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# Parallel Imports of Patented Goods: TRIPS and Indian Law

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# PARALLEL IMPORTS AND EXHAUSTION OF RIGHTS

Parallel imports take place when a product is imported into a country by a third party without the authorization of the IP title holder or his licensees in those cases where the product has been lawfully put on the market anywhere else in the world. The importation by the third party parallels the importation by the IP title holder or his licensee. Parallel trade does not refer to unofficial, illegal, or informal-sector activities that may take place inside a country or among countries. Parallel trade is not trade in pirated or counterfeit products. The latter are unauthorized versions of products that infringe an IP right. Parallel imports (also called gray-market imports) are genuine, often branded, products that do not violate an IP right. Importing the products from one country to another, however, may not be authorized by the right holder.

Parallel imports involve two doctrinal players, they are first sale and exhaustion.[1] Exhaustion means the consumption of rights in intellectual property subject matter as a consequence of the legitimate transfer of the title in the tangible article that incorporates or bears the intellectual property asset in question. Exhaustion takes place due to the event of first sale occurred in the tangible asset. Exhaustion, therefore, is a natural consequence of the intangible nature of the assets covered by intellectual property, such as expressions, knowledge, reputation, quality, origin. Because of their intangible nature, they do not follow the tangible article with which they are associated[2]. Thus, these intangible IP right to exclude is limited by the doctrine of exhaustion of rights.

After first sale whether the movement of the tangible asset could be regulated by the IP holder is the main issue. If first sale marks the exhaustion of IP rights internationally then free movement of goods without barrier of boundaries become possible. In *Jack Walters,* [3]the United States Court of Appeals for Seventh Circuit held that in the absence of exhaustion every time if a car owner wished to resell his used car, he would have to request a license from the car maker and this would lead to an absurd situation of implying automatic compulsory licenses. Without an exhaustion doctrine IPR holders would perpetually exercise control over the sale, transfer or use of the relevant good, and would have a grip on commercial relations[4]. Exhaustion takes place with regard to distribution right of

[1] Frederick M. Abbott, *Parallel Importation: Economic and Social Welfare Dimensions*, (2007).
[2] *Interface Between Exhaustion Of Intellectual Property Rights And Competition Law,* CDIP/4/4 Rev./Study/Inf/2, (June 1, 2011)
[3] *Jack Walters & Sons Corp. v. Morton Building, Inc.*, 737 F.2d 698, 704 (7th Cir. 1984)
[4] UNCTAD/ICTSD, TRIPS and Development Resource Book, (2005).

the IP holder[5]. If these rights are retained the IP holder will be able to regulate movement of that tangible good over which some other person have legitimate right using his intangible interest. Then, the IP right owner will be able to charge for subsequent sale of the goods which would be unjustified. Patent or trademark registrations give their owner the exclusive right to exploit an intangible asset (e.g. an invention, a fancy trademark or a work of art), but not the physical goods incorporating that asset, which can therefore be freely resold[6]. In an early UK case it was held that "where a man has purchased an article he expects to have control of it, and there must be some clear and explicit agreement to the contrary to justify the vendor in saying that he has not given the purchaser his license to sell the article or to use it wherever he pleases as against himself."[7]

An author of a novel publishes it as a book is entitled to produce and sell copies of the book in the market these copies which are already sold are free to circulate with changes in ownership of the physical copies. He cannot regulate resale or control distribution of those copies which are already in circulation in the market. The author can prohibit third parties from copying or printing and selling his book as he has copyright over the novel but he cannot prevent a lawfully acquired copy from being resold. The overall purpose of exhaustion regimes is therefore to strike and maintain a balance between a public interest (i.e. free movement of innovative goods) and the private interest of IPR owners (i.e. remuneration for their creative and artistic efforts).[8] However, the doctrine of exhaustion is circumscribed by the following factors:

i) "Exhaustion" kicks in only if the "first sale" is made by or with the authorisation of the patentee.

ii) "Exhaustion" in relation to a particular patented article does not impact the patentee's other exclusive rights. Nor does it affect the patentee's rights with respect to "other" patented articles. In other words, the buyer of a patented article, in respect of which the patent right has been exhausted does not get the right to "sell" or "distribute" "other" patented articles that she has not purchased.[9]

There are three types of exhaustion of rights geographically which affects parallel importation.

