

Report of United States Group of AIPPI

Question Q205

Exhaustion of IPRs in cases of recycling and repair of goods



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Questions

I. Analysis of the current statutory and case law

1. Exhaustion

In your country, is exhaustion of IPRs provided either in statutory law or under case law with respect to patents, designs, and trademarks? What legal provisions are applicable to exhaustion? What are the conditions under which an exhaustion of IPRs occurs? What are the legal consequences with regard to infringement and the enforcement of IPRs?

Patents: The doctrine of exhaustion of patent rights has no direct statutory origin but rather was developed by the courts and premised on a patentee's basic right to exclude others from making, using, selling, offering to sell, or importing the patented invention. Accused infringers typically raise exhaustion as an affirmative defense in the context of downstream use of a licensed product.¹ Patent exhaustion, though seemingly simple in scope, has proven complex in application.²

In a series of mid-nineteenth century cases, the U.S. Supreme Court initially acknowledged that a patent holder's rights could be exhausted through lawful purchase of the patented product. In *Adams v. Burke*, the Court succinctly noted that when a patentee sells an article "whose sole value is in its use, he receives the consideration for its use and he parts with the right to restrict that use."³ The Supreme Court further defined this concept, also known as the first-sale doctrine, seventy years later in *United States v. Univis Lens Co.*:

¹ See, e.g., *Monsanto Co. v. Scruggs*, 459 F.3d 1328, 1333-36 (Fed. Cir. 2006).

² The answers to questions 1-11 of this section have been prepared in view of the current state of the case law governing the patent-exhaustion doctrine in the United States. Currently, the Supreme Court is reviewing the Federal Circuit's 2006 decision in *LG Electronics, Inc. v. Bizcom, Inc.*, which may significantly affect the patent-exhaustion landscape. The Court's forthcoming decision, *Quanta Computer, Inc. v. LG Electronics, Inc.*, may require amendment of the answers to questions 1-11 to properly reflect any changes in U.S. law.

³ 84 U.S. 453, 456 (1873).

An incident to the purchase of any article, whether patented or unpatented, is the right to use and sell it, and upon familiar principles the authorized sale of an article which is capable of use only in practicing the patent is a relinquishment of the patent monopoly with respect to the article sold.

The full extent of the monopoly is the patentee's . . . "exclusive right to make, use, and vend the invention or discovery." The patentee may surrender his monopoly in whole by the sale of his patent or in part by the sale of an article embodying the invention. His monopoly remains so long as he retains the ownership of the patented article. But sale of it exhausts the monopoly in that article and the patentee may not thereafter, by virtue of his patent, control the use or disposition of the article.⁴

In this seminal case, the defendant, having several patents with claims for finished lenses, manufactured lens blanks, using three types of licensees to finish and distribute the product. The defendant collected a royalty only from the first sale to the first licensee, but attempted to impose price-fixing parameters on the downstream licensees. While the case was appealed based on violations of the Sherman Antitrust Act, the Supreme Court decided the case using principles of patent exhaustion developed in the prior century. The Court remained mindful of the antitrust relationship, declaring, "the patentee cannot control the resale price of patented articles which he has sold, either by resort to an infringement suit, or, consistently with the Sherman Act . . . by stipulating for price maintenance by his vendees." *Id.* at 250. Of great significance was the Court's determination that the lens blanks, sold only to licensees who would finish the product, embodied "essential features" of the patented device:

[W]here one has sold an uncompleted article which, because it *embodies essential features* of his patented invention, is within the protection of his patent, and has destined the article to be finished by the purchaser in conformity to the patent, he has sold his invention so far as it is or may be embodied in that particular article. The reward he was demanded and received is for the article and the invention which it embodies and which his vendee is to practice upon it. He has thus parted with his right to assert the patent monopoly with respect to it and is no longer free to control the price at which it may be sold either in its unfinished or finished form.⁵

The Court ruled that the defendant exhausted its patent rights on its first sale (or, alternatively, the first sale by licensees who manufactured the lens blanks) and could not control later sales. As defined by the Court, the patent-exhaustion doctrine therefore applies not only to the sale of patented articles, but also to the sale of

⁴ 316 U.S. 241, 249-50 (1942).

⁵ *Id.* at 250-51 (emphasis added).

unpatented items having an *essential feature* of the final patented item and no other use except in the final patented item. While the definition of “essential feature” was not clearly stated in *Univis Lens*, the Federal Circuit provided further meaning to this term by stating that a feature of a patent claim that distinguished over the prior art was an essential feature.⁶ In other words, an unpatented article containing this type of feature, when sold, may subject a patented combination or finished product, of which it is a part, to patent exhaustion.

The Federal Circuit has distinguished between apparatus and method claims in the context of patent exhaustion, though such a distinction appears no longer necessary. “The doctrine that the first sale by a patentee of an article embodying his invention exhausts his patent rights in that article . . . is inapplicable here, because the claims of the [patent] are directed to a ‘method of retreading’”⁷ In an ostensibly contradictory statement, the court also declared, “The defense of repair is applicable to process claims, as well as to apparatus claims, when the patented process was used in the United States and the patent right has been exhausted for the articles produced thereby.”⁸ No discernible reason exists to limit the doctrine to apparatus claims.

Although a patentee exhausts his or her rights at the first sale, the exhaustion doctrine is not pertinent unless that sale is unconditional, since “private parties remain free to contract concerning conditions of sale.”⁹ Of course, to be conditional for purposes of the doctrine, any restriction must be lawful, e.g., the conditions cannot violate antitrust laws or constitute other types of patent misuse.¹⁰ As a license is a contract, lawfulness also requires any conditions be subject to applicable laws of contract and include any relevant equitable considerations.¹¹ Any condition must also be expressly set forth.¹²

While licenses containing restrictions that violate laws or equitable considerations are not enforceable, violations of valid license conditions allow the patentee to seek action for patent infringement or breach of contract.¹³ In sum, an express condition is enforceable through contract as a patent right as long as it is lawful, e.g., does not violate antitrust provisions or broaden the patent scope “with anticompetitive effect.”¹⁴ Any restriction of competition so scrutinized by the court will be subject to the rule of reason.¹⁵ While an action for patent infringement lies within the federal courts’ exclusive jurisdiction, licenses are enforced through an individual state’s contract laws at the state level, unless diversity of citizenship gives rise to federal jurisdiction.

⁶ *Cyrix Corp. v. Intel Corp.*, 846 F. Supp. 522, 534 (E.D. Tex. 1994), aff’d, 42 F.3d 1411 (Fed. Cir. 1994).

⁷ *Bandag, Inc. v. Al Bolser’s Tires Stores, Inc.*, 750 F.2d 903, 924 (Fed. Cir. 1984).

⁸ *Jazz Photo Corp. v. Int’l Trade Comm’n*, 264 F.3d 1094, 1108 (Fed. Cir. 2001).

⁹ *Mallinckrodt, Inc. v. Medipart, Inc.*, 976 F.2d 700, 708 (Fed. Cir. 1992).

¹⁰ *Id.*

¹¹ *B. Braun Med., Inc. v. Abbott Labs., Inc.*, 124 F.3d 1419, 1426 (Fed. Cir. 1997).

¹² *Id.*

¹³ *Id.*

¹⁴ *Id.*

¹⁵ *Mallinckrodt*, 976 F.2d at 708.

Concerning design patents, the Federal Circuit has declared, “[T]he principle of exhaustion applies to the design patents as well as to the utility patents. The design patent right, like all patent rights, is exhausted by unrestricted first sale in the United States, and is not infringed by the importation and resale of the repaired articles in their original design.”¹⁶ Thus, the doctrine of patent exhaustion is equally applicable to design patents.

Trademarks: The Trademark Act of 1946 (the “Lanham Act”)¹⁷ contains no reference to the principle of exhaustion. Rather, exhaustion is a concept derived from case law and applied by the courts, typically raised as a defense in claims of trademark infringement in which the defendant has resold or distributed a genuine good bearing the trademark of another.¹⁸ A defendant's successful application of the exhaustion rule depends on whether the goods in question are genuine; at its most basic level, the exhaustion rule permits the resale of genuine branded goods without liability for trademark infringement. Within this context, the word “genuine” is a term of art. Proper use of this term requires an examination of (1) whether the trademark owner had adequate control over the goods before their entry in the market and (2) whether the goods were materially different from other goods sold under the same mark. Where a defendant accused of trademark infringement can establish that the goods it resold are “genuine,” such defendant will escape liability.

