

# International Exhaustion of Patent Rights and Parallel Imports: A Comparative Study between India and Japan (\*)

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*The principle of exhaustion establishes that the rights of the intellectual property holder with respect to the property stand exhausted when the property is legally sold in the market. It exists in terms of regional, national and international exhaustion. The scope of the research paper is limited to the principle of international exhaustion only. Furthermore, international exhaustion can be with respect to several intellectual property rights but the present research paper deals in respect to the right of patents.*

*India recognizes the principle of international exhaustion under section 107-A(b) of the Indian Patents Act, 1970 where the scenario stands friendly to the principle of parallel imports unlike United States which follows the principle of national exhaustion and EU which follows regional exhaustion. Japan does not exhibit any proper legislative framework; however, the Supreme Court and the subordinate courts have interpreted and decided several issues pertaining to the doctrine of international exhaustion and parallel imports but there is lack of consensus in their approach.*

*Article 6 of the TRIPS Agreement allows member countries in the WTO to follow their own rules on exhaustion and no reference can be made to the Dispute Settlement Body in this respect but there is growing need for harmonization in law for legitimate free movement of goods and services without division of markets.*

*The research paper addresses the basic ambiguities in the laws of parallel imports in India and Japan. The researcher concludes with the remark that the role of judiciary in both the countries is of substantial importance. In India, the judges while interpreting section 107-A (b) need to give paramount consideration to the right of the patentee; in Japan owing to the uncertainty of the term 'implied license', the courts have important role to play to balance out the interests between parallel imports and intellectual property rights.*

## Introduction

The term international exhaustion and parallel imports, though used interchangeably, sometimes appear to be mutually exclusive and collectively exhaustive while dealing with the issue relating to exhaustion of Intellectual Property Rights (IPR). International exhaustion precisely means an authorized sale of a patented product by the patentee or his authorized licensee anywhere in the world, exhausts the right to control further disposition. Parallel import refers to goods produced and sold legally, and subsequently exported. In that sense, there is nothing “grey” about them, as the English Patent Court correctly pointed out in the *Deltamethrin decision*<sup>1</sup>. This decision is followed

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<sup>1</sup> *Roussel Uclaf v. Hockley International decision* of 9 October 1995, [1996] R.P.C.441.

by the Japanese Supreme Court in the BBS Aluminum wheel case<sup>2</sup>

Patent rights have territorial jurisdiction and are regulated by the patent law of each country. A patentee has the option to obtain his patent right in one or in more than one country of respective jurisdiction and each patent is mutually independent in emergence, transfer and termination, i.e. the validity of the patent is not affected by the invalidity, termination or the period of subsistence etc., of a patent in another country as per the established norms of Article 4<sup>bis</sup> of the Paris Convention. This implies that a patent granted in one country has no effect beyond the territorial boundary of that country and cannot be infringed in other countries unless Patented in each of those countries.

## **Objectives of the Research**

The objective of this research is to identify the exact meaning of ‘exhaustion’ in the context of patent rights as pronounced by various judicial decisions and jurisprudence under common law and as codified under various civil laws. The research analysis will examine the issue of International Exhaustion and Parallel Imports on the basis of such pronouncements and laws and the practice followed in different jurisdictions with special reference to Japan and India, while drawing references and inferences for various international treaties and conventions including Paris Convention, TRIPS Agreement and WIPO treaties including Patent Cooperation Treaty. The European Union (EU) has expanded the territory of protection for IPRs through the European Patent Convention and now Unified patent system.

## **Meaning of Doctrine of Exhaustion**

The term Exhaustion has not been defined in law, not even in the TRIPS Agreement but colloquially its dictionary meaning is diminution of the IPR rights and it acts as a limitation to some of the exclusive rights granted under the IPR laws. Patent rights for example include right to make, use, sale, resale, import etc., granted to the Patentee as per the broader legal framework of TRIPS<sup>3</sup> and the other established international conventions such as Paris Convention<sup>4</sup>.

