PARALLEL IMPORTATION, PATENT RIGHT EXHAUSTION, AND STRATEGIES FOR NAVIGATING THE EVOLVING LANDSCAPE

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Abstract

Parallel importation provides a means for purchasers and consumers of commercial goods protected by intellectual property law to acquire products for prices lower than the price set by intellectual property right holders. This form of “legal piracy” of grey-market goods is conducted by legally purchasing products in jurisdictions with lower prices, which allows distributors to import products into jurisdictions with higher prices, leading to a competitive advantage. The doctrine of patent exhaustion, especially when applied internationally, allows this practice by giving authorized purchasers of products unfettered ownership and control over the specific articles they acquire.

Analysis of how the United States and the State of Japan address the problem will be instructive in ascertaining how cultural, historical and economic factors, along with legal factors, have led to different treatments of the parallel importation problem.

Finally, possible solutions for patent holders regarding parallel importation will be discussed in light of attempts to harmonize the international discord over patent right exhaustion. However, those solutions present their own legal problems that patent holders must address as well.

LEGAL BACKGROUND

Patent Law

Any discussion of the doctrine of patent right exhaustion starts with the patent rights themselves. As an example, the Congress of the United States, through one of its constitutionally enumerated powers\(^1\), enacted Title 35, which contains the patent law provisions in their most recent iteration.\(^2\)

The rights contained in Title 35 are granted to anyone who invents a new and useful process, composition or product, or an improvement of a process, composition or product.\(^3\) Beyond the allowed patentable subject matter, an invention must pass muster through other statutory requirements.\(^4\) If the invention satisfies these requirements, a patent is granted for a period of 20 years from the date the inventor filed for it\(^5\), and it grants the inventor the “right to exclude others from making, using, offering for sale, or selling the invention throughout the

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\(^1\) U.S. CONST. art. II, § 8(8); (“The Congress shall have the power to... [t]o promote the Progress of Science and useful Arts, by securing for limited Times to Authors and Inventors the exclusive Right to their respective Writings and Discoveries[.]”).


\(^3\) Id. § 101.

\(^4\) Id. § 102-3, 112.

\(^5\) Id. § 154(a)(2).
United States, or importing the invention into the United States.” In Japan, the Patent Law of 1959 grants the inventor an analogous importation right into Japan.

**Doctrine of Exhaustion**

The exclusive rights in a patented article are limited by the first sale doctrine, or the doctrine of exhaustion, in which the purchaser of a patented article acquires full ownership and rights in the article, if lawfully purchased from the holder or the owner of the patent. The seemingly straightforward exhaustion of rights in a patented article, however, becomes substantially more complex through the issue of parallel importation of grey-market goods, and whether the sale of such grey-market goods exhausts the patent holder’s exclusive rights.

Parallel importation occurs when an authorized foreign purchaser of an article protected by a domestic patent resells the same article in the domestic jurisdiction without the authorization of the domestic patent holder. The question regarding these grey-market goods entails whether the foreign sale of a patented product exhausts the domestic rights of the patent holder, or whether those rights are preserved due to the foreign nature of the sale. The Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPs), due to disagreement between the United States, European nations and nations of the developing world, declined to state a position that would have provided an international standard in regards to the question, and instead left individual nations the discretion to apply their own policy.

**International Exhaustion**

The doctrine of International Exhaustion has been adopted by nations that apply patent right exhaustion to all sales of patented articles, regardless if the sale occurred in either a domestic or foreign jurisdiction. The rationale behind this doctrine is that once a patent holder has received a financial gain from an authorized sale of a patented article, the holder has no right to receive additional financial gain from subsequent sales by the purchaser, regardless of where the sale occurred.

**National Exhaustion**

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6 Id. § 154(a)(1).
11 Id. at 609.
12 Agreement on Trade-Related Aspects of Intellectual Property Rights, art. 6, , Jan. 1, 1995, http://www.wto.org/english/tratop_e/trim_e/t_home_e.htm (“For the purposes of dispute settlement under this Agreement … nothing in this Agreement shall be used to address the issue of the exhaustion of intellectual property rights.”).
14 See Erlikham *supra* at 308-9.
The doctrine of National Exhaustion has been adopted by jurisdictions that apply patent rights exhaustion to authorized sales that occur in the domestic jurisdiction only, and not to authorized sales that occur in foreign jurisdictions. One nation that currently applies the doctrine of National Exhaustion is the United States.\textsuperscript{15} The United States bases its policy on the lack of extraterritorial effect of United States patent law in regards to authorized foreign sales.\textsuperscript{16}