Adequate premarket control

Branded goods will not be found genuine, and thus the exhaustion rule will not apply, where the trademark owner was unable to exert adequate control over the goods before their entry in the market. This situation may arise where a trademark owner's manufacturer has distributed marked goods without authorization.¹⁹ Under these circumstances, “the actual quality of the goods is irrelevant: it is the control of quality that a trademark holder is entitled to maintain.”²⁰ A trademark owner is free to prohibit goods from entering the marketplace for any reason or no reason at all. Thus, branded goods manufactured in excess of the number authorized by the mark owner²¹ that have not been inspected by the mark owner²² or that were authorized only for sale abroad²³ will not be found genuine where an alleged infringer has engaged in the sale of these types of goods.

¹⁶ *Jazz Photo*, 264 F.3d at 1110.

¹⁷ 15 U.S.C. §1051, et seq.

¹⁸ The exhaustion rule is also referred to as the “first-sale doctrine” because of its similarity in principle to the first-sale doctrine of copyright law. First proclaimed in *Bobbs-Merrill v. Straus*, 210 U.S. 339 (1908), copyright law's first-sale doctrine provides that after the first sale of a lawfully made copy of a copyrighted work, any subsequent owner of that copy may sell or dispose of it in any way without incurring liability for copyright infringement. The doctrine was ultimately codified at 17 U.S.C. §§109(a), 109(d).

¹⁹ See, e.g., *El Greco Leather Products Company v. Shoe World, Inc.*, 806 F.2d 392 (2d Cir. 1986).

²⁰ *Id.* at 395.

²¹ *Too, Inc. v. TJX Companies, Inc.*, 229 F. Supp. 2d 825 (S.D. Ohio 2002).

²² *Ford Motor Co. v. Cook*, 25 U.S.P.Q.2d 1050 (N.D. Ill. 1992), aff'd, 53 F.3d 333 (7th Cir. 1995) (unpublished); see also J. Thomas McCarthy, *McCarthy on Trademarks and Unfair Competition*, § 25:42 (4th ed. 2007) (hereinafter “*McCarthy*”) (discussing *Ford Motor Co. v. Cook*).

²³ *Abercrombie & Fitch v. Fashion Shops of Kentucky, Inc.*, 363 F.Supp.2d 952 (S.D. Ohio 2005).

Not materially different

Where a trademarked item has already been placed in the stream of commerce subject to adequate control by the trademark owner, the inquiry turns to one of quality: Were the branded goods that were resold by the defendant materially different from when they were originally sold by the trademark owner? The exhaustion rule will not serve as a valid defense to the unauthorized repackaging, reconstruction, or other alteration of goods by a distributor.²⁴ Such unauthorized actions by a distributor could create mistake and deception as to who should be held accountable for the changes to the goods. If the goods being resold are materially different from when the trademark owner authorized their introduction to the market, then they are not "genuine" and the alleged infringer cannot raise the exhaustion rule as a defense to a claim of trademark infringement.²⁵ Not all differences under this inquiry will be material. "To be material, a difference must be one that consumers consider relevant to a decision about whether to purchase a product."²⁶ The key to this inquiry is whether a consumer would be confused about whether the trademark owner or the reseller was responsible for the material difference. If the consumer would tend to be confused, then the branded good is not "genuine" and the exhaustion doctrine is unavailable to the alleged infringer.

Adequate notice of a material difference will prevent likelihood of confusion

Notwithstanding the above, a defendant that resells materially different items may do so if he or she provides adequate notice of the difference so as to avoid such difference being attributed to the mark owner. The seminal case on this issue held that "when [a] mark is used in a way that does not deceive the public [there is] no such sanctity in the word as to prevent its being used to tell the truth."²⁷ Thus, in that case the defendant was not liable for trademark infringement where the defendant disclosed on its product's label that the plaintiff's trademarked product was a component of the defendant's final product.

Similarly, the U.S. Supreme Court has also "held that where a trademarked product is repaired or reconditioned, the trademark can be retained on the product so long as the fact of the repair and used status of the product is clearly, distinctly, and permanently marked on the product itself as well as on the packaging."²⁸ Such disclosure "gives the [original] manufacturer all the protection to which he is entitled" and adequately prevents consumer mistake or confusion.²⁹

2. International or national exhaustion

²⁴ *McCarthy* § 25:41.

²⁵ *Id.* § 25:42.

²⁶ *Brilliance Audio, Inc. v. Hights Cross Communications, Inc.*, 474 F.3d 365, 370 (6th Cir. 2007) (citing *Davidoff & CIE, S.A. v. PLD*, 263 F.3d 1297, 1303 (11th Cir. 2001) ("The question of materiality is a fact-based inquiry requiring an examination of the products and markets at issue.")).

²⁷ *Prestonettes, Inc. v. Coty*, 264 U.S. 359, 368 (1924).

²⁸ *McCarthy* § 25:39 (discussing *Champion Spark Plug Co. v. Sanders*, 331 U.S. 125, 130 (1947)).

²⁹ *Champion Spark Plug Co. v. Sanders*, 331 U.S. 125, 130 (1947).

Does the law in your country apply international exhaustion for patents, designs, or trademarks? If yes, are there any additional conditions for international exhaustion compared to regional or national exhaustion, such as lack of marking on products that they are designated only for sale in a specific region or country or the non-existence of any contractual restrictions on dealers not to export products out of a certain region? What is the effect of breach of contractual restrictions by a purchaser?

If your law does not apply international exhaustion, is there regional exhaustion or is exhaustion limited to the territory of your country?

In case your country applies regional or national exhaustion, who has the burden of proof regarding the origin of the products and other prerequisites for exhaustion and to what extent?

Patents: *United States law does not recognize a doctrine of international exhaustion. With respect to foreign activity, “[t]he patentee’s authorization of an international first sale does not affect exhaustion of that patentee’s rights in the United States.”*³⁰ *In Fuji Photo Film Co. v. Jazz Photo Corp., the court noted that “foreign sales can never occur under a United States patent because the United States patent system does not provide for extraterritorial effect.”*³¹ *Concurring with its previous line of cases, the Federal Circuit reiterated that “[t]he affirmative defense of repair only applies to products whose patent rights have been exhausted through a first sale in the United States.”*³² *Court precedent is clear that the patent-exhaustion doctrine, if it applies, does so only to activity within the United States. In addition, once a patented product is sold lawfully in the United States, any subsequent purchaser benefits from any patent exhaustion realized at the original sale.*³³

The burden of establishing an affirmative defense lies with the party who raised it.³⁴ To satisfy this burden, that party must establish the defense by a preponderance of the evidence.³⁵

Trademarks: *The United States ostensibly applies international exhaustion with regard to trademarks in that the "Lanham Act § 42 is not a basis to prevent parallel imports.”*³⁶ *Several courts have held “[t]he plain language of the statute does not bar importation if the goods are genuine”*³⁷ *In general, goods may be imported if they emanate from an affiliate company of the brand owner and the goods do not differ*

³⁰ *Fuji Photo Film Co. v. Jazz Photo Corp.*, 394 F.3d 1368, 1376 (Fed. Cir. 2005).

³¹ *Id.*

³² *Fuji Photo Film Co., Ltd. v. Int’l Trade Comm’n*, 474 F.3d 1281, 1293 (Fed. Cir. 2007).

³³ *Jazz Photo Corp. v. Int’l Trade Comm’n*, 264 F.3d at 1105.

³⁴ *Id.* at 1102.

³⁵ *See id.*

³⁶ *McCarthy* § 29:50.50.

