A PRIMER ON PARALLEL IMPORTATION AFTER *LEXMARK*

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On May 30, 2017, the US Supreme Court released its opinion in *Impression Products, Inc. V. Lexmark International, Inc*., a case dealing with parallel importation of patented goods. What is the case about? In short, parallel importation. The below is an attempt to explain the underlying issues--in less than four pages.

It is based on Daniel Gervais and Susy Frankel, 'International Intellectual Property Rules and Parallel Importing', in *Research Handbook on Exhaustion and Parallel Imports* (I Calboli and E Lee, eds) (Edward Elgar, 2016), pp. 85-105

1) Defining parallel importation & exhaustion of rights

Parallel importation means an import of a good protected as a patent or copyright or bearing a protected trademark is 'parallel' to a domestic intellectual property (IP) right in the country of importation. Put differently, there is a 'parallel' IP right in the country from which the good is exported. The owner or exclusive licensee of the right in both territories may or may not be the same. The price at which the good is sold is often different (reflecting market conditions) thus creating an arbitrage incentive for export to a higher priced market. This is known as *price discrimination*.

There is a relationship between the legal concept of parallel importing and *exhaustion of rights* at domestic law. When IP is embodied in a physical product, the sale of that product transfers ownership rights in the product, but not the underlying IP. For example, the person who purchases a copy of a copyright book cannot make and sell new copies of the book. However the distribution-related IP rights are said to be 'exhausted'. This means that *that copy* of the book can be resold or otherwise treated as the property of the purchaser. If a country or trade territory allows the importation of a copy sold in another country or trade territory, then it is said to allow parallel importing. In this way the IP rights in both countries, or trade territories, are put in 'parallel'.

Each country can make its own rules on parallel importation under the main international instrument regulating intellectual property, the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS Agreement). Then each country can also make different rulers on whether to allow parallel imports for different types of IP rights. Australia and New Zealand, for example, allow parallel imports of goods protected by trademarks and copyright but not patents.

2) Parallel imports and the different IP rights

As noted above, the Supreme Court of the United States has now made it clear that US law allows parallel imports of goods protected by patents (*Lexmark*). It did the same in 2013 for copyrighted goods in *Kirtsaeng v. John Wiley & Sons, Inc.* (568 U. S. 519). This answers some questions for the US market but raises others. For trademarks the rule was already that goods cannot be parallel imported under their US trademark if they are physically and materially different than the authorized goods sold in the U.S. Let us consider the differences among different IP rights.

Patents must be applied for country by country. In some cases (for example many European countries), a single patent application can cover several countries). Each patent granted is independent which means that if a patent challenged by an alleged infringer is found to be invalid by courts on one country a similar patent in a different country remains valid. There are rules in the TRIPS Agreement about patentability but countries retain a large measure of flexibility to define and apply patentability criteria. This means that the scope of a patent can vary by jurisdictions as each patent office can ask the patent applicant to revise the scope of the claimed invention. Then it is expensive to apply for a patent and inventors rarely if ever try to get an invention patented in every possible country. This means that many inventions are only protected in a few countries. Major multinational inventors that rely heavily on patents like pharmaceutical companies, often patent a new pharmaceutical in most significant potential markets, but not everywhere.

Copyright, which protects books, music, film, software, pictures, art and many other forms of literary and artistic creations, can be obtained without formalities. Even in the US copyright registration is not fully mandatory. The protection of new original works is automatically available around the world to approximately 180 countries.

Trademarks (like words or logos that typically identify the company that manufactured or supervised the manufacturing a product) are protected in countries that share a common law legal tradition because they are used in commerce *in that country*. In jurisdictions with a different legal tradition (including most of Europe), registration is generally required. Indeed, even in common law countries registration is recommended. This means that the owner of a trademark must take steps to protect a trademark in multiple countries and that worldwide protection is not automatic.

3) Parallel imports, gray market goods, licensing and counterfeit goods

Parallel importation of goods legally put in the market in a different country with the consent of the owner of the intellectual property right. Having said that, there are many different fact patterns that can arise.

Let us assume the same goods are sold in countries A , B, C, D and E, with the following differences.

- *Country A* is a major country where the goods are protected by patent and where parallel imports are allowed (say, the United States);
- *Country B* is another country where the same goods are protected by a similar patent and sold by the patent owner;
- *Country C* is another country where the same goods are protected by a similar patent and sold by an *exclusive licensee* of the patent owner;
- *Country D* is a country that issued a *compulsory license* to manufacture the patented product. A compulsory license allows a third party not licensed by the patent owner to produce the product at price usually set by a governmental authority; and
- *Country E* where the goods are *not protected by patent* (ether because no patent was ever applied for or because a patent was invalidated) and manufactured by a third party with no license from the owner of the patent in countries A-D.