**Regional Exhaustion**

A modification of the above doctrines involves the harmonization of national laws through the doctrine of Regional Exhaustion. In the European Union, this harmonization has been achieved through a single market which bars member states from enacting laws that restrict the free movement of goods, including bars on parallel importation from one member state to another.\textsuperscript{17} As a result, the European Union practices a form of regional exhaustion known as community exhaustion, where all European intellectual property rights, not just patent rights, exhaust within the community upon an authorized first sale that also occurs within the community.\textsuperscript{18}

**CASE STUDY: American Patent Law and Exhaustion**

**Historical and Cultural Background**

The current state of the United States inventive technology industry developed slowly through its history as colonies in a mercantilist system, which required and benefitted from the unrestricted transfer of technology from Europe to the Americas.\textsuperscript{19} England did not anticipate the colonies becoming viable economic rivals instead of markets for domestic products and sources for raw materials, and regulation of technology transfer was not a priority.\textsuperscript{20} Meanwhile, colonial authorities were interested in both attracting additional colonists and economic development, which necessitated the emigration of trained artisans from Europe to America to recreate European living conditions and the spread of knowledge in certain trades\textsuperscript{21}, such as the manufacture of linen.\textsuperscript{22}

As the American colonies developed, England began to treat the colonies more as competitors by regulating technology transfers and prohibiting the practice of competing industries in the colonies.\textsuperscript{23} These restrictions hampered the growth of American industries, such

\begin{footnotesize}
\begin{enumerate}
\item Id. at 309.
\item Fuji Photo Film Co. v. Jazz Photo Corp., 394 F.3d 1368, 1376 (Fed. Cir. 2005), citing Int'l Rectifier Corp. v. Samsung Elecs. Co., 361 F.3d 1355, 1360 (Fed. Cir. 2004) ("Further, it is well known that United States patent laws 'do not, and were not intended to, operate beyond the limits of the United States,'" quoting Brown v. Duchesne, 60 U.S. 183, 195, 15 L. Ed. 595 (1856)).
\item Id at 345.
\item Id.
\item Id. at 19.
\item Id. at 20.
\item Id. at 22-5.
\end{enumerate}
\end{footnotesize}
as the textile industry. The colonies addressed the problem by awarding patents of importation to those who introduced technology that could assist colonial industries keep pace with innovation in England.

The colonies differed in their specific treatment of patents in regards to inventors and importers. Until the Revolution, Pennsylvania did not award patents to those who invented new technologies or manufacturing methods, and instead gave patents to those in introduced technology. In 1715, Connecticut enacted a rule that anyone who imported technology into the colony would be treated as the inventor of the technology.

However, certain colonies did attempt to encourage invention. Connecticut passed a law promising “encouragement” for anyone who discovered “any Commodities, that may b e of use for the Country[.]” Massachusetts, Connecticut and South Carolina were the only colonies, however, that were “major actors” in the issuing of patents to inventors. South Carolina’s colonial patent law, for example, had significant impact in its influence on the Intellectual Property Clause of the Constitution.

The debate between protecting the rights of inventors and encouraging the dissemination of technology continued after independence and into the politics of the early American patent laws. Early American society held an aversion to technological innovation, as it did not appear to be critical to the development of an economy that had been utilizing and rewarding dissemination. However, the rise of capitalism and the market economy after the War of 1812 led to a more favorable outlook of monopolies for inventors as a way to encourage growth by rewarding innovation. This shift in thought corresponded with a shift in the judiciary, which transitioned from imposing moral restrictions on inventors to favoring inventors in order to promote technological progress.

Case Law

Jazz Photo

Historically, United States courts generally decided cases involving patent rights exhaustion according to a limited international exhaustion scheme. In Dickerson v. Matheson, the Second Circuit held that if an article patented in both a foreign country and the United States is sold abroad by the owner or licensee of each patent, the foreign purchaser acquires full ownership in the article, which includes the right to use or sell the article in the United States.
However, the Circuit restricted this result to instances where the owner or licensee under the United States patent consented to the importation and domestic sale; without such consent, the United States owner or licensee would not lose his exclusive rights in the patented article.\textsuperscript{38}