The doctrine of exhaustion, deals with the exhaustion of some of these exclusive rights such as right to use, dispose and resale upon ‘first sale’ by the right holders and this principle of

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<sup>2</sup> The Supreme Court Judgement, July 1, 1997, Minshu, Vol.51, No.6, p. 2299/Hanji, No.1612, p. 3/Hanta, No.951, p.105 (the BBS case).

<sup>3</sup> For example Article 28 read with article 6 of the TRIPS Agreement

<sup>4</sup> Article 4<sup>bis</sup>

Patents: *Independence of Patents Obtained for the Same Invention in Different Countries*

(1) Patents applied for in the various countries of the Union by nationals of countries of the Union shall be independent of patents obtained for the same invention in other countries, whether members of the Union or not.

exhaustion applies across the globe in some form or the other for all different types of IPRs including for patents, copyrights, trademarks and several other types of IPRs. The present research is however limited to Exhaustion of Patent Rights only.

WIPO<sup>5</sup> in its communication to SMEs, has defined the term exhaustion as “Exhaustion refers to one of the limits of intellectual property rights. Once a product protected by an IP right has been marketed either by your SME or by others with your consent, the IP rights of commercial exploitation over this given product can no longer be exercised by your SME, as they are exhausted”.

The term ‘Exhaustion’ has come in the patent literature for the first time from Germany when the Supreme Court of Germany, Reichsgericht<sup>6</sup> (1879-1945) decided in the case of Guajakol-Karbonat as early as 1902 that “if the patentee has marketed his products under the protection of a right that excludes others, he has enjoyed the benefits that a patent right confers on him and thereby consumed his right.” The term Exhaustion has also been defined by a German academic Josef Kohler as “Remuneration Doctrine”<sup>7</sup>.

The genesis of the principle of Exhaustion was adopted in common law in the 19<sup>th</sup> Century and was known as ‘First Sale Doctrine’ as per the Supreme Court decisions of United States<sup>8</sup> and ‘Implied License’ as per the Privy Council decision in United Kingdom<sup>9</sup> as referred by Christopher<sup>10</sup>.

### **Meaning of Implied Licence**

The gist of the rule of “Implied License” as held in U.K Courts is that the patentee can only invoke restrictive conditions for goods that have been lawfully marketed if these restrictions have been brought home with the purchaser. The license to freely deal with a product is thus “implied” unless there is an express limitation that is made known to the purchaser. In another judgment in U.K, Lord Hoffman distinguished the doctrine of exhaustion from the theory of implied licence and stated that “the difference in the two theories is that an implied licence may be excluded by express contrary agreement or made subject to conditions while the exhaustion doctrine leaves no

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<sup>5</sup> [www.wipo.int/sme/en/ip\\_business/export/international\\_exhaustion.htm](http://www.wipo.int/sme/en/ip_business/export/international_exhaustion.htm)

<sup>6</sup> Reichsgericht (1879-1945) decided in Guajakol-Karbonat (Reichsgericht, 26 March, 1902) 51 RGZ 139, referred to in European Council, Records of the Luxembourg Conference on the Community patent 1975, Volume 1: Free Movement and Competition Law (Oxford University Press, Oxford, 2003) 75.

<sup>7</sup> “Remuneration Doctrine” as first advocated by the Germany Academic Josef Kohler in his book on Patent published in 1900, “Handbuch des deutschen Patentrechts 452 (1900). Kohler, Josef: Handbuch des deutschen Patentrechts in rechtsvergleichender Darstellung Mannheim. 1900 Signatur: Dt 15 Lk 45 [Hauptbd.]

<sup>8</sup> In US for instance, in Adams v. Burke 84 US (17Wall) 453 (S. Ct., 1873) and Appolinaris v. Scherer 27 F 18 (CC SDNY, 1886).

<sup>9</sup> In UK, in Bells v. Wilmott(1870-71)LR 6 Ch App 239 and subsequently elaborated by Privy Council in Nat’l Phonograph Co. of Australia v. Menck [1911] 28 R.P.C. 229.