³⁷ *Id.* § 29:50.50 (quoting *Olympus Corp. v. United States*, 792 F.2d 315 (2d Cir. 1986)).

materially from those marketed in the United States. As noted earlier, goods that are materially different from those sold (or licensed for sale) under the same mark in the United States are not considered genuine. Material differences have been found to exist in parallel imports based upon: differences in packaging;³⁸ differences in ingredients or formulation;³⁹ and the use of instructions, warranty cards, or other product related documents printed in a language other than English.⁴⁰

Note that material differences may be found to exist even in cases where both goods (the one made for the U.S. market and the import) are manufactured by the U.S. trademark owner or its affiliate and thus otherwise seemingly "genuine." That is, "when the trademark is applied to physically different goods, the [parallel import] is not 'genuine' from the viewpoint of the American consumer"⁴¹ In such cases, the U.S. trademark owner may request the exclusion of such goods from entry into the U.S. market unless the parallel imports are clearly labeled to inform consumers of the material differences between the import and those manufactured for the U.S. market.⁴²

The Tariff Act: An Exception to International Trademark Exhaustion

Section 526(a) of the United States Tariff Act presents a limited exception to international trademark exhaustion. The Act makes it "unlawful to import into the United States any merchandise of *foreign manufacture*, bear[ing] a trademark *owned by a citizen* of, or by a corporation or association created or organized within, the United States, *and registered* in the Patent and Trademark Office"⁴³ As indicated above, however, the restriction does not apply to a parallel good that was manufactured abroad by an affiliate of the trademark owner *unless* such parallel good is both materially different from its U.S. market counterpart *and* lacks labeling sufficient to alert consumers to the material differences.

License Restrictions: An Exception to International Trademark Exhaustion

The Second Circuit has observed that "a distributor's failure to observe a restrictive condition on the type of class of customers with whom it may deal can constitute trademark infringement."⁴⁴ For example, where a product has been packaged only for professional users and is sold to the general public by a distributor, the distributor is liable for trademark infringement under the theory that its unauthorized sales expose the trademark owner to product-liability suits by consumers that were never intended to use the product.⁴⁵ The concern is that consumers buying professional-use goods will mistakenly believe they are purchasing home-use products

³⁸ *Societe Des Produits Nestle, SA v. Casa Helvetica, Inc.*, 982 F.2d 633 (1st. Cir. 1992).

³⁹ *Id.*

⁴⁰ *Original Appalachian Artworks, Inc. v. Granada Electronics, Inc.*, 816 F.2d 68 (2d Cir. 1987).

⁴¹ *McCarthy* § 29:50.50, note 5 (citing *Lever Bros. Co. v. United States*, 981 F.2d 1330 (D.C. Cir 1993)).

⁴² *Id.*

⁴³ 19 U.S.C. §1526(c) (*emphasis added*).

⁴⁴ *Polymer Technology Corp. v. Mimran*, 97 F.2d 58 (2d Cir. 1992), after remand, 37 F.3d 74 (2d Cir. 1994).

⁴⁵ *Clairol, Inc. v. Boston Discount Center, Inc.*, 608 F.2d 1114 (6th Cir. 1979).

they associate with the trademark owner.⁴⁶ However, as noted above, where the products are in fact physically identical, it has been held that the unauthorized sale of a genuine product in a retail outlet that the manufacturer has not approved does not *per se* deceive consumers about what they are receiving and thus no trademark infringement liability can be found.⁴⁷

The Ninth Circuit has held that an express condition may be imposed by a trademark owner on a buyer of goods as to the terms and scope of resale. But the condition will bind only the parties to the original transaction; the condition does not "run with the goods," and thus does not bind downstream buyers who had no notice of the condition.⁴⁸ Further, if a party does resell a genuine (or appropriately labeled) good in violation of the condition, the trademark owner's remedy will be based on breach of contract, not trademark infringement.

The holder of a registered mark has a civil cause of action against anyone using an imitation of it in commerce when "such use is likely to cause confusion, or to cause mistake, or to deceive."⁴⁹ The burden of proving likelihood of confusion rests with the plaintiff. "If a plaintiff succeeds in making out a prima facie case of trademark infringement, including the element of likelihood of consumer confusion, the defendant may offer rebutting evidence to undercut the force of the plaintiff's evidence on [any] element, or raise an affirmative defense to bar relief even if the prima facie case is sound, or do both [A]ll the defendant needs to do is to leave the factfinder unpersuaded that the plaintiff has carried its own burden"⁵⁰ Under this rubric, it could be said that there is *per se* no likelihood of consumer confusion where exhaustion applies. Thus, a defendant successfully arguing the exhaustion doctrine will negate the likelihood of confusion element that a plaintiff must prove in a trademark-infringement suit.

3. Implied License

Does the theory of implied license have any place in the laws of your country? If so, what differences should be noted between the two concepts of exhaustion and implied license?

Patents: The theory of implied license may arise in some circumstances when the patentee sells a nonpatented product that can be used to practice a patented invention. To determine whether the sale of a product carries with it an implied license to practice the patented invention, courts must determine that "the equipment involved [has] no non-infringing uses" and that "the circumstances of the sale . . . plainly indicate

⁴⁶ *Id.*

⁴⁷ *Matrix Essentials, Inc. v. Emporium Drug Mart, Inc.*, 988 F.2d 587 (5th Cir. 1993) ("We are not persuaded by Matrix's arguments to expand the reach of section 1125(a) to provide a cause of action merely for the unauthorized stocking and sale of a manufacturer's products.").

⁴⁸ *McCarthy* §25:47; *Denbicare U.S.A. v. Toys "R" Us*, 84 F.3d 1143 (9th Cir. 1996) (court injunction limiting resale to nations other than the U.S. and Canada does not bind downstream buyers with no notice of the injunction).

⁴⁹ 15 U.S.C. § 1114(1)(a).

⁵⁰ *KP Permanent Make-Up, Inc. v. Lasting Impression I, Inc.*, 543 U.S. 111, 120 (2004).

that the grant of a license should be inferred.”⁵¹ Once the court determines that an implied license exists, it must then “look further to the circumstances of the sale to determine the scope of the implied license.”⁵²

When a patentee fails to place express restrictions on the use of a nonpatented product sold to a customer, the customer is then “free to use it for its intended purpose to practice the [claimed] invention.”⁵³ Moreover, after obtaining an implied license, the customer is also free to use equipment obtained from third parties in conjunction with the non-patented product purchased from the patentee to practice the patented invention.⁵⁴ Otherwise, the product purchased from the patentee would be worthless because it would have no other use.⁵⁵

The implied license, however, may be limited in scope by the nonpatented product sold by the patentee. For example, in *Carborundum*, the Federal Circuit limited the scope of an implied license to the lifetime of the non-patented product sold by the patentee.⁵⁶ In these circumstances, the court held that “[t]he limitation [in the implied license] is inherent in the nature of the product that is sold, in this case a component, not the entire apparatus.”⁵⁷

The doctrine of exhaustion, by contrast, applies when “an authorized sale of a patented product places that product beyond the reach of the patent.”⁵⁸ According to the court, “[T]he unrestricted sale of a patented article, by or with the authority of the patentee, ‘exhausts’ the patentee’s right to control further sale and use of that article by enforcing the patent under which it was first sold.”⁵⁹ Further, “when a patented device has been lawfully sold in the United States, subsequent purchasers inherit the same immunity under doctrine of patent exhaustion.”⁶⁰

Trademarks: “Some [U.S.] courts will imply both a trademark license and a requirement for quality control from the dealings of the parties”⁶¹ For example, in *University Book Store v. University of Wisconsin Board of Regents*,⁶² a license to use the University’s mascot mark was found to exist based upon informal, implied grants allowing nearby “stores to sell apparel with the mascot on it when the quality of the apparel remained at an acceptable level.”⁶³ It follows therefore, that, as with an express license, the conditions and restrictions placed on a licensee via an implied license may

⁵¹ *Carborundum Co. v. Molten Metal Equip. Innovations Inc.*, 37 U.S.P.Q.2d 1169, 1172 (Fed. Cir. 1995).

⁵² *Id.*

⁵³ *Id.* at 1173.

⁵⁴ *Id.*

⁵⁵ *Id.*

⁵⁶ *Id.* at 1174.

⁵⁷ *Id.*

⁵⁸ *Intel Corp. v. ULSI Sys. Tech., Inc.*, 27 U.S.P.Q.2d 1136, 1138 (Fed. Cir. 1993).

⁵⁹ *Jazz Photo Corp. v. United States*, 78 U.S.P.Q.2d 1180, 1186 (Fed. Cir. 2006).

⁶⁰ *Id.*

⁶¹ *McCarthy* § 18:43.50.