In Jazz Photo v. Int’l Trade Comm., the Federal Circuit promulgated a rule that more closely corresponds to national exhaustion.\textsuperscript{39} Fuji Photo Film alleged that Jazz Photo, through the importation of single-use cameras that had been refurbished for use overseas, had infringed fifteen of its patents.\textsuperscript{40} The Circuit recognized that lawful sale in the United States gives subsequent purchasers the “same immunity under the doctrine of patent exhaustion” held by the holders of the patents themselves.\textsuperscript{41} However, sales occurring under foreign patent laws did not impart the same immunity to purchasers.\textsuperscript{42}

The Circuit reaffirmed the Jazz Photo holding in Fuji Photo Film Co., Ltd v. Jazz Photo Corp.\textsuperscript{43} According to the Circuit, because the authorized purchases by Jazz Photo occurred abroad, the patent rights held by Fuji Photo Film did not exhaust due to the lack of extraterritorial effect of the United States patent laws.\textsuperscript{44} In short, the Circuit clarified that Jazz Photo “expressly limited first sales under the exhaustion doctrine to those occurring within the United States.”\textsuperscript{45}

**Quanta**

The Supreme Court, in Quanta Computer, Inc. v. LG Electronics, Inc.\textsuperscript{46}, determined the methodology for determining whether a process comprising of a patented process and other components can be considered the same as the patented process for the purposes of patent rights exhaustion. LG Electronics had licensed the right to use its patented process, embodied as computer microprocessors and chipsets, to Intel to combine with its own products to sell.\textsuperscript{47} A condition imposed by a related master agreement was that neither Intel, nor its downstream purchasers, could combine the Intel products with third-party products.\textsuperscript{48} LG accused Quanta, a downstream purchaser from Intel, of infringing its patents though the very combination disallowed in the LG-Intel master agreement.\textsuperscript{49}

The test used by the Supreme Court to determine if LG’s patent rights were exhausted by the new combination of third party products with LG products that embodied its patent was whether the Quanta products substantially embodied the LG patent.\textsuperscript{50} Because the Quanta

\textsuperscript{38} Id.
\textsuperscript{39} Jazz Photo Corp. v. ITC, 264 F.3d 1094, 1105 (Fed. Cir. 2001), (“United States patent rights are not exhausted by products of foreign provenance. To invoke the protection of the first sale doctrine, the authorized first sale must have occurred under the United States patent.”).
\textsuperscript{40} Id. at 1098.
\textsuperscript{41} Id. at 1105.
\textsuperscript{42} Id.
\textsuperscript{43} 394 F.3d 1368 (Fed. Cir. 2005).
\textsuperscript{44} Id. at 1376.
\textsuperscript{45} Id.
\textsuperscript{46} 553 U.S. 617 (U.S. 2008).
\textsuperscript{47} Id. at 623.
\textsuperscript{48} Id. at 623-4.
\textsuperscript{49} Id. at 624.
\textsuperscript{50} Id. at 631-4.
products did not have a “reasonable non-infringing use”,\textsuperscript{51} and because they embodied the same inventive elements of the LG patents\textsuperscript{52}, the Court found that the Quanta products substantially embodied the LG patents. Since the sale by Intel to Quanta was authorized, the Court found that exhaustion occurred, despite the presence of the non-combination condition imposed on Quanta.\textsuperscript{53}

However, the only mention the Court made of foreign sales was in footnote 6, where the Court stated that the physical location of the products at issue was not an issue when determining whether the products practiced the patents.\textsuperscript{54} The Court also distinguished the act of practicing as an act independent of territory from the question of whether the products were infringing, which is an act which must occur within the jurisdiction.\textsuperscript{55}

The opening left by the Quanta Court and footnote 6 has resulted in a split in the courts regarding the issue of whether foreign authorized sales of patented products or of products that substantially embody a patent trigger patent right exhaustion. The Northern District of California, in LG Electronics, Inc. v. Hitachi, interpreted Quanta broadly, stating that since the Court acknowledged foreign sales in footnote 6, yet it did not limit its holding to sales in the United States, foreign exhaustion applies.\textsuperscript{56} The Eastern District of Texas took the opposite approach in finding that the doctrine of exhaustion was not triggered by foreign sales.\textsuperscript{57}

**Benun**

The Federal Circuit again took up the question of patent right exhaustion as the result of foreign sales in Fujifilm Corp. v. Benun, where it held that the Quanta Court “did not eliminate the first sale rule's territoriality requirement.”\textsuperscript{58} The Circuit took note of the distinction made by the Quanta Corp between practicing a patent and infringing a patent in footnote 6 of Quanta in order to support the proposition that because infringement can only occur where a patent is enforceable, due to the lack of extraterritoriality in patent law, the doctrine of exhaustion is limited by the requirement that the first sale occur domestically.\textsuperscript{59}

Petition for a writ of certiorari to the Supreme Court was filed by Benun on October 8, 2010, which was docketed for October 13, 2010.\textsuperscript{60} A granting of certiorari by the Supreme Court would presumably address the ambiguity regarding the relation of foreign sales with the patent exhaustion doctrine.