<sup>10</sup> Christopher Stothers; Milbank, Tweed, Hadley & McCloy LLP, London.

patent rights to be enforced.” This distinction is very important because in India the law clearly speaks about the doctrine of international exhaustion u/s 107A (b) of the Indian patent Act 1970, whereas in Japan, the Supreme Court in BBS Case has spoken about the spirit of the implied licence which gives the option to the patentee to exclude import of patented goods in Japan

### **Different Types of Exhaustion**

The subject matter of exhaustion of patent and other IP rights has become controversial on the issue of geographical territories and accordingly it is classified into three categories as (i) **National Exhaustion**, which implies in brief as exhaustion of the right to use and resale the patented product within the territory of a nation once the product is put in the market by the right owner directly or by his licensee or by any other authorised person. (ii) **Regional Exhaustion**, **which** means that once the patented goods have been put to the market in any part of the territory of that particular region, the right of the patentee is exhausted in the whole of the territory of the region and the patented product can move freely within the region irrespective of the national boundary of a particular nation state without any infringement as followed by European Union. (iii) **International Exhaustion** means free distribution of goods across the globe as a single market, once it is put in the market by the patentee himself or with the authorization of the Patentee. There is freedom to frame law on exhaustion under Article 6 of the TRIPS Agreement of WTO and therefore some nations follow international exhaustion and some not.

The issue of international exhaustion is more relevant today as we talk of free trade and non-tariff barriers under the WTO trade laws and at the same time talk of restrictions on international trade through IPR by not allowing import of patented goods involving questions on law and economics. Parallel trade is possible only when all the countries will follow the doctrine of international exhaustion which needs to be equated with the reward and remuneration for the invention in equitable manner. This research work has tried to identify these conflicting interests across various countries including U.S., Japan and India.

### **Patent Law in India and Japan on Exhaustion**

In India a patentee is granted an exclusive right of making, using, offering for sale, selling or importing for products as well as for the process u/s 48 of the Indian Patent Act. However the rights of importation are subject to the restriction on the doctrine or the principles of international exhaustion of the patent rights. India believes that the exclusive right to a patent is exhausted the moment there is a first sale whether in India or outside India irrespective of the geographical

boundaries and considers the whole globe as a single market. Accordingly section 107A (b) of the Indian patent Act clearly provides that “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 infringement of patent rights”

In Japan, on the other hand, Article 2, Para 3, Sub-Para(i) of the Japan Patent Act defines the meaning of the “working of an invention, which is more or less similar to Section 48 of the Indian Patent Act 1970 and includes the following acts in case of an invention of a product, act of manufacturing, using, assigning, leasing, importing or offering for assignment or lease (including displaying for the purpose of assignment or lease-hereinafter the same) of the product and also for an invention of the process. Section 68 deals with the exclusive rights of a patentee to work the patented invention as business and Section 100 provides for the right of a patentee to take appropriate action for prevention of the infringement of the invention. However unlike India, the Japan Patent law does not deal with the issue of exhaustion at all in its statute and therefore there is no exception to the use of patent by the patentee or by his authorized person. It is therefore very important to understand the practice followed in Japan which fully relies on the judicial decisions and the general provisions of the civil law. The general principles of exhaustion are derived primarily from the Civil code of Japan<sup>11</sup>. Article 1 (Fundamental Property) of the Civil Code provides (1) Private rights must conform to the public welfare, (2) The exercise of rights and performance of duties must be done in good faith, (3) No abuse of rights is permitted. Thus Japanese Courts have fundamentally followed their own legal system while deciding the cases with due respect to the international treaties.

Japan followed the principles of national exhaustion of IP on the patent rights on the basis of its Civil Code and on the basis of Article 4<sup>bis</sup> of the Paris Convention which was upheld by Osaka Dist. Court on June 9, 1969 in the Used Bowling-Pin Stand Machine case<sup>12</sup> and the principle of national exhaustion was followed until July 1, 1997 when the principles of Exhaustion were explicitly laid down by the Supreme Court of Japan in BBS Aluminum Wheel case<sup>13</sup> which also laid down that import of patented goods into the territory of Japan will not result into infringement of Patent Right unless the patentee has explicitly excluded such import into the territory of Japan by way of an agreement in writing and with an explicit indications of such intentions on the face of the patent goods.