⁶² 33 U.S.P.Q.2d 1385 (T.T.A.B. 1994).

⁶³ *McCarthy* § 18:43.50 (citing *University Book Store*, 33 U.S.P.Q.2d at 1396).

prohibit further sales or distributions that would otherwise be permissible under the exhaustion theory.

It should be noted, however, that in the context of the exhaustion theory, the significance of restrictions contained in a license (be it express or implied) is highly dependent on the subject matter of the license. For example, unlike patent law, which indicates that the breach of a "restriction on reuse . . . may be remedied by action for patent infringement,"⁶⁴ under copyright law, the "exclusive right to vend the transferred copy rests with the vendee, who is not restricted by statute from further transfers of that copy, even though in breach of an agreement restricting its sale . . . [and the vendee] may be liable for the breach but he is not guilty of infringement."⁶⁵

At least one U.S. court has opined that there is no authority to suggest that "trademark's 'first sale' doctrine should be made to conform to patent law, rather than to copyright law,"⁶⁶ the outcome being "that conditions placed on a first sale do not run with the goods."⁶⁷

4. Repair of products protected by patents or designs

Under what conditions is a repair of patented or design-protected products permitted under your national law? What factors should be considered and weighed? Does your law provide for a specific definition of the term "repair" in this context?

Once an article is purchased with no lawful restrictions, the owner may do with it as he or she pleases, with no fewer rights than the purchaser of an unpatented article, absent one. "[T]he rights of ownership do not include the right to construct an essentially new article on the template of the original, for the right to make the article remains with the patentee."⁶⁸ Although reconstruction is not permitted, an owner may repair a purchased article, since ownership includes "the right to preserve the useful life of the original article."⁶⁹ In practice, the repair/reconstruction distinction is not always obvious, although the Supreme Court originally formulated a test in *Aro Manufacturing Co. v. Convertible Top Replacement Co.*:

The decisions of this Court require the conclusion that reconstruction of a patented entity, comprised of unpatented elements, is limited to such a true reconstruction of the entity as to "in fact make a new article," [T]o call the monopoly . . . into play for a second time, it must, indeed, be a second creation of the patented entity Mere replacement of

⁶⁴ *Mallinckrodt, Inc. v. Medipart, Inc.*, 976 F.2d 700 (Fed. Cir. 1992).

⁶⁵ *United States v. Wise*, 550 F.2d 1180, 1187 (9th Cir.), *cert. denied*, 434 U.S. 929 (1977).

⁶⁶ *Denbicare U.S.A. v. Toys "R" Us*, 84 F.3d 1143 (9th Cir. 1996) citing *American Int'l Pictures, Inc. v. Foreman*, 576 F.2d 661, 664 (5th Cir. 1978); *Wise*, 550 F.2d 1180.

⁶⁷ *Denbicare*, 84 F.3d 1143 (9th Cir. 1996).

⁶⁸ *Jazz Photo Corp. v. Int'l Trade Comm'n*, 264 F.3d 1094, 1102 (Fed. Cir. 2001).

⁶⁹ *Id.*

individual unpatented parts, one at a time, whether of the same part repeatedly or different parts successively, is no more than the lawful right of the owner to repair his property.⁷⁰

This distinction between repair and reconstruction, while critical to discerning lawful activity, remains blurry when actually applied, depending wholly on the particular facts of a situation, i.e., what is commonly referred to as the “totality of the circumstances.”⁷¹ For example, Federal Circuit decisions have cited, among other things, reapplication of a nonstick coating to a cooking device, replacement of an inner container for medical waste, modification of unused printer cartridges, and replacement of disks in a tomato harvester all as permissible repair.⁷² On the other hand, when a patented drill bit could no longer be resharpened, the court held the construction of an entirely new *cutting tip* of the bit to be reconstruction.⁷³

Timing of any type of replacement will not itself turn repair into reconstruction, as, “nothing in law prevents a purchaser of a device from prematurely repairing it or replacing an unpatented component.”⁷⁴ Neither will the frequency of replacement.⁷⁵

Indeed, while Supreme Court case law has never detailed an accepted list of factors for determining whether an activity is permissible repair or infringing reconstruction, the Federal Circuit has recognized a common thread running through prior cases. The *Jazz Photo* court cited precedent for identifying repair as “the disassembly and cleaning of patented articles accompanied by replacement of unpatented parts that had become worn or spent, in order to preserve the utility for which the article was originally intended,”⁷⁶ and further recognized that “consideration of the remaining useful capacity of the article, and the nature and role of the replaced parts in achieving that useful capacity” is significant to repair.⁷⁷ More specifically, “The replacement of unpatented parts, having a shorter life than is available from the combination as a whole, is characteristic of repair, not reconstruction.”⁷⁸ “At a minimum, repair exists if the part being repaired is a readily replaceable part.”⁷⁹ The Federal Circuit has additionally noted that simple reuse of a part, without replacement, is neither repair nor reconstruction.⁸⁰

⁷⁰ 365 U.S. 336, 346 (1961).

⁷¹ *Jazz Photo Corp.*, 264 F.3d at 1107.

⁷² *Id.* at 1104 (citations omitted).

⁷³ *Id.* (citing *Sandvik Aktiebolag v. E.J. Co.*, 121 F.3d 669 (Fed. Cir. 1997)).

⁷⁴ *Kendall Co. v. Progressive Med. Tech., Inc.*, 85 F.3d 1570, 1575 (Fed. Cir. 1996).

⁷⁵ *Aro Mfg.*, 365 U.S. at 346.

⁷⁶ 264 F.3d at 1103-1104.

⁷⁷ *Id.* at 1106.

⁷⁸ *Id.* at 1107.

⁷⁹ *Husky Injection Molding Systems v. R & D Tool Engineering Co.*, 291 F.3d 780, 787 (Fed. Cir. 2002).

⁸⁰ *Jazz Photo*, 264 F.3d at 1107.

The use of a patented part for replacement will violate a separate patent for that part and, if not expressly allowed, would impose liability for direct infringement.⁸¹ In addition, if the original patented entity being repaired is itself unauthorized (i.e., not an exhausted right), the use of any replacement part will be unauthorized repair, and the supplier of that part risks a suit for indirect infringement.⁸² As the Supreme Court noted in *Univis Lens*, “We may assume also . . . that sale of the blanks by an unlicensed manufacturer to an unlicensed finisher for their completion would constitute contributory infringement by the seller.”⁸³ On the other hand, “[b]oth an alleged direct infringer and an alleged contributory infringer benefit from the permissible repair exception.”⁸⁴ Certainly, lawful repair can be an effective affirmative defense to a charge of infringement once exhaustion of the patent right is established.

5. Recycling of products protected by patents or designs

Under what conditions is a recycling of patented or design-protected products permitted under your national law? What factors should be considered and weighed? Does your law provide for a specific definition of the term “recycling” in this context?

“Recycling” as a defined term is not specifically identified in the context of repair and reconstruction. It will lie somewhere within the spectrum bookended by repair and reconstruction, but, like those two concepts, cannot be determined without knowledge of specifics. For example, in *Jazz Photo*, a case with facts not outside the bounds of what could traditionally be called recycling, the appellants imported “single-use” cameras that were “refurbished” overseas. The refurbishers removed the cardboard cover, opened the camera body, modified the film cartridge for insertion, reset the film counter, replaced the battery, wound new film, resealed the body, and applied a new cardboard cover.⁸⁵ Although the International Trade Commission adopted the administrative law judge’s findings that this was a reconstruction, and therefore prohibited, the Federal Circuit decided otherwise.⁸⁶ Because the changes made to the camera related to film replacement, the refurbished camera otherwise remained “as originally sold” and was characterized as repaired.⁸⁷ Of significant note, the court did not recognize the patentee’s intention that the camera not be reused, as stated in the patent specification. Instead, the court declared, “[T]he patentee’s unilateral intent, without more, does not bar reuse of the patented article, or convert repair into reconstruction.”⁸⁸ Recycling, while not described per se, should be analyzed within established limits of repair and reconstruction, described above.

⁸¹ See, e.g., *Porter v. Farmers Supply Serv., Inc.*, 617 F. Supp. 1175, 1186 (D. Del. 1985), *aff’d*, 790 F.2d 882 (Fed. Cir. 1986).