**CASE STUDY: Japanese Patent Law and Exhaustion**

\textsuperscript{51} Id. at 631-2, *citing* Univis, *supra*, at 249 (1942) (“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.”).

\textsuperscript{52} Id. at 632-3, *citing* Univis, *supra*, at 250-1 (1942) (“Second, the lens blanks in *Univis* ‘embodie[d] essential features of [the] patented invention.’”).

\textsuperscript{53} Id. at 635-7.

\textsuperscript{54} Id. at 632, n.6.

\textsuperscript{55} Id. (“Whether outside the country or functioning as replacement parts, the Intel Products would still be *practicing* the patent, even if not infringing it.”)


\textsuperscript{58} Fujifilm Corp. v. Benun, 605 F.3d 1366, 1371 (Fed. Cir. 2010).

\textsuperscript{59} Id. at 1371-2.

Historical and Cultural Background

Japan’s history of innovation and technology somewhat mirrors the development of the United States innovation industry in that ultimately relied on integrating foreign technology in order to achieve development. Japan’s history reveals a common thread of acquiring technology through dissemination, from sending scholars to China to bring back Buddhist knowledge to officials “absorbing anything new to their eyes” in the West. Even Japanese honorific titles reflect a cultural value in the spread of knowledge.

In the Meiji Period, Japanese officials attempted to create the first iron-manufacturing factory utilizing Western methods in 1875, even going as far as hiring a British engineer to supervise the facility. The factory failed due to the incompatibility of Western methods and Japanese coal, which was better suited for indigenous methods for manufacturing iron and steel. However, instead of improving Japanese methods, government officials chose instead to import coal from China, in order to make the imitated foreign methods feasible.

After World War II, Japanese attempts to acquire knowledge through imitation continued. Engineers from Japan visited American factories that manufactured transistors in order to observe the processes involved and to transcribe what they saw into diagrams to be sent home. Their American peers were eager to show them their technologies, not knowing that they were participating in the Meiji Era concept of acquiring technology through “Japanese spirit and Western knowledge.”

Many factors continue to be at play in making Japan a nation that places value on disseminating knowledge rather than providing strenuous rights for the inventor. Because of a highly regulated financial system and an underdeveloped venture capital market, individuals and small enterprises seeking to innovate often find themselves short on resources. As a result, while 19% of patentees in the United States are individuals, the corresponding figure in Japan is 1.8%. The contrast between American and Japanese patent laws also plays a role in the disparity in the relative numbers of individual patentees. In Japan, a “disclosure at application” system requires inventors to open up their inventions to the public one and a half years after they apply for a patent, forcing individual inventors with few resources to turn to manufacturers and companies. In the United States, on the other hand, disclosure to the public can occur as late as

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63 See id. at 146 ("PhD" in Japanese is Hakushi, which roughly translates to one who acquires knowledge and spreads it to other people. “Teacher” is Sensei, which roughly translates to a person who is born before and teaches his or her knowledge to children.).
64 See Tsurumi, at 152.
65 See Id.
66 See Id. at 153-4.
67 Nakajima, supra at 143.
68 Id. at 143-4.
69 See id. at 145, citing M. INUI, JAPANESE AND CREATIVITY, 226 (Kyoritsu Press 1982).
70 Id.
71 See id. at 146-7.
occur at registration, which, along with the unique “first to invent” priority system of the United States, gives individual inventors more control over when their invention becomes public.\textsuperscript{72}

**Case Law**

**Brunswick Corp v. Orion Kogyo K.K.**

Unlike the shift from implied international patent right exhaustion to national exhaustion exhibited by the United States Federal Circuit, the first Japanese court to consider the question of parallel importation and exhaustion initially followed a territorial approach to the question of patent right exhaustion.\textsuperscript{73} In 1969, the Osaka District Court in Brunswick Corp. v. Orion Kogyo, K. K., dealt with a claim of infringement brought by a holder of patents in bowling pin installing devices in both Australia and Japan against a purchaser of twenty-two devices in Australia who then imported the devices into Japan.

