

Exhaustion of rights? When is a purchaser's implied licence not a licence?

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On 5 July 2019, the Full Court of the Federal Court of Australia (**Full Court**) handed down its judgment in the appeal and cross-appeal in *Calidad Pty Ltd v Seiko Epson Corporation* [2019] FCAFC 115. The judgment considers in-depth the extent to which a patentee can:

1. prevent those who have acquired title to a patented product (either the first buyer or a subsequent buyer) from manipulating or "repurposing" the patented product for subsequent sale; and
2. prevent entities from importing and selling such "repurposed products" in Australia.

The Full Court found that the implied licence did not extend to allowing purchasers to perform acts that amount to "making" a patented product. In coming to this conclusion, the Full Court made some notable pronouncements on the scope of the implied licence.

The original Epson cartridges vs Calidad's "repurposed" cartridges

The case involved Seiko Epson Corporation's (**Seiko**) "EPSON" branded printer cartridges that embodied the invention in two Australian Patents (**Seiko Patents**).

After original consumers had purchased, used and discarded the original Epson cartridges, third parties including Ninestar Image (Malaysia) (**Ninestar**) would obtain the cartridges and modify them so that they could be refilled with ink and resold.

The modification process followed by Ninestar involved roughly four steps:

1. preparation - determining the suitability of the cartridge for restoration, emptying, cleaning and removing the seal covering the outlet hole for the ink created by its first use;
2. refilling - of the cartridge with ink, which involved creating a new hole to refill the cartridge and sealing the new hole and the original outlet hole;
3. memory replacement / reprogramming - of the cartridge's memory chip to reset the ink level to full and change the cartridge status to unused; and
4. research and development work - to make alterations to the content of the memory chip to ensure that the cartridge could be used.

In this case, Ninestar modified the original Epson cartridges to produce "repurposed" cartridge products that were imported into Australia and sold by Calidad Distributors Pty Ltd (**Calidad**). Seiko contended that Calidad infringed the Seiko Patents by importing, offering for sale and selling the repurposed cartridges that embodied the essential integers of claim 1 of the two Seiko Patents.

In reply, Calidad contended that Seiko had released the original Epson cartridges "on the market" and, upon their sale, Seiko authorised, or should be taken to have authorised, any purchaser or subsequent owner of the cartridges to treat them as an "ordinary chattel" to deal with as they saw fit, and that the exhaustion of rights doctrine meant that any dealing with the cartridges could not infringe.

Calidad's submissions referred to the Privy Council's decision in *National Phonograph Company of Australia Limited v Menck* (1911) 12 CLR 15 (**Menck**), the relevant principles of which were as follows:

1. the general doctrine is that an owner/purchaser of patented goods has absolute freedom to use or dispose of them as he or she thinks fit, subject to any restrictions which the owner/purchaser may have agreed with the vendor;
2. a patentee may place restrictions on how a purchaser can deal with its patented products only if the purchaser has knowledge of the restrictions, and that knowledge is clearly brought home to the purchaser, at the time of sale; and
3. in the case of a resale, a subsequent purchaser may be presumed to have the full right of ownership unless the patentee's restrictions have been brought home to him or her at the time of sale. It is not sufficient that the ultimate purchaser may know of the patent and its application to the goods acquired. There must be actual knowledge of the limitations imposed by the patentee at the time of the sale.

Seeking to apply *Menck*, Calidad contended that:

1. Seiko did not place any restrictions on the buyers of its Epson cartridges at the time of sale such that they would be prevented from repurposing the products, and its rights were thus totally exhausted;
2. Seiko thus had no ability to prevent Ninestar refilling and modifying the original Epson cartridges; and
3. Calidad's import and sale of the repurposed cartridges in Australia came within the "umbrella" of the implied licence from the patentee.

Did Calidad have an implied licence to import the "repurposed" products?

The Full Court unanimously rejected Calidad's arguments even though it accepted Calidad's contention that Seiko had not placed any restrictions on the patented goods to prevent "repurposing". However, the Full Court found that the implied licence to purchasers, in the absence of any restrictions, only allows purchasers to perform some acts of exploitation, namely to:

"hire, sell, otherwise dispose of the product, offer to sell, hire or otherwise dispose of it, use or import it, or keep it for the purpose of doing any of those things"

The implied licence did not provide purchasers with the right to "make" a product that fell within the claims, even though the definition of "exploit" in Schedule 1 of the *Patents Act 1990* (**Patents Act**) includes the right to "make" the product. So the implied licence arising after the first sale of a patented product is only a limited licence to use, and does not extend to full exploitation of the patents in question.

Justice Jagot's reasons summarised the position as follows:

"The implied licence arising on Seiko's unrestricted sale of the printer cartridges did not extend to any of the modifications necessary to enable the cartridges to be re-used. The modifications did not amount to the repair of any cartridge. Rather, in each case, the totality of the modifications constituted the making of a new embodiment of the invention claimed in the patents, being conduct outside the scope of the licence implied by Seiko's act of sale without express restrictions brought to the notice of the original purchasers of the cartridges at the time of sale"

It followed that Calidad's importation of the "repurposed" cartridges was outside of the scope of the implied licence and infringed Seiko's exclusive rights. The Full Court held that the implied licence extended only to those rights consistent with "ownership" of a patented product, and that once Calidad undertook "material modifications" to "make" a new embodiment of a claimed invention (e.g. creating a new injection hole, resealing holes, resetting memory chips and substituting memory chips), the conduct fell outside the implied licence to use, or to repair. For example, Justice Jagot's views on the refilling step was as follows:

"Nor do I see how it could be concluded the implied licence ... could be thought to extend to re-purposing the cartridge once it was empty of ink by creating a new injection hole for ink to enable the cartridge to be re-filled and sealing the original and new holes so the cartridge ... was made into a new material container. That is not a use of the patented article as sold at all; it is the making of a new article within the scope of the patent."

These re-purposing modifications seem relatively immaterial as it is clearly the same cartridge that Calidad used to refill and reset (and in two categories, replace memory chips). It seems something of a stretch to find that such actions lead to the creation of a new product.

In our view, this decision is a significant departure from established authority, including *Menck*, *Betts v Willmott* [1871] 6 Ch App 239 and the obiter discussion by the High Court of Australia in *Interstate Parcel Express Co. Pty Ltd v Time-Life International (Netherlands) B.V.* (1977) 138 CLR 534 (**Time Life**). In *Time Life* (a copyright case) Stephen J noted that the implied licence under the Patents Act only arises:

"because of the special nature of the monopoly accorded to the patentee; the licence, whether absolute or qualified, which arises upon such a sale is attributable to the existence and character of that monopoly. Absent that monopoly, peculiar to patents, there is no occasion for any licence."

The parties appear to have agreed that the implied licence does not extend across the breadth of the patentee's right to exploit the patented invention. It is difficult to reconcile this position with Justice Stephen's statement that the licence attaches to the monopoly granted under the Patents Act and derives from that monopoly.

As foreshadowed by the parties, perhaps it is time for the High Court to decide whether the exhaustion of rights doctrine is alive and kicking in Australia.