⁸² *Aro Mfg. Co. v. Convertible Top Replacement Co.*, 377 U.S. 476, 485-87 (1964).

⁸³ 316 U.S. at 249.

⁸⁴ *Husky Injection*, 291 F.3d at 784.

⁸⁵ 264 F.3d at 1101.

⁸⁶ *Id.* at 1105.

⁸⁷ *Id.* at 1106-07.

⁸⁸ *Id.*

6. Products bearing trademarks

Concerning the repair or recycling of products such as reuse of articles with a protected trademark, has your national law or practice established specific principles? Are there any special issues or case law that govern the exhaustion of trademark rights in your country in case of repair or recycling?

For the purposes of the U.S. trademark exhaustion doctrine, repair or recycling refers only to changes to or refurbishment of the goods. Claims of infringement based on changes to the actual mark, whether intentional or as a byproduct of the repair process, continue to be analyzed under the traditional likelihood-of-confusion test.⁸⁹

A trademark owner's ability to enforce its rights in a genuine branded product is exhausted after the first legitimate sale of that product. Thus, with respect to repair or recycling, subsequent owners of the branded product are essentially free to use that product in any way they see fit so long as the use does not cause confusion among consumers. The seminal case on repairing and reconditioning goods in the United States is the 1947 *Champion Spark Plug* case.⁹⁰ In that case, the defendant collected used *Champion* spark plugs, repaired and reconditioned them, and sold them under the *Champion* mark. The U.S. Supreme Court held that where a trademarked product is repaired, restored, or reconditioned into an operable condition, the trademark can be retained on the product so long as the fact of the repaired and used status of the item is clearly, distinctly, and permanently marked on the product itself as well as on the packaging.⁹¹ Since then, lower courts have commented on the intersection of trademark protection and the reuse of goods. "For used or refurbished goods, customers . . . do not expect the product to be in the same condition as a new product . . . For used or refurbished products, consumers are not likely to be confused by—and indeed expect—differences in the goods compared to new, unused goods."⁹² The key to repaired and refurbished products is whether the consumer can readily distinguish between a new and used product. It is worth noting that the obligation to disclose the reconditioning is triggered merely by the reconditioner's retaining the original label bearing the original manufacturer's trademark.

There are limits to the rule announced by *Champion*, however. The Supreme Court in that case indicated that a different result may have been reached had the repair or reconditioning been so extensive that it would be false and misleading to keep the original trademark on the changed product, despite the use of the word "used" or "repaired." In other words, the extensive nature of the repair would render it a complete misnomer to even call the article a used version of the original. The Ninth Circuit has

⁸⁹ *McCarthy* 25:40 citing: *Intel Corp. v. Terabyte Int'l*, 6 F.3d 614 (9th Cir 1993) (altering the trademark on a computer chip to suggest faster performance created "a likelihood of confusion, mistake or deception as to the grade or capacity of the product.") and *Adobe Systems Inc. v. One Stop Micro, Inc.*, 84 F. Supp. 2d 1086 (N.D. Cal 2000) (sales of "repackaged and de-labeled versions" of plaintiff's software were deemed to be trademark infringement).

⁹⁰ *Champion Spark Plug Co.*, 331 U.S. 125 (1947).

⁹¹ *Id.* at 130.

⁹² *Nitro Leisure Products, L.L.C. v. Acushnet Co.*, 341 F.3d 1356, 1362 (Fed. Cir. 2003).

held that if the substance of the repair or rebuild involved the construction of a different product associated with the original trademark, then there can be trademark infringement.⁹³ Watch reconstruction cases exemplify this point. In *Bulova Watch Co. v. Allerton Co.*, the defendant placed a Bulova watching movement mechanism in a new casing and used the Bulova mark on the watch dial.⁹⁴ The court found that the new watch no longer constituted a Bulova watch and enjoined the defendant from using the Bulova mark. The extensive changes noted under the repair and reconditioning cases relate to the "not materially different" test under the exhaustion doctrine generally. To restate the general rule, exhaustion will be applied only to the resale of genuine goods. The items described above would simply not constitute genuine goods.

7. IPR owners' intention and contractual restrictions

- a. *In determining whether recycling or repair of a patented product is permissible or not, does the express intention of the IPR owner play any role? For example, is it considered meaningful for the purpose of preventing the exhaustion of patent rights to have a marking stating that the product is to be used only once and disposed or returned after one-time use?***

The express intention of the IPR owner may play a role in determining whether recycle or repair is permissible. For example, U.S. courts have held that a patentee may impose a one-time use restriction on a patented item as long as the purchasers of the item are placed on notice of the restriction and have an opportunity to reject it.⁹⁵

- b. *What would be condition for such kind of intentions to be considered?***

To be considered, the patentee should place the purchasers of the item on notice of the restriction and give the purchaser an opportunity to reject it.⁹⁶

- c. *How decisive are other contractual restrictions in determining whether repair or recycling is permissible? For example, if a license agreement restricts the territory where a licensee can sell or ship products, a patentee may stop sale or shipment of those products by third parties outside the designated territory based on his patents. What would be the conditions for such restrictions to be valid?***

⁹³ *Karl Storz Endoscopy America, Inc. v. Surgical Technologies, Inc.*, 285 F.3d 848 (9th Cir. 2002) (quotation marks omitted).

⁹⁴ *Bulova Watch Co. v. Allerton Co.*, 328 F.2d 20 (7th Cir. 1964).

⁹⁵ See *Mallinckrodt, Inc. v. Medipart, Inc.*, 976 F.2d 700, 707 n.6 (Fed. Cir. 1992); see also *Arizona Cartridge Remanufacturers Assoc. Inc. v. Lexmark Int'l Inc.*, 68 U.S.P.Q.2d 1786, 1793 (N.D. Cal. 2003).

⁹⁶ See *Arizona Cartridge Remanufacturers Assoc. Inc. v. Lexmark Int'l Inc.*, 68 U.S.P.Q.2d 1786, 1793 (N.D. Cal. 2003).

To be valid, such restrictions may not constitute patent misuse. According to U.S. courts, a patent grant allows a patentee to engage in what might otherwise be considered as anticompetitive practices, as an incentive for disclosing the invention to the public.⁹⁷ A patentee, though, may not impermissibly broaden the scope of the patent grant with anticompetitive effect.

As part of the patent grant, a patentee may further place restrictions on the use of a patented product. For these restrictions to be valid, however, the anticompetitive effects of the restrictions must relate to the subject matter within the scope of the patent claims.⁹⁸ Thus, courts uphold restrictions having anticompetitive effects that relate to the subject matter of the patent claims.

If, however, an anticompetitive effect does not relate to the patent, courts must further analyze the restriction to rule on its validity. Some restrictions, such as “tying” arrangements, have been held to constitute patent misuse. Restrictions that are not considered *per se* violations are judged under the rule of reason. Under this analysis, “the finder of fact must decide whether the questioned practice imposes an unreasonable restraint on competition, taking into account a variety of factors, including specific information about the relevant business, its condition before and after the restraint was imposed, and the restraint’s history, nature, and effect.”⁹⁹ If a restriction is not considered a *per se* violation and it survives analysis under the rule of reason, then it does not violate the antitrust laws or constitute patent misuse.

d. Are there any other objective criteria that play a role besides or instead of factors such as the patentee’s intention or contractual restrictions?

Any contractual restriction must not violate the doctrine of patent misuse or constitute an antitrust violation. See the answer to question 7(c).

e. How does the situation and legal assessment [re: the effect of an IPR owner’s express intention on the permissibility or recycling or repair of a product] differ in the case of designs or trademarks?

See response to question 3.

8. Antitrust considerations

According to your national law, do antitrust considerations play any role in allowing third parties to recycle or repair products which are patented or protected by designs or which bear trademarks.

⁹⁷ See *Mallinckrodt, Inc. v. Medipart, Inc.*, 976 F.2d 700, 708 (Fed. Cir. 1992); see also *Monsanto Co. v. McFarling*, 363 F.3d 1336, 1343 (Fed. Cir. 2004).

⁹⁸ See *Mallinckrodt*, 976 F.2d at 708.

⁹⁹ *Virginia Panel Corp. v. Mac Panel Co.*, 133 F.3d 860, 869 (Fed. Cir. 1997).