The court acknowledged that the patent rights regarding the purchased devices were exhausted in Australia.\textsuperscript{74} However, because the license granted by Brunswick did not cover the territory of Japan, its Japanese patent rights could still be enforced despite the authorized sale in Australia.\textsuperscript{75} The court reasoned that because a patent applicant who wishes to acquire patents in multiple countries must file multiple applications with each country, the territorial nature of such patents applies to the collection of royalties as well, and patent exhaustion only occurs in the nature where there is an authorized first sale.\textsuperscript{76}

**BBS Aluminum**

The Tokyo District Court, in Jap Auto Products K. K. v. BBS Kraftfahrzeug Technik A.G. (BBS Aluminum), addressed a foreign sale in Germany\textsuperscript{77} and a license which did not exclude Japan as a territory.\textsuperscript{78} BBS sought to prevent the importation of their patented goods by relying on the reasoning of the Osaka District Court in Brunswick and the territoriality principle.\textsuperscript{79} The District Court aligned itself with the Osaka Court by refusing to apply the international exhaustion doctrine to patented goods, as it felt that the doctrine was inconsistent with the patent law’s purpose of encouraging the full disclosure of inventions.\textsuperscript{80}

The Tokyo High Court reversed the District Court on appeal, holding that the international exhaustion doctrine did apply to patented goods.\textsuperscript{81} The High Court reasoned that the

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\textsuperscript{72} See id. at 147.


\textsuperscript{74} Id.

\textsuperscript{75} Id. at 568-9.

\textsuperscript{76} Id. at 569.

\textsuperscript{77} Id. at 569, citing Jap Auto Products Kabushiki Kaisha and Another v. BBS Kraftfahrzeug Technik A.G., Tokyo District Court July 22, 1994 (Hanrei Jihou 1501.72; Hanrei Times 854.84).


\textsuperscript{79} Naoko, supra at 570.

\textsuperscript{80} Id.

\textsuperscript{81} Id. at 571, citing Jap Auto Products, K. K. and Another v. BBS Kraftfahrzeug Technik A.G Tokyo High Court, Ne-No. 3272 of 1994, March 23, 1995.
patent laws sought to harmonize the protection of the interests of inventors along with the interest the public had in disclosure and economic development. Since BBS had already been compensated once for the authorized sale of its goods in Germany, the High Court found that BBS was not entitled to another royalty in the importation to Japan, and its Japanese patent rights in the particular articles were exhausted by the international first sale.

BBS appealed the High Court’s decision to the Supreme Court, which ultimately upheld the High Court’s application of international exhaustion. The Court reasoned that because BBS had not excluded Japan from the distribution area or the territory of use in the license that ultimate resulted in the sale in dispute, BBS was not entitled to receive injunctive relief. Further rationale for the application of international exhaustion entailed the need for balance between the protection of inventions and the interests of society, the principle of a purchaser of goods receiving full title to the purchased goods from the seller in a free market, and the policy of allowing the patent owner only one profit per patented product once he sells the particular article embodying the patent.

The BBS Aluminum Court further clarified its stance on the exhaustion of patent rights after a foreign first sale by stating that when patented products are sold to a purchaser in a foreign country, it is assumed that the products could be imported into Japan and that any such sale without restriction as to distribution area or territory of use is accompanied with an implied license to import the products into Japan. However, the Court did limit the application of international exhaustion. In light of the lack of a territorial restriction in BBS Aluminum compared to Brunswick, the Court permitted patent owners and foreign purchasers to freely negotiate distribution areas to exclude Japan from said area, thus allowing patent owners an avenue to bar parallel imports into Japan.

HARMONIZATION

The above analysis shows that the discretion allowed by TRIPs Article 6 has resulted in a disjointed arrangement of contrasting national legal treatments of the exhaustion of patent rights in regards to international first sales. To ameliorate this issue, several proposals have been made harmonization, including shifting United States policy towards international exhaustion, regional exhaustion, and allowing patent holders to use contract and business solutions to work around parallel importation.