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[5] This principle is also commonly referred as the "first sale doctrine", a doctrine which *"…stands for the proposition that, absent unusual circumstances, courts infer that a patent owner has given up the right to exclude concerning a patented article that the owner sells." S*ee *Glass Equipment Development Inc*. v. *Besten Inc*., 174 F.3d 1337 as quoted in Words and Phrases (Permanent Edition Vol. 17), "First Sale".

[6] N. Pires De Carvalho, *The TRIPS Regime of Patent Rights*.

[7] *Betts v Willmott*, (1871).

[8] M. Slotboom, *The Exhaustion of Intellectual Property Rights - Different Approaches in EC and WTO Law*, Vol. 6 Part 3 Journal of World Intellectual P property, (2003).

[9] *US* v. *Moore*, 604 F. 2d 1228

National Exhaustion - holds that the exclusive rights of IP right holders over protected products cease after the first sale of the product within national borders. It is also referred to as the first sale doctrine.
Regional Exhaustion- The exclusive rights of IP right holders over protected products cease after the first sale in the regional market.
International Exhaustion- Right holders' exclusive rights over protected products cease after the first sale in any market.

The different exhaustion regimes have varied implications on parallel importation. In the case of national exhaustion, right-holders can block parallel imports from entering the local market, even though their rights are exhausted in that market. When the regime is one of regional exhaustion, parallel trade is allowed within a group of countries, but right holders can ban parallel imports from countries outside the region. In countries following international exhaustion, right holders cannot exclude parallel imports from entering the local market because their rights with respect to that market are exhausted.

Parallel imports reduce prices and encourage foreign title holders to establish themselves locally in order to monitor the market and adjust business strategies to changing conditions.[10] Parallel importation is but a natural fallout of mechanisms like price differentials and market segmentation deployed by the IPR holders to maximize their profits.

## EXHAUSTION OF RIGHTS AND TRIPS

Article 6 of the TRIPS Agreement deals with the exhaustion of intellectual property rights.[11]Article 6 simply excludes the dispute settlement mechanism under the agreement to address the issue of exhaustion of IPRs, so long as the provisions of national treatment and MFN treatment under Article 3 and 4 are complied with. The members were not able to reach a concise to follow national or international exhaustion in negotiations and such a stand was taken. It does not say that Members are restricted in their choice of exhaustion policies. This can be interpreted to mean that parallel imports are legal thus freeing the movement of goods and services in international

[10] J H Reichman, Implications of the Draft TRIPS Agreement for Developing Countries as Competitors in an Integrated World Market (*1993*)

11 Article 6 -For the purposes of dispute settlement under this Agreement, subject to the provisions of Articles 3 and 4 nothing in this Agreement shall be used to address the issue of the exhaustion of intellectual property rights.

trade. But it cannot be considered ad an absolute freedom because in case of any issue with regard to exhaustion a member country cannot approach WTO dispute settlement authority as of right.

Article 28[12] of TRIPS grants patent holders the right to prevent third parties from importing patent protected goods without their consent. But the footnote 6 to Article 28 indicates that the right of importation granted to patent holders under Article 28 may not be used to address the subject matter of exhaustion in dispute settlement under TRIPS[13]. In other words, no Member may be challenged in the WTO for adopting an international exhaustion rule based on the word "import" in Article 28[14]. This can be maintained as allowing international exhaustion and thus parallel imports.

All doubts whether Article 6 prevented nations from adopting their own policies and rules on the subject of exhaustion of IPRs was firmly eliminated by paragraph 5(d) of the Doha Declaration on the TRIPS Agreement and Public Health.[15]Some authors also raise the question that whether disallowing parallel trade in goods which are legitimately placed in the market by the right holder, amounts to double protection for owners of IPRs, if the principle of international exhaustion is not applied in the context of restriction over anti-competitive practices under Article 40.[16]

Reading this entire together one could interpret that TRIPs agreement is not against international exhaustion.

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12 Article 28

1. A patent shall confer on its owner the following exclusive rights:(a) where the subject matter of a patent is a product, to prevent third parties not having the owner's consent from the acts of: making, using, offering for sale, selling, or importing, for these purposes that product;(b) where the subject matter of a patent is a process, to prevent third parties not having the owner's consent from the act of using the process, and from the acts of: using, offering for sale, selling, or importing for these purposes at least the product obtained directly by that process.