Patents: U.S. courts may consider U.S. antitrust laws when deciding whether a patentee can place restrictions on allowing a third party to recycle or repair a product. An antitrust ruling depends on whether a patent has violated the doctrine of patent misuse. If a patentee's restrictions on the recycle or repair of a patented object do not rise to the level of patent misuse, then these same actions cannot violate U.S. antitrust laws.¹⁰⁰ By contrast, if the patentee's restrictions do violate the doctrine of patent misuse, then these same restrictions may violate U.S. antitrust law, but a court would have to analyze the restrictions under U.S. antitrust laws, which require "more exacting proof than suffices to demonstrate patent misuse."¹⁰¹ For example, antitrust violations require a party to show intent to monopolize on the part of the patentee, market power in a relevant market by the patentee, and damages attributable to the patentee's alleged antitrust violations.¹⁰² In summary, while restrictions that do not violate the doctrine of patent misuse also do not violate U.S. antitrust laws, restrictions that do run afoul of patent misuse *may* also violate U.S. antitrust laws. A separate analysis must be performed to determine if an antitrust violation has occurred. Please see section 7(c) for a discussion of the patent-misuse doctrine.

Trademark: Although agreements involving trademarks are common, and even favored under the law, these agreements must still be valid under U.S. antitrust laws. Unlike patent law, in which courts may rely on the doctrine of patent misuse, trademark law does not have a broadly accepted doctrine of trademark misuse. Instead, antitrust violations using trademarks are determined using the well-accepted tests to determine antitrust violations.

A contract involving trademarks may violate U.S. antitrust laws in two ways, either by being an unreasonable restraint on trade or by constituting an unlawful attempt to create a monopoly. To determine if a contract involving trademarks is an unreasonable restraint of trade in violation of § 1 of the Sherman Act, a court must engage in a two-part analysis. First, the court must determine if the contract by the trademark holder is one that courts have condemned as an unreasonable restraint on trade.¹⁰³ Second, if the contract is not a *per se* restraint on trade, a court must then apply the rule of reason to the contract to determine "if the restraints in the agreement are reasonable in light of their actual effects on the market and their procompetitive justifications."¹⁰⁴ A contract will be held valid only if it passes both these tests. Similarly, to hold that a contract involving a trademark is an unlawful attempt to monopolize, a court must find that the trademark holder has monopoly power and that the trademark holder engaged in "a willful acquisition or maintenance of that power as distinguished from growth or development as a consequence of a superior product, business acumen, or historic accident."¹⁰⁵ Thus, a contract involving the recycle or

¹⁰⁰ See *Virginia Panel Corp. v. Mac Panel Corp.*, 133 F.3d 860, 873 (Fed. Cir. 1997).

¹⁰¹ *Id.*

¹⁰² *Id.*

¹⁰³ See *Clorox Co. v. Sterling Winthrop, Inc.*, 117 F.3d 50, 55-56 (2d Cir. 1997).

¹⁰⁴ *Id.*

¹⁰⁵ *Id.* at 61.

repair of a trademarked product may violate U.S. antitrust laws if the contract meets either the unreasonable-restraint-on-trade test or the monopolization test.

9. Other factors to be considered

In the opinion of your Group, what factors, besides those mentioned in the Discussion section above, should be considered in order to reach a good policy balance between appropriate IP protection and public interest?

Courts and policymakers should keep in mind the overall rationale behind IP rights to reach a policy balance between appropriate IP protection and the public interest. The United States enacted a patent and copyright system “to promote the Progress of Science and useful Arts.”¹⁰⁶ Thus, instead of using a natural-rights foundation in which IP rights inure naturally to an inventor or creator, the United States based its IP system on the idea that IP rights create a socially beneficial stimulus for the development of new technologies. Although the United States creates this stimulus by providing an exclusive right for authors and inventors, the method used within an IP system, be it patents, copyrights, or trademarks, should not transcend the overall goals of that system. Accordingly, to reach a good policy balance when enacting IP protection, policymakers should ensure that society receives an overall benefit from granting IP rights to authors and inventors.

10. Interface with copyrights or unfair competition

While the present Question is limited to patents, designs, and trademarks as noted in the Introduction above, does your Group have any comments with respect to the relationship between patent or design protection and copyrights or between trademarks and unfair competition relative to exhaustion and the repair and recycling of goods?

Unlike patent exhaustion, exhaustion of copyright is embodied within the United States Code. Specifically, § 109(a) of the Copyright Law provides:

Notwithstanding the provisions of section 106(3), the owner of a particular copy or phonorecord lawfully made under this title, or any person authorized by such owner, is entitled, without the authority of the copyright owner, to sell or otherwise dispose of the possession of that copy or phonorecord.¹⁰⁷

Section 106(3), referenced above, gives the copyright owner the exclusive right to sell or transfer ownership of copyrighted work. More commonly known as the first-sale

¹⁰⁶ U.S. Const., § 8, clause 8.

¹⁰⁷ 17 U.S.C. § 109(a).

doctrine, § 109(a) parallels the fundamental premise of patent exhaustion. One of the first cases to address this concept prior to enactment of § 109(a) was *Bobbs-Merrill Co. v. Straus*, in which the Supreme Court declared, “one who has sold a copyrighted article, without restriction, has parted with all right to control the sale of it.”¹⁰⁸ Akin to patent exhaustion, in which a purchaser of a patented product can sell but not make (i.e., reconstruct), a purchaser of a copyrighted work can sell but not copy (subject to the fair use provision of §107 of the U.S. copyright act).

In determining whether a first sale has occurred, the U.S. Court of Appeals for the Second Circuit analogized copyrights directly to patents, stating, “the ultimate question embodied in the ‘first sale’ doctrine—‘whether or not there has been such a disposition of the article that it may fairly be said that the patentee (or copyright proprietor) has received his reward for the use of the article . . . is answered in the affirmative.”¹⁰⁹

As with U.S. patent law, whoever, without authority, imports a copyrighted work acquired outside the United States, is an infringer.¹¹⁰ However, importers typically cannot use the first-sale doctrine as a defense to an infringement charge even if the copyrighted material was *lawfully* made overseas. As one court noted, in order to avoid rendering § 602(a) meaningless, “[t]he words ‘lawfully made under this title’ in § 109(a) grant first sale protection only to copies legally made and sold in the United States.”¹¹¹ In order not to penalize purchasers who bought copyrighted material lawfully made overseas and imported with authorization from the copyright owner, the Ninth Circuit subsequently held that § 109(a) applies to copies legally made outside the United States *only if* the copies were sold in the United States by the authority of the copyright owner.¹¹² In addition, if the copyrighted work was first made in the United States, sold abroad, and then imported back into the United States, the first-sale doctrine will apply as an infringement defense.¹¹³

Certain prohibitions exist within the context of the first-sale doctrine on an owner’s right to dispose of that property. Under 17 U.S.C. § 109(b), owners of phonorecords and owners of copies of computer programs cannot, without authority, rent, lease, or lend the phonorecord for “commercial advantage.” The Sixth Circuit has interpreted “phonorecord” under this section to mean a sound recording of a musical work only, excluding audiobooks and similar works.¹¹⁴ A few minor exceptions do exist under this provision directed primarily to nonprofit situations, as well as to the use of certain computer programs embodied in particular products in which the computer programs cannot be copied during normal operation.

¹⁰⁸ 210 U.S. 339, 350 (1908).

¹⁰⁹ *Platt & Munk Co. v. Republic Graphics, Inc.*, 315 F.2d 847, 854 (2d Cir. 1963) (citing *United States v. Masonite Corp.*, 316 U.S. 265, 278 (1942)).

¹¹⁰ 17 U.S.C. § 602(a).

¹¹¹ *BMG Music v. Perez*, 952 F.2d 318, 319 (9th Cir. 1991), *cert. denied*, 505 U.S. 1206 (1992).

¹¹² *Denbicare U.S.A., Inc. v. Toys “R” Us, Inc.*, 84 F.3d 1143, 1150 (9th Cir. 1996), *cert. denied*, 519 U.S. 873 (1996).

¹¹³ *Quality King Distrib. v. L’Anza Research Int’l, Inc.*, 523 U.S. 135 (1998).