International Exhaustion in the United States: Costco v. Omega

Two landmark United States cases, Quality King Distributors, Inc. v. L’anza Research International, Inc. and Omega S.A. v. Costco Wholesale Corp., characterize United States

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82 Id.
83 Id.
84 Doi supra at 388.
85 Id. at 389.
86 Id. at 390.
87 Id.
88 Id. at 390-1.
89 See supra note 12.
91 541 F.3d 982 (9th Cir. Cal. 2008), aff’d per curiam, (131 S.Ct. 565, 2010).
policy towards the application of the doctrine of exhaustion in regards to copyrights. A key difference between the patent exhaustion doctrine and the copyright exhaustion doctrine is that the former was a judicially created rule\textsuperscript{92}, while the latter was enacted in statute as the first-sale doctrine in Section 109(a).\textsuperscript{93} However, the granting of certiorari by the Supreme Court to Costco has lead some retailers and other business entities to link the patent and copyright exhaustion doctrines in an attempt to settle the debate in favor of international exhaustion for both.\textsuperscript{94}

**Quality King v. L’anza**

The Supreme Court addressed the issue of copyright exhaustion after international first sale in Quality King, which involved a dispute between L’anza, a manufacturer of shampoo bottles, and Quality King, a downstream distributor. L’anza manufactured bottles with copyrighted labels in the United States and sold the bottles in Malta to Quality King, who then imported the bottles into the United States.\textsuperscript{95} L’anza sought to enjoin the importation of the bottles by relying on the Copyright Act’s prohibition on unauthorized importation, which barred the unauthorized importation of copyrighted works that were acquired outside of the United States.\textsuperscript{96}

However, the Supreme Court found that the importation prohibition was not an unrestricted prohibition, since the prohibition was defined as infringement of the copyright owner’s exclusive right to distribute copyrighted works under section 106.\textsuperscript{97} In addition, section 106 was subject to section 109(a), which allowed authorized purchasers and owners of copyrighted works that had been “lawfully made under this title” to dispose of his possession of the particular work.\textsuperscript{98} Because the typical commercial transaction involved in importation generally involves a transfer of possession, the Court found that the act of importation fell under the first-sale doctrine.\textsuperscript{99}

The first-sale doctrine also required that the work in dispute be “lawfully made under this title.”\textsuperscript{100} L’anza argued that, because section 602(b) covered unlawfully made copies,\textsuperscript{101} section 601(a) would be rendered pointless if lawfully made copies could be imported under the first sale doctrine.\textsuperscript{102} The Court, however, found that “lawfully made copies” in fact constituted two separate categories of works; “lawfully made” under United States copyright law, and “lawfully made” under foreign copyright law.\textsuperscript{103} Support for the division of international markets was

\textsuperscript{92} See supra notes 31-3.
\textsuperscript{93} 17 U.S.C. § 109(a), (“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.”).
\textsuperscript{95} Quality King, 523 U.S. at 138-9.
\textsuperscript{96} 17 U.S.C. § 106(3).
\textsuperscript{97} See id. § 109(a).
\textsuperscript{98} Quality King, 523 U.S. at 151-2.
\textsuperscript{99} See id. § 109(a).
\textsuperscript{100} Quality King, 523 U.S. at 146.
\textsuperscript{101} 17 U.S.C. § 602(b), (“In a case where the copies or phonorecords were lawfully made, United States Customs and Border Protection has no authority to prevent their importation unless the provisions of section 601 are applicable.”).
\textsuperscript{102} See Quality King, 523 U.S. at 146.
\textsuperscript{103} Id. at 148.
found in the legislative history of the copyright act, where it was suggested that a ban on imports be extended to foreign-made works.\textsuperscript{104} Therefore, the Court found that while section 602(a) applied to ban the import of all lawfully made works, the first-sale doctrine allowed the importation of works that were manufactured in the United States, even if the first authorized sale occurred abroad.\textsuperscript{105} Justice Ginsburg confirmed this view, and at the same time opened the door for further litigation, by noting in a concurring opinion that the decision did not apply to works manufactured abroad.\textsuperscript{106}

\textbf{Costco v. Omega}

The Ninth Circuit took up the remaining issue of foreign-made goods in a dispute between watch-manufacturer Omega, who manufactured watches in Europe, and Costco, who purchased watches from third parties and marketed the watches in California for lower prices.\textsuperscript{107} The Circuit found that no exhaustion defense exists for authorized copies of a work under a United State copyright if the work was manufactured abroad, unless the copies were already sold domestically with the copyright holder’s authority.\textsuperscript{108} The general rule in the Ninth Circuit that only copies legally made in the United States could fall under section 109(a) did not seem to conflict with Quality King, and so the Circuit held that the rule remained binding precedent.\textsuperscript{109}