The aforesaid position of law on international exhaustion in India as well as in Japan has certain amount of anomalies and ambiguities. One of the ambiguities in the Japan is about the

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<sup>11</sup> Civil code (Act No. 89 of 1986 of Japan).

<sup>12</sup> Brunswick Corp. v. Orion Kogyo KK, 1 MutaiSaishu 160 (Osaka Dist. Ct., June 9, 1969).

<sup>13</sup> *Ibid.* 2.

implication of the ‘implied licence’ for parallel import of the patented goods, which is more guided by an agreement between the patentee and the first buyer of the patented goods. Parallel import is legitimate way of import of genuine goods and is also referred to as gray market in some countries. The basic advantage of parallel import is to take advantage of the price differential in different market and to make the market more competitive which is good for the consumer and the society and for free flow of goods. It is different from trade of counterfeited goods and piracy which is for the fake goods and which is illegal. International exhaustion on the other hand is more forceful and does not leave discretion with the patentee. China, Singapore and many other developing countries have adopted the principles of international exhaustion in their statute and Japan being a civil law country is yet to adopt the same in its patent law.

### **International Exhaustion and Other IPR Laws in India, Japan with Reference to Select Countries**

It is however to be noted that in several other IPR laws, such as Copy Rights law, Plant Variety law and Integrated Circuit law, Japan has incorporated the principles of international exhaustion in its statute. At the same time in India, the principles of international exhaustion has not been accepted in its copyrights law and once an attempt was made to amend section 2(m) of the Indian Copyrights Act, 1957 to incorporate the principles of international exhaustion but later dropped. However in India the trade marks law provides for international exhaustion which has also been upheld by Delhi High Court in a recent judgment which is now pending before the Supreme Court of India. Thus, the issue of international exhaustion and parallel import is not one size fits all and even in US the Supreme Court has accepted the principles of international exhaustion in *Kirtsaeng v. John Wiley & Sons Inc*<sup>14</sup> en banc on the copyrights law and is looking at another controversial judgment on patent law in the case of *Lexmark V. Impression*<sup>15</sup> where it has granted the writ of certiorari against the judgment of the Court of Appeals of Federal Circuit.

However there is no such explicit provision for ‘Exhaustion’ in US Patent law in 35 U.S.C. It only deals with the patent rights and for its infringement. A U.S patent confers on the patentee “the right to exclude others from making, using, offering for sale, or selling the invention throughout the United States or importing the invention into the United States.” 35 U.S.C. 154(a) (1). A Patentee may preclude another from making, using or selling an article that embodies its patented invention. 35 U.S.C. § 271(a). However the rule of exhaustion do apply in United States and there

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<sup>14</sup> 133 S Ct. 1351 (2013)

<sup>15</sup> Nos. 14-1617,-1619 (Fed. Cir. Feb. 12, 2016); Writ of Certiorari granted by Supreme Court of United States on December 2, 2016.

are different decisions including the one in *Quanta Computer, Inc. Vs. L.G Electronics, Inc*<sup>16</sup> holding that the initial authorized sale of a patented item terminates all patent rights to that item, and the first sale confers on the purchaser, or any other subsequent owner the right to use or sell the thing as he sees fit.