2. Patent owners shall also have the right to assign, or transfer by succession, the patent and to conclude licensing contracts.

13 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.

14 *Ibid* @ 4.

15 5. Accordingly and in the light of paragraph 4 above, while maintaining our commitments in the TRIPS Agreement, we recognize that these flexibilities include:

[...]

(d) The effect of the provisions in the TRIPS Agreement that are relevant to the exhaustion of intellectual property rights is to leave each Member free to establish its own regime for such exhaustion without challenge, subject to the MFN and national treatment provisions of Articles 3 and 4.

16 Control of anti-competitive practices in contractual licences.

## PARALLEL IMPORTS AND INDIAN PATENT LAW

India follows a regime of international exhaustion under Section 107A (b) of the Patent Act 1970. The Patent Act does not expressly employ the terms "parallel import" or "exhaustion". The legislative intent to allow parallel imports can be deciphered from the Statement of Objects and Reasons to the Patents (Amendment) Act, 2002. The Parliamentary debates on the Patents (Amendment) Act, 2005 clarifies that section 107A (b) [17] was aimed at permitting parallel imports and endorsing the principle of international exhaustion.

India introduced provisions facilitating parallel import; it is believed this will act as a market mechanism to facilitate access to patented products at affordable cost. Section 107A (b) was included in the Act to facilitate import of products patented in India from other countries. This provision puts limitations on the rights of the owner of the patent to restrict the movement of the product from one country to another once it is legally manufactured and sold in the market. The idea of this provision is to allow the circulation of products legally manufactured in another country into the Indian market while the patent is still in force in India through distributors not authorized by the owner of patent. Thus, even though the owner of the patent may supply the Indian market (either through local manufacture or through importation); still, Section 107 A (b) authorizes any other person in India to import and distribute the products in India. This is permissible as long as the product is purchased from a manufacturer in a third country who has legally manufactured the product in that country. This is irrespective of the territorial limit for the sale of products included in the conditions of the license by the owner of the patent (in case the product is patented in that third country) on the manufacturer in the third country. This freedom is evident from the phrase "who is duly authorized under the law to produce and sell or distribute the product". [18] This language, which was included in the section by the 2005 amendment, is broad in scope. It permits importation of products patented in India even from countries not recognizing a patent for that invention. The word "patented product", used in this section, only means the product is patented in India, and not in the country from where the product is imported. This is clear since the exclusion from infringement is evidently of the patent granted in India. Similarly, the word

[17] Section 107A (b) reads: "importation of patented products by any person from a person who is duly authorized under the law to produce and sell or distribute the product shall not be considered as an infringement of patent rights". This clearly indicates that India has opted for the international exhaustion principle.

[18] Section 107A (b) reads: "importation of patented products by any person from a person who is duly authorized under the law to produce and sell or distribute the product shall not be considered as an infringement of patent rights".

"law" used in this section is the law applicable in the country from which the product is imported and not the Indian law.[19]

Thus, the principle of exhaustion has been interpreted from the point of view of the public interest; the Indian provision is structured to take full advantage of the flexibility available under the TRIPS Agreement to make the patented products available to the Indian public at the cheapest possible price.

Therefore we can expect that courts are likely to give a strict literal reading in favour of a more purpose driven interpretation to enable subsequent sales or distribution of patented products within India. But what step we will take with regard to process patents and conditional sales are still a question.[20]

## THE DECISIONS

The first time the United States Supreme Court addressed the issue of exhaustion of patent rights was in *Bloomer v. McQuewan* in1853.[21] The *Bloomer* case involved a patent whose term was extended by an Act of Congress. The patentee attempted to enforce the rights against someone who had acquired a patented machine and obtained a license for using it during the patent term. In denying the patentee's right against that purchaser, the Court drew a distinction between a license of the patent right and the acquisition of a patented machine. In the event someone acquires a license for the duration of the first patent term, the renewal of that term does not generate automatically the renewal of the license. The patent owner is entitled to license again or exclude the former licensee from using the invention for the remaining term. 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. The inventor might lawfully sell it to him, whether he had a patent or not, if no other patentee stood in his way. And

[19] *Paper 6: TRIPS flexibilities: the case of India,* Intellectual property and access to medicines:

Papers and perspectives, WHO, (2010).

[20] Shamnad Basheer and Mrinalini Kochupillai, *Trips, patents and parallel imports in India: A proposal for amendment*, (2008).

