted chapter XVI of the Patents Act, through the 2002 amendment. Section 48 of the Patents Act, confers upon the patentee the exclusive right to prevent third parties from the act of making, using, offering for sale, selling or importing for those purposes, the patented product or the product directly obtained by the patented process in India. This grant of exclusivity is subject to Section 107A (b), which provides that importation of the patented products by any person from a person, who is duly authorized by the patentee to sell or distribute the product, shall not be considered infringement. The Patents Act, however does not define consent or proper authorization. It also does not impose any limitation or qualification as to the circumstances under which consent or due authorization is deemed to be given. Further, there is no suggestion of any requirement of special relation governing the exhaustion doctrine, whether by corporate structure or the contractual relationship, such as, licensee, or assignees.

Although no court decision has been issued yet on the scope of the provisions, one can presume that the issue of consent and due authorization will depend upon facts of the individual cases, which in majority may include express authorization either as a written contract or even oral agreement. The consent may also be based on the circumstances of the transaction, such as bulk sale to the retailer or the marketing of a patented product under compulsory licence. Under both circumstances, India would prefer the English precedent wherein a stricter set of the circumstances is necessary to impute exhaustion to the patentee.

The patentee may by virtue of the monopoly grant, prevent exhaustion of the rights in the patented product by placing contractual restrictions prohibiting resale or export of the patented product from the country of the origin. Following the precedent in England, the contractual restrictions are more likely to be enforceable if they are clear and explicit and brought to the notice of the party importing the patented goods. This has been supported by the provisions of the Sales of Goods Act, 1930, which carries an implied guarantee that the buyer shall enjoy undisturbed possession of goods free from all encumbrances not known to the buyer before or at the time of the contract of sale. The burden therefore, in case of exhaustion, would be on the patentee to show that restriction was communicated to the party who acquired the patented product. If the foreign licensee is contractually restricted from exporting the patented product, the patentee would prevent subsequent purchasers without notice to such restraint from importing product into India. The restriction imposed by the patentee to prevent exhaustion is subject to the provisions of the Secion 140 of the Patent Act and the Competition Act of India.

Conclusion

The concept of exhaustion has been developed, particularly, the nature, scope and ambit of the doctrine of patent exhaustion in view of commercial transactions involving licensing, assignment, sale, disposal or offer of disposal of the patented articles. It emerges that those conditions which are within the scope of patent monopoly act as limits to the doctrine of exhaustion of right in the sold goods. The exhaustion of right is in the patented goods and therefore the purchaser has all rights in patented goods except the right to reconstruct. Further, the author is of the view that grant of patent monopoly to making, using, offering for sale, selling, or importing and in the event of their violation, is centered on the infringement remedy which is analogous to the covenants associated with land. Therefore, exhaustion in relation to the import though having international ramifications, should not be the national policy determinant. Consequent to it, the right of exhaustion under the patented goods in terms of interaction between two countries and any restriction on the claim should be treated as non-tariff barrier rather than exhaustion i.e., national, regional, international. The nomenclature appearing in the Article 6 provision appearing in the TRIPS Agreement indeed requires a rethinking.

References

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8 Bauer & Cie v O’Donnell, 229 US, 17 1 (1913), Reasoning that such restrictions were ‘beyond the protection and purpose of the [Patent] Act’.
9 Motion Picture Patents Co v Universal Film Co, 243 US 502, 506 (1917).
10 General Talking Pictures Corp v Western Electric Co, 304 US 175, 181 (1938).
11 Mallinckrodt Inc v Medipart Inc, 976 F.2d, 700 (Fed Cir 1992).
15 Cyrix Corp v Intel Corp, 846 F Supp 522 (ED Tex 1994).
16 Adams v Burke, 84 US (17 Wall) 453 (1873).
18 Mitchell v Hawley, 83 US (16 Wall) 544 (1873).