## **Methodology of Research and Key Findings**

The Methodology followed in the research was to rely on several existing studies and the literature dealing with the issue on international exhaustion and parallel imports. The existing literature on the subject is fragmented on different individual aspects of the exhaustion of IP rights including the debates and deliberations which took place during the Uruguay Round and inclusion of Article 6 to the TRIPS Agreement<sup>17</sup> whereby it was agreed that the Dispute Settlement Body (DSB) of the WTO will not deal with the issue on exhaustion as long as the member country complies with the basic criteria on National Treatment (NT) and Most Favored Nation (MFN) as contained in Article 3 and Article 4 of the TRIPS Agreement. Reference has also been made to various judgments on the issue relating to the topic of research and two important judgments of the Supreme Court of Japan namely the BBS case<sup>18</sup> on parallel imports and the Ink Cartridge case<sup>19</sup> on import of recycled goods. Interviews were conducted of the few IP experts including former judges with the assistance and support of IIP, through circulation of a questionnaires in advance and the views expressed by these experts have been incorporated for clear understanding of the research findings and for correct interpretation of the Statutory provisions and the relevant case laws. It has also been observed that the IP owner in Japan are comfortable in complying with the ruling on parallel imports as per the judgment of the BBS case for the past two decades since 1997 and no further litigation has surfaced on the issue of parallel imports of patented goods. Similarly there is clarity on the import of recycled patented goods as per the decision of the Supreme Court in the Ink Cartridge case since 2007 as long as the recycled patented goods do not characterize as a novel product.

## **Conclusions**

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<sup>16</sup> 553 U.S. 617, 625 (2008).

<sup>17</sup> Article 6: deals with Exhaustion and provides:

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

<sup>18</sup> *Ibid.* 2.

<sup>19</sup> The Supreme Court Judgement, November 8, 2007, *Minshu*, Vol.61, No.8, p. 2989/*Hanji*, No.1900, p.3/*Hanta*, No.1258, p.62 (the Ink Tank case).

That Article 4<sup>bis</sup> of the Paris Convention<sup>20</sup> speaks about national territorial rights of a patent and thus come in the way of international exhaustion of patent rights by first sale in one country for the same invention for which there is a registered patent in another country and may have different claims and may have different period of validity and thus the parallel import may amount to infringement of the rights of the patentee. This argument is still debatable for the countries which follow Paris convention and do not follow either implied license theory like Japan or UK. This is also evident from the judgment in Brunswick<sup>21</sup> case in Japan until the position was altered by the BBS case in 1997<sup>22</sup>. On the same very principles infringement action was denied to a US Company namely Akira Fujimoto against a Japanese Company namely K. K. Newlon, where the US Company did not have a corresponding Patent in Japan in the case of Akira Fujimoto vs. K. K. Newlon<sup>23</sup>.

That there is increasing consensus towards harmonization of law on international exhaustion as is evident from the trend of recent decisions of Supreme Court in U.S and in other countries.

There is controversy and complexity in deciding about the first sale doctrine in cases of self-replicating technologies<sup>24</sup>.

It is felt necessary to have further empirical research in the area to find out the economic impact of the rules on exhaustion and the co-relation on the pricing of the products, competition, counterfeiting or piracy and the overall impact on the industry and the consumers. It also needs to be studied whether some modified form of international exhaustion rules is possible say for pharmaceuticals and how research activities are impeded. A broader view is necessary for promotion of trade and industry for economic development which should be at the core of the TRIPS Agreement for free movement of goods without any kind of non-tariff barriers and a way-out should be found for harmonization of IPR laws with respect to the law on Exhaustion.

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<sup>20</sup> *Ibid.* 4.

<sup>21</sup> *Ibid.* 12.

<sup>22</sup> *Ibid.* 2.

<sup>23</sup> Akira Fujimoto v. K K Newlon, (Sup. Ct. 1st Petty Bench, Sept. 26, 2002; Japan) Interpretation of Section 271 (b) and (c) of the U.S Patent Act. The Plaintiff Akira Fujimoto was the owner of a U.S Patent for an invention entitled "FM Signal Demodulating Apparatus" but had no corresponding Japanese Patent. The defendant KK Newlon had a subsidiary, Newlon Electronics, Inc. in US to whom, KK Newlon exported card readers which were manufactured in Japan.

<sup>24</sup> Bowman v. Monsanto Co., 133 S. Ct. 1761 (2013).