[21] In a previous case, *Wilson v. Rousseau*, 45 U. S. 646 (1846), the Supreme Court had scrutinized a contract under which the patent rights were assigned (with territorial restrictions). The issue at bar, even if it has certain similarities with discussion in *Bloomer*, was nevertheless different. In the latter case, exhaustion resulted from the sale of the patented article and, as the doctrine would be fixed later on, was limited to the commercial use of the article. In *Wilson*, exhaustion was the result of the transfer of the right itself. This is a matter of contract law, rather than of patent law.

when the machine passes to the hands of the purchaser, it is no longer within the limits of the monopoly. It passes outside of it, and is no longer under the protection of the act of Congress.[22]

The United States Supreme Court reaffirmed the exhaustion doctrine, in *Adams v. Burke* (1873). In this case, the licensee had the right to make, sell, and use patented coffin-lids within a ten-mile circle around Boston. The licensee sold a coffin-lid in Boston to the defendant, who then took it outside of Boston and used it outside the ten-mile circle. The license restriction was clearly a proper and valid limitation on the grant of patent rights, but the Court held that the patent was exhausted nevertheless because there were no conditions on its subsequent use by the defendant: "The right to manufacture, the right to sell, and the right to use are each substantive rights, and may be granted or conferred separately by the patentee. But in the essential nature of things, when the patentee, or the person having his rights, sells a machine or instrument whose sole value is in its use, he receives the consideration for its use and he parts with the right to restrict that use. Whatever, therefore, may be the rule when patentees subdivide territorially their patents as to the exclusive right *to make* or *to sell* within a limited territory, we hold that in the class of machines or implements we have described, when they are once lawfully made and sold, there is no restriction on their use to be implied for the benefit of the patentee or his assignees or licensees."[23]

The Federal Circuit in *Jazz Photo Corp. v International Trade Commission*[24], dealt with exhaustion. In that case, Fuji Photo Film Co. charged that Jazz Photo Corp. and others were infringing Fuji Photo's patents on its single- use camera by acquiring used cameras, opening them up, refurbishing them, and re-selling them. Some of the cameras that were refurbished were originally sold in the United States but some were sold abroad. The court found that the patents were exhausted with respect to cameras sold in the United States but not with respect to cameras sold abroad. Thus the court recognised national exhaustion.

The United States Supreme Court in *Quanta v. LGE*[25], the case which involved a licensing arrangement between LGE, the patentee, and Intel in relation to chipsets. The key issue was whether or not LGE's patent rights had been "exhausted" after the sale by Intel (the licensee) to Quanta (one of Intel's customers), leaving Quanta free to do what it wished with the chipsets. Intel was required under one of the contracts with LGE to give notice to

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[22] *Bloomer v. McQuewan*, 55 U.S. 539, 549 (1853). The Court reiterated the exhaustion doctrine in the context of the extension of the patent term in various other cases, namely in *Bloomer v. Millinger*, 68 U.S. 340 (1863) and in *Mitchell v. Hawley*, 83 U. S. 544 (1872).

[23] *Adams v. Burk,* 84 US 453, 456, 457 (1873).

[24] *Jazz Photo Corp. v International Trade Commission*, 264 F.3d 1094 (Fed. Cir. 2001)

[25] *Quanta Computer, Inc. v LG Electronics, Inc.*, 533 U.S. 617 (2008).

customers that they could not combine the chipsets with devices by other manufacturers. The Supreme Court held in favour of Quanta's right to deal with the product as it wished i.e. Quanta could combine the Intel chipset with other products. Specifically, it disagreed with LGE that "exhaustion" applied only to product patents. It categorically held that it applied to process patents or method patents as well. In the light of Indian parallel import provision, it is interesting to note here that section 107A (b) is limited to "patented products". The narrow definition of "patented article", a term used interchangeably with "patented products", may mean that one cannot widely construe such terms to include patented processes as well. One might argue that a judge could, in the light of the section 2 phraseology "unless the context otherwise requires" also interpret "patented article" to mean a patented process in the context of section 107A (b).

In *Lexmark* International *v. Impression Products*[26], Federal Circuit made two significant determinations relating to the doctrine of patent exhaustion, also referred to as the "first sale" doctrine. First, the Federal Circuit found the first sale doctrine does not apply to patented articles sold subject to restrictions on resale and reuse communicated to the buyer at the time of sale. Second, the Federal Circuit determined the first sale doctrine does not apply to patented articles first sold outside of the United States.