\textbf{Amici Curiae in Costco}

Costco’s petition for writ of certiorari was granted by the Supreme Court on April 19, 2010\textsuperscript{110}, and oral arguments were held on November 8, 2010.\textsuperscript{111} In anticipation of the appeal, several retailers and other business entities filed amici curiae briefs.\textsuperscript{112} One such brief, filed by Intel Corporation, supported Costco and its arguments in favor of international exhaustion.\textsuperscript{113} However, Intel went further in attempting to argue for international exhaustion for both copyrights and patents. Intel first linked together the law of copyrights and the law of patents by pointing to the “historic kinship” between the two fields of law\textsuperscript{114}, and because of that historic linkage, the decision to codify the first sale doctrine in section 109(a) around the time the parallel patent doctrine treated foreign and domestic sold goods equally as exhausting clearly indicated

\textsuperscript{104}Id. at 147, \textit{citing} Copyright Law Revision: Report of the Register of Copyrights on the General Revision of the U.S. Copyright Law, 87th Cong., 1st Sess., 125-6 (H.R. Judiciary Comm. Print 1961), (“When arrangements are made for both a U.S. edition and a foreign edition of the same work, the publishers frequently agree to divide the international markets. The foreign publisher agrees not to sell his edition in the United States, and the U.S. publisher agrees not to sell his edition in certain foreign countries. It has been suggested that the import ban on piratical copies should be extended to bar the importation of the foreign edition in contravention of such an agreement.”).

\textsuperscript{105}Id. at 148.

\textsuperscript{106}Id. at 154 (Ginsburg, J., concurring).

\textsuperscript{107}Omega 541 F.3d at 983-4.

\textsuperscript{108}Id. at 983.

\textsuperscript{109}Id. at 990, \textit{citing} BMG Music v. Perez, 952 F.2d 318, 319 (9th Cir. Cal. 1991).

\textsuperscript{110}Costco Wholesale Corp. v. Omega S.A., 130 S. Ct. 2089 (U.S. 2010).


\textsuperscript{112}See Mullin.


\textsuperscript{114}Id. at 6-7, \textit{citing} Sony Corp of Am. V. Universal City Studios, Inc., 464 U.S. 417, 439 (1984).
the same intent behind section 109(a).\footnote{Id. at 13-4.} Intel then pointed to the Quanta decision, which it interpreted as clearly applying international exhaustion to foreign sales of patented goods due to the lack of a limitation of the rule to sales in the United States\footnote{Id. at 18-9, citing LG Elecs., 655 F. Supp. 2d at 1045.}, as a rationale for reversing the Ninth Circuit and preventing the “end-run around exhaustion” that the Circuit allowed.\footnote{Id. at 22, citing Quanta, 553 U.S. at 630.}

Whether the Supreme Court determines that the first sale doctrine applies to goods manufactured abroad, or follows Quality King in distinguishing between domestic and foreign manufacture, remains to be seen. However, with the Court’s decision in Omega and a potential grant of certiorari in Benun\footnote{Supreme Court Docket, http://www.supremecourt.gov/Search.aspx?FileName=/docketfiles/10-486.htm (last visited November 7, 2010).}, a resolution in the debate over the patent exhaustion in favor of international exhaustion could be influenced by a corresponding clarification in the copyright exhaustion doctrine.

Regional Exhaustion

Common Markets

Another model for harmonization of the different national models of patent exhaustion is the development of regional exhaustion through international communities. These communities of nations often form common markets, with the goal of providing for economic progress within the community through removing barriers to trade and harmonizing customs.\footnote{See Treaty Establishing the European Economic Community, pmbl., Jan. 1, 1958, http://www.ena.lu/?lang=2&doc=18771, (last visited November 8, 2010), see also Cartagena Agreement, pmbl. 1973, http://www.worldtradelaw.net/fta/agreements/cartagenafta.pdf, (last visited November 8, 2010).}

The process of removing trade barriers and custom harmonization was achieved in the European Community through the Treaty of Rome, which mandated that quantitative restrictions on trade between Member States, along with other restrictions with similar affect, be prohibited.\footnote{See Treaty Establishing the European Economic Community, ch. 2, art. 30-1.} The Treaty also required Member States to refrain from making any existing quotas or equivalent measures more restrictive and extend any bilateral quotas with any one Member State to all Members of the Community.\footnote{See id. ch. 2, art. 32-3.} Finally, the Treaty required Member States prohibit quantitative export restrictions along with import restrictions.\footnote{See id. ch. 2., art. 34.}