¹¹⁴ *Brilliance Audio, Inc. v. Hights Cross Commc’n, Inc.*, 474 F.3d 365, 372 (6th Cir. 2007).

Contrasted with patent law, the concepts of repair and recycling are not as prevalent within the expressions protected by copyright. Computer programs, however, present an interesting issue concerning “repair” of software code. 17 U.S.C. § 117(a) allows the owner of a copy of a computer program to make an “adaptation” of that program if it is created as an “essential step” in using that program in a machine. This follows logically since a copyright owner has the exclusive right to prepare derivative works.¹¹⁵ Courts, at least for purposes of § 117, have ruled that adaptations made to allow the use of a computer program for which it was purchased are “essential” and therefore not infringing.¹¹⁶ These adaptations include not only fixes to inherent program bugs but the addition of features to enhance functioning.¹¹⁷ The correlation of this type of “repair” with repairs of patented items is not exact since mere bug fixes to a computer program change that program in a way that likely does more than “preserve utility” in the patent sense. Regardless, § 117(b) only allows transferral of these adaptations with the authorization of the copyright owner. In essence, a “repair” and subsequent sale of a computer program is not allowed under U.S. copyright law without prior authorization, the first-sale doctrine notwithstanding. With the doctrine of patent exhaustion, however, not only is a repair of a patented article purchased with no lawful restrictions allowed, but the purchaser, may, of course, dispose of the article at will. Moreover, a purchaser of a patented item who “improves” that item may be able to obtain patent protection on the improvement, with no prior authorization of the original patent owner required at any stage of the process.

11. Additional issues

In the opinion of your Group, what would be further existing problems associated with recycling and repair of IPR-protected products which have not been touched by these Working Guidelines?

In the United States, “famous marks” enjoy additional protections under the 2006 revised version of the Federal Dilution Act.¹¹⁸ In relevant part, this federal legislation provides a remedy to the owner of a famous and distinctive mark “subject to the principles of equity.”¹¹⁹ The owner of such a mark may seek injunctive relief “against

¹¹⁵ 17 U.S.C. § 106(2).

¹¹⁶ *Krause v. Titleserv, Inc.*, 402 F.3d 119, 125-129 (2d Cir. 2005).

¹¹⁷ *Id.*

¹¹⁸ Pub. L. 109-312, § 2, 120 Stat. 1730 (effective Oct. 6, 2006). This piece of legislation is sometimes referred to as the Trademark Dilution Revision Act (“TDRA”) because it revises and further clarifies federal trademark dilutions legislation that was passed in 1996. The impetus for the 2006 revision was the U.S. Supreme Court case *Mosely v. V Secret Catalogue, Inc.*, 537 U.S. 418 (2003). In that case, the U.S. Supreme Court held that violation of the 1996 federal antidilution law required a finding of actual dilution to the famous mark. Unhappy with this result, the International Trademark Association worked on revisions to the statute to make clear that a trademark owner need only establish a likelihood of dilution to succeed on a trademark dilution claim. The 2006 revision also expressly recognizes that dilution may occur by both blurring and tarnishment to the protected mark. See McCarthy § 24:96. It also should be noted that there is currently a split between the 2nd and 9th Circuit Courts of Appeal in the U.S. as to whether U.S. law protects famous/well-known marks that have not been used in the U.S.

¹¹⁹ 15 U.S.C. § 1125(c).

another person who . . . commences use of a mark or trade name in commerce that is likely to cause dilution by blurring¹²⁰ or dilution by tarnishment¹²¹ of the famous mark, regardless of the presence or absence of actual or likely confusion, of competition, or of actual economic injury."¹²² Whether a mark is famous—and thus may enjoy the protections afforded by this legislation—depends on the extent to which the mark is recognized by the public.¹²³ Notwithstanding the foregoing, the Federal Dilution Act includes exclusions from this cause of action for fair use, news reporting, and noncommercial uses.¹²⁴

Within the context of the recycling and reuse of trademarked goods, the owner of a famous mark could plausibly argue that the reconditioning or recycling of its marked goods is likely to cause dilution by blurring.¹²⁵ While there has yet to be a case under this theory, dilution remains an interesting concept to bear in mind. The argument could be made that even if extensive reconditioning or refurbishing of genuine marked goods is not found to cause confusion among consumers, such reconditioning or refurbishment could nonetheless dilute the goodwill associated with that trademark. While this argument sounds enticing, such a cause of action would likely be unsuccessful, as a dilution cause of action per se involves two different (but similar) trademarks. In cases of restoring and reconditioning goods, on the other hand, the mark is simply retained from one generation of the goods to another, so that there is really only one trademark at issue. The trademark owner would essentially have to argue that the mark was diluting his or her own mark.

II. Proposals for uniform rules

1. *What should be the conditions under which patent rights, design rights and trademark rights are exhausted in cases of repair and recycling of goods?*

Any discussion of repair and recycling of patented articles must begin with the existence of patent exhaustion. Without complete exhaustion of rights, repair of a patented article may not be lawful, that repair likely falling squarely within the original patent right. Once patent rights are exhausted, the question of repair becomes applicable.

Patent exhaustion as a general policy serves the goals of the patent system in that the patent holder receives just compensation for selling a patented article—a full royalty for each complete article sold, no more, no less. Compensation for such inventive activity exemplifies any patent system's policy of creating incentives for

¹²⁰ "Dilution by blurring" is association arising from the similarity between a mark or trade name and a famous mark that impairs the distinctiveness of the famous mark. 15 U.S.C. § 1125(c)(2)(B).

¹²¹ "Dilution by tarnishment" is association arising from the similarity between a mark or trade name and a famous mark that harms the reputation of the famous mark. 15 U.S.C. § 1125(c)(2)(C).

¹²² 15 U.S.C. § 1125(c)(1).

¹²³ See 15 U.S.C. § 1125(c)(2).

¹²⁴ See 15 U.S.C. § 1125(c)(3).

¹²⁵ See McCarthy's § 24:99 (setting forth the elements of a prima facie case for dilution by blurring).

technological progress. While the consumer may be restricted in the rights to a patented invention, without the incentives the patent system created, that invention may never have come to fruition. Further inuring to consumers' benefit, the exhaustion doctrine allows purchasers, who have now paid for a property right, to exercise that right as they could with any other type of personal property, freeing up the flow of goods in an economy based on market demands. As a result, exhaustion removes at least some uncertainty from the purchaser, enhancing technological trade and commerce and increasing market efficiency.

These goals are easily and clearly met with the sale of a patented article. But these goals are also met if the article sold, while not separately patented, does indeed embody the same essential features of a patented combination (i.e., the patentably indistinct features¹²⁶). The unpatented article, because it *is not* patentably distinct from the actual patented combination, "represents" the patented combination for practical purposes. Again, the patent holder is compensated and purchasers can exercise unhindered control of their personal property. On the other hand, the right to use one patented invention does not imply the right to use another, so the sale of a patented article that *is* patentably distinct from a patented combination (i.e., two separate patents) should not exhaust the rights of the patentee to the patented combination, since a patent holder may recover two separate royalties for two separate patents. In other words, the patentee should be able to collect a full royalty for each patentably distinct invention. In this scenario, while the patented article is exhausted, the patented combination is not.

Limitations at the time of sale on the use of a patented article are permissible because a buyer and seller retain the right to contract the conditions of sale. These contract rights should be upheld if freely entered into by a willing buyer and seller. For example, an unpatented article that embodies an essential feature of a combination claim and therefore has no noninfringing use, could be restricted in sale or license with respect to the number or type of use, which is reflected in the royalty paid. As long as some rights are retained by the patentee, the purchaser cannot have full rights and the patent is not exhausted. As these retained rights typically concern the right to use, the right to repair is correspondingly affected. Restricting use rights is perfectly acceptable because those rights lie within the original rights granted by the patent. The restriction of the right to sell, in contrast, frequently manifests itself in a restriction on price (e.g., price-fixing) or includes tying arrangements, and a somewhat more circumspect approach may be necessary since these restrictions arguably fall outside the original right to exclude sale. But the fundamental contention still holds, and, for example, some semblance of tying is allowed under U.S. law.¹²⁷

With this in mind, any purchase that results in exhaustion of a patent right should allow the purchaser to repair that article to the extent necessary to preserve its useful life. A personal property holder, absent restriction, should be allowed to maximize the

¹²⁶ See John W. Osborne, *A Coherent View of Patent Exhaustion: A Standard Based on Patentable Distinctiveness*, 20 Santa Clara Computer & High Tech. L.J. 643, 654-658 (2004).