On March 23, 1995, a decision regarding parallel imports was delivered by the Tokyo High Court.[27] In that case, BBS Kraftfahrzeug Technik A.G. ("BBS") of Germany held both German and Japanese patents for certain aluminium automobile hubcaps. The hubcaps were legitimately purchased in Germany by a Japanese company which was engaged in the export of the relevant goods to Japan where an affiliated Japanese company was engaged in the sale of the goods. These two companies were virtually under the same management when the goods were imported into Japan for sale at a price lower than that charged by BBS dealerships in Japan. Subsequently, BBS filed suit for patent infringement in Tokyo District Court in June of 1994. The district court found that the two companies had infringed the BBS Japanese patent. However, on appeal the judgment in favour of BBS was reversed. In reversing the district court, the High Court held that the patentee's right to enforce its Japanese patent against the imported goods had been exhausted since the patentee had legally transferred title to a legitimate purchaser of the patented product. Because parallel imports of patented goods had previously constituted infringement of patents in Japan, this appellate court decision has invoked substantial controversy.[28]

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26 No. 14-1617 (Fed. Cir. 2015)

[27] *Jap Auto Products, K. K. and Anr*. v. *BBS Kraftfahrzeug Technik AG*, No. 3272 of 1994, (March 23, 1995).

[28] Nanao Naoko, Koyama Takahiro and Sudo Hiromi, *Decisions on parallel imports of patented Goods,*1996 by the PTC Research Foundation of Franklin Pierce Law Center IDEA: The Journal of Law and Technology,(1996)

And in the *Aluminium Wheels* case, the Japanese Supreme Court affirmed, in July 1997, that Article 4 bis of the Paris Convention ('Independence of patents for the same invention in different countries') did not apply in Japan and that the issue of parallel imports was a matter of national policy of each country.

## PRACTICAL MEASURES TO AVOID EXHAUSTION

From different cases and practices followed we could make out that some arrangements can make the patent holder retain his rights without exhausting it.[29]

1. *Contractual restrictions*. Include language that excludes prohibited conduct from the scope of the license grant, provided that the prohibitions do not raise antitrust concerns. If the behaviour is not within the grant of the license, then the sale is not an authorized sale and the exhaustion doctrine will not apply to it.

2. *License rather than sell.* The exhaustion doctrine is known as the first sale doctrine because it requires a sale. If the transaction can be structured so that the object of the license is never sold, there will be no exhaustion. For example, rather than selling copies of its software, a software vendor could sell its software as a service on the internet. Then its customers will never take title to any software media and the exhaustion doctrine will never apply.
3. *Product differentiation*. If products intended for different markets can be differentiated in material ways, they can often be excluded even if a rule of international exhaustion would otherwise be applicable, as in the case of trademarked goods in the United States.
4. *Splitting up ownership of intellectual property geographically*. If international exhaustion is ultimately based upon the identity of the rights holder, so that any sale is considered an authorized sale in any country where the rights holder has corresponding rights, then an effective geographic division of the international market could require that the rights be divided among separate entities. Retention of common control, however, could well defeat such a strategy by prompting a court to lump the entities together for purposes of exhaustion.

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[29] L. Donald Prutzman, *The Exhaustion Doctrine in the United States,(*2013)

# CONCLUSION

IPRs are not 'natural' rights but state-enforced monopolies which artificially create a scarcity. A consideration of the public welfare impact must enter into the definition and interpretation of the scope of such rights. Parallel import could address the drugs access problem and in turn work pro-competitively towards lowering of prices. Alternate and affordable access to drugs is a human right. The fear of the holder's right to re-importation can be handled through other policy measures like border control.

In the Indian scenario, a reading of the statutory provisions and legislative intent provide a leeway for enabling parallel imports. The judicial interpretation leaves a lot to be desired and has to be in line with the above two for the ordinary man to benefit from them. Finally, the law is what the court says it is. So, the responsibility of the judiciary is paramount for providing access wherever allowed. The Indian Government should shy away from entering into TRIPS plus treaties which might take away the flexibities afforded for access to vital IP based products. Parallel imports must be allowed as tool to create pro-competitive environment which helps in reduction of price and thus add to welfare of the country.