Question: Can the goods from countries B, C, D, and E be imported in country A?

Though answers to this question remain somewhat controversial in some jurisdictions, the following seems likely to be correct:

With respect to goods from *country B*, the answer (under *Lexmark*) is yes.

With respect to goods from *country C*, the answer should be the same, again using the *Lexmark* rationale of a sale with 'authority' from the patent owner.

With respect to goods from *country D*, one can say, first, that *Lexmark* does not apply because there was no 'authority' for the sale from the patent owner. Second, there are specific international rules with respect to patent compulsory licensing that limit re-export of patented goods made under a compulsory license such conditions, especially art 31(f) of the TRIPS Agreement. An amendment to TRIPS (Art. 31*bis*) modified this rule for phamarmceutcial exports to *least-developed nation*s. The amendment contains detailed rules concerning diversion to more economically developed markets. In the *copyright* field, by contrast, compulsory licensing is allowed in certain circumstances. For example, under the Appendix to the principal international copyright instrument, the Berne Convention, which was incorporated into the TRIPS Agreement, developing countries can issue reproduction and translation licenses for books. Compulsory licensing of *trademark*s is generally not permitted (TRIPS Agreement, art. 21).

Country E is a somewhat harder question. The rights cannot have been said to be exhausted because there were never any rights to exhaust so that the traditional rationale for parallel importation should not apply. Yes the goods are undoubtedly legal in their territory. *Lexmark*, by focusing on the import of *authorized* goods seems to assume exhaustion and the answer would, therefore, be no, the goods cannot legally make it into country A.

4) Diverging rationales

The main rationale *against* parallel importation of goods protected *by copyright or a patent* is that it prevents price discrimination. In the copyright field, a book publisher can charge a different price depending on the perception of what the market can bear in that particular country. When international exhaustion applies, a publisher might decide not to publish ion lower-priced markets to avoid diversion to more expensive ones, as had happened in *Kirtsaeng*. In that case a student had purchased authorized books in Thailand and brought them back into the United States and was able to resell the books undercutting the average US sales price by quite a significant margin. Being allowed to charge the maximum price possible in all markets allows both to charge more on "richer" markets and less in less economically developed ones. This can create a subsidy effect where richer buyers subsidize the owner of the intellectual property right to create and invent more. Finally if the owner of the IP right has given an exclusive license limited to one territory (say country C in our list above) and goods produced by the patent owner itself (or by a different licensee) in another territory (say, country B in our list above) can be exported to country C, then the exclusive licensee in country C might suffer economic harm as a result.

The main rationales *for* parallel importation of goods protected *by copyright or a patent* are, first, that it allows a country to obtain cheaper goods by importing them from a market where they are sold at a lower price. Relatedly, it can be used to introduce competition into an otherwise non-competitive market, which should also exert a downward pressure on price. Finally, it can be used to expand the range of available products and their varying qualities if only a limited range is locally available. All these rationales are directly linked to consumer welfare narratives.

It is also essential to take account of the fact that *patents and copyright apply to different types of goods*. A copyrighted work is usually purchased by individual consumers, while important categories of patented goods such as pharmaceuticals are often purchased by state entities in charge of public

health systems. There are significant public welfare impacts when access to books and medicines is restricted but there is very often a substitute for a book, musical work or film--a pharmaceutical product may have no substitute--and substitutes for copyrighted material are also often freely available online. Consequently, the public health impacts of restricting access to patented goods are often heavier than those that come from restrictions to specific copyrighted works. In the case of copyright, there is another reality to factor in: billions of works cross borders every day because they are available online. This changes the contours of the debate about parallel importation in that context.

In the case of *trademark* goods, the debate about parallel import rationales is somewhat different. Trademark rights are not protected, unlike copyright and trademark, as a reward for creating or inventing something. They are, at least as a matter of theory, designed to avoid confusion among potential buyers. Thus if a good imported from country B is the same as the one sold under the same trademark in country A, there is no confusion and the rationale for preventing importation isn't clear.

5) Possible future steps

It is quite likely that the pharmaceutical industry will try to get the US Congress to 'overturn' *Lexmark* by amending the US Patent Act. It was said that copyright industries would do the same after *Kirtsaeng* but no amendment has been made up to now. It is also likely that at least some producers of patented goods will modulate their price discrimination strategies differently. Many products that can be purchased in foreign markets, often using online resellers. Two issues should arise in that context. First, *quality assurance* will be used to convince buyers not to acquire goods from foreign sources. Attempts to block imports of pharmaceuticals (say, from Canada to the US) are often justified not on patent grounds but as a safety (regulatory) issue. That route may be explored further. Second, goods that require maintenance or service acquired from foreign sources may not benefit from locally available extra warranties or 'service packages' that companies may offer as an incentive to buy from a local (or at least domestic) source.