¹²⁷ 35 U.S.C. § 271(d).

utility of the article purchased. If the patentee has given up the right to use and dispose of the patented article sold, that right fully transfers to the purchaser.

Concerning foreign sales, the logical premise is that the first sale, if it is to exhaust a country's patent rights, must take place within that country. As foreign sales are not covered by U.S. patent law, a patent holder should be able to obtain a royalty under a foreign patent and, for the same product, require a license before importation or sale domestically under a corresponding domestic patent. For example, if a purchaser from the United States purchases a patented article outside the U.S. and brings it back to the U.S. expecting the U.S. rights to be exhausted, that purchaser benefits from an exhaustion of rights to which he or she was never subject. A home country's patent rights are greatly diminished if a patentee cannot exclude importation into, or sale within, that country by virtue of a sale abroad. This is certainly true if the sale abroad is unauthorized, but even if the patentee has obtained patent protection and licensed the product in another country, the corresponding domestic patent would be meaningless if a foreign sale precluded the use of the domestically obtained rights. Paralleling the "patentably distinct" analysis above for an international setting, the patentee should be able to obtain value for each patent obtained (each patent being patentably distinct by virtue not necessarily of subject matter, but of separate sovereigns), even for a single article purchased.

2. *Should the repair and the recycling of goods be allowed under the concept of an implied license?*

As discussed above in question 1, the restriction of use rights is perfectly acceptable because those rights lie within the original rights granted by the patent. By extension, when the patentee makes an unrestricted sale of the patented item, the purchaser should be allowed to repair the article to the extent necessary to preserve its useful life. Thus, the unrestricted sale carries with it an implied license for the purchaser to make needed repairs to the purchased item.

3. *Where and how should a line be drawn between permissible recycling, repair and reuse of IP-protected products against prohibited reconstruction or infringement of patents, designs and trademarks?*

The difference between repair and reconstruction lies in the fact that repair *preserves* useful life, whereas reconstruction *creates* the article anew. Even if the personal-property rights have been exhausted by a sale, the patent holder always retains the right to make the article (unless a separate exclusive license has been granted for this purpose). It is this distinction between preserving personal property and creating new property that defines when "repair" is a proper defense to an infringement claim.

4. *What effect should the intent of the IPR holders and contractual restrictions have on the exhaustion of IPRs with respect to recycling and repair of protected goods?*

As discussed in the answer of the first question of this section, limitations at the time of sale on the use of a patented article are permissible because a buyer and seller retain the right to contract to the conditions of sale. These contractual rights, including restrictions on the exhaustion of IP rights, should be upheld if freely entered into by a willing buyer and seller.

5. *Should antitrust issues be considered specifically in cases or repair or recycling of goods? If so, to what extent and under which conditions?*

Antitrust issues should not be considered for cases of repair or recycling of patented goods because the restriction of use rights lies within the patent grant. Accordingly, the patent system provides what may be considered an exception to the antitrust laws by allowing a patentee to restrict the repair or recycling of goods.

As noted above in answering question 8, trademark rights are not as extensive as patent rights. Accordingly, trademark rights should not prevent antitrust laws from being applied to cases of repair or recycling of trademarked goods.

6. *The Groups are invited to suggest any further issues that should be the subject of future harmonization concerning recycling, repair, and reuse of IP protected products.*

Future efforts of harmonization could focus on the question of international exhaustion of IP protected goods. Although each nation has an interest in promoting technological progress and protecting its citizens, national exhaustion can have the effect of impeding global trade and international travel by restricting the shipment of goods between countries. An international exhaustion scheme has the potential to promote international trade by allowing a company to pay for a patented item once, and then use or sell that item in whichever country would provide the greatest profit. However, under an international exhaustion regime, the potential also would exist for a country, into which a patentee may wish to sell its patented products, to impose price restrictions and/or compulsory licensing, resulting in patented products being placed on the local market at artificially low prices. Price differentials might also result from manufacturers voluntarily lowering their selling prices in certain low income nations in order that they might be able to serve the local market at some level, as contrasted with not selling their products there at all. Either contingency might result in sufficiently low prices that the conditions for arbitrage would be created, allowing purchasers of the patented product to resell it in a "full-price" country that did not have such restrictions, undercutting the patentee's ability to sell at more reasonable higher prices in such countries.

Although a patentee could attempt to rely on geographical field-of-use licenses to avoid exhaustion, the use of such licenses may not be an acceptable answer to the underlying problems that could arise from an international exhaustion regime. It is possible that such licenses may not be acceptable or enforceable in many countries around the world.

7. Based on answers to items 1 to 6 above, the Groups are also invited to provide their opinions about how future harmonization should be achieved.

If international exhaustion is to be explored, it should probably be approached in the context of an international treaty. Implementing international exhaustion as a part of an international treaty may allow multiple nations to reach a consensus on the desirable scope of international exhaustion, and on other mechanisms to prevent the type of problems discussed in answer to question 6, above. Such an effort also could lead to the further improvement of intellectual property laws on a national level.

SUMMARY

***Patent Summary:** Courts in the United States apply a doctrine of patent exhaustion on a national level. Once a U.S. patentee sells a patented item, or an item manufactured by a patented process, the patentee exhausts its rights to that item. According to U.S. courts, a patentee receives a right to exclude others from making, using, selling, offering to sell, or importing the patented product. The patentee surrenders this exclusive right by the unrestricted sale of the patented item. Under U.S. law, a patentee may make a restricted, or conditional, sale of a patented item. Any restriction, however, must be lawful under U.S. antitrust laws.*

Under U.S. law, a party that makes an unrestricted purchase of a patented item obtains the right to repair it to preserve its the useful life. The right to repair, however, does not carry with it the right to construct an essentially new item using the old item as a blueprint. Although U.S. courts have not always made clear the dichotomy between allowed repair and infringing reconstruction, the U.S. Supreme Court has formulated a test to determine if an action is repair or reconstruction. According to the Court, a reconstruction occurs when a party makes a second creation of the patented item. By contrast, lawful repair may include the replacement, one at a time, of unpatented components of a patented item to allow the continued operation of the patented item.

Finally, a court may infer that a patentee has granted a license to practice a patented invention when the patentee sells nonpatented equipment that can be used to practice the invention. To determine whether the sale of a product carries with it an implied license to practice the patented invention, courts must determine that the equipment involved has no noninfringing uses and that the circumstances of the sale plainly indicate that the grant of a license should be inferred. Once the court determines that an implied license exists, it must then look further to the circumstances of the sale to determine the scope of the implied license.

Trademark Summary: *The United States applies a doctrine of trademark exhaustion on an international level. Thus, once a U.S. trademark owner sells a good bearing the mark in one territory, the trademark owner's rights to that particular good are exhausted in all territories. The justification for this concept of trademark exhaustion is that trademark rights exist primarily to benefit consumers by preventing confusion about the source or origin of a given product. It follows, therefore, that exhaustion applies only to those goods that either are genuine (i.e. have not been materially altered from the state in which the mark owner first introduced them to market) or have been permanently labeled to inform consumers about the material differences between the product in its altered state and as originally sold by the trademark owner.*

A trademark owner can rely on a contract to prevent the exhaustion of his or her rights. But such contractual limits, if contravened, allow the mark's owner to seek a remedy for breach of contract only. A breach of such provisions will not form the basis for a claim of trademark infringement, and contractual limitations will not run to third parties with subsequent sales of the goods. Notwithstanding the above, where a distributor is contractually bound to distribute certain goods to a particular class of consumers, such distributor may be liable to the mark owner for trademark infringement if breach of this contractual obligation would also cause harm to the goodwill associated with the trademark.

The international aspects of U.S. trademark exhaustion are subject to certain limits imposed by section 526(a) of the United States Tariff Act. This law blocks the importation of foreign-made goods bearing a registered U.S. trademark belonging to a U.S. citizen unless the goods are manufactured by an affiliate of the mark owner and sufficiently labeled to show any material differences between the foreign good and those manufactured for the U.S. market.