However, the Treaty did include a list of restrictions that Articles 30-34 could not prohibit, one of which included restrictions for the protection of industrial and commercial property.\footnote{See id. ch 2., art. 36.} This permitted restriction was central to the disputes over the protection of patents in interstate trade within the Common Market, most notably Merck & Co., Inc. v. Stephar B.V.\footnote{Case 187/80, Merck & Co. v. Stephar BV, 1981 E.C.R. 2063, available at http://eur-lex.europa.eu/smartapi/cgi/sga_doc?smartapi!celexplus!prodCELEXnumdoc&numdoc=61980J0187&lg=en (last visited Oct. 21, 2010).}

Merck, which owned patents for the drug Moduretic in the Netherlands, marketed the drug in Italy, where it did not have a patent due to an Italian restriction on the patenting of
pharmaceutical drugs. Stepbar purchased the drugs in Italy, and then attempted to import the drugs into the Netherlands in direct competition with Merck. In the ensuing infringement dispute, the question was referred to the European Court of Justice, which considered whether Articles 30-34 prohibited the restriction of the importation of a patented drug from a Member State where the drug was introduced by the patent holder himself.

Merck pointed to a 1974 European Court case, where Article 36 was used to allow the restriction of importation of patented products. However, the Court found a critical distinction in the facts of that case and the case at hand. While the previous case involved products manufactured by third parties who did not obtain authorization from the patent holder, Merck had placed its product into the Italian market itself. Merck argued that despite the distinction, the protection afforded by the patent would not be achieved if it could not receive the benefit for its research and if it could not be afforded the right to be the first to place its product in a particular market.

The Court sided with Stepbar in finding that because the patent owner has the exclusive right to be the first to place a patented product in a market, and to choose the markets, he must accept whatever consequence would arise from actually doing so. Because the free movement of goods in a common market is one of the conditions that must be considered in the decision of whether to place a patented product within the common market, the later movement of such products within that market cannot be restricted, even if such movement is undesirable to the patent holder. The Court found support for its position in prior decisions, which all stated that holders of patents could not rely on the patent to bar importation of patented products which the holder himself, or others with his consent, placed into the stream of commerce of another Member State.

Problems with Regional Harmonization

While harmonization of legal systems through the common market mechanism can be achieved, problems exist with that mechanism that can hamper that process. Some problems have been identified as procedural, arising out of the difficulty of changing several nations’ laws relative to changing the laws of just one nation. Other problems are more substantive in that they arise out of differences in the laws themselves and the traditions behind those laws.

125 See id. at para. 2.
126 See id.
127 See id. at para. 3.
128 See id. at para. 4, citing Case 15/74, Centrafarm BV et Adriaan de Peijper v Sterling Drug Inc. 1974 E.C.R. 1147.
129 Id. at para. 5.
130 Id. at para. 6.
131 Id. at para. 8.
132 Id. at para. 11.
133 See id.
136 See id.
137 See id. at 201.
Regional harmonization in Europe exemplified those procedural issues. Driven by the standard goal of common markets (that of removing obstacles to trade within a common market), the regional movement necessarily ignored to a certain extent other concerns, which found more sympathy in the legislatures of the national governments.\(^\text{138}\) Because harmonization is also handled on a gradual basis, regional legislation is often slow, giving more opportunities for lobbying to influence the process in order to affect a balance that may be beneficial for the interests behind the lobbying but which is ultimately non-ideal.\(^\text{139}\) However, once a certain balance is struck, the ultimate goal of removing trade barriers in regards to a certain industry have technically been removed, making and necessary revisions much more difficult to achieve than the initial harmonization.\(^\text{140}\)

The regional harmonization movement regarding copyright exceptions provides more insight into the problems that can arise from harmonizing the laws of nations with common interests but different legal backgrounds.\(^\text{141}\) Nations that derive their copyright law from a more utilitarian background view copyrights as a right that is granted to arrive at a particular outcome, and if the desired goals are not achieved, exceptions to the right are easily proposed and implemented to achieve those goals.\(^\text{142}\) Nations that derive their copyright law from the droit d’auteur system, which recognizes the copyright as a natural right that flows not from the state but from the author’s act of creation, limit exceptions to exceptional circumstances and rights a higher priority than intended goals.\(^\text{143}\) Any sort of regional integration achieved by the harmonization movement risks focusing on these differences between national systems, and can ignore the more central issues that a regional system must face.\(^\text{144}\)

**International Exhaustion Limited by Contract Strategies**

Another solution to the disparity of exhaustion systems is for the implementation of an international exhaustion system, limited by the availability of business and contract solutions that can allow parties to a transaction to bind themselves to an arrangement that avoids the problem of parallel importation. Such an approach was recognized and approved by the BBS Aluminum Court\(^\text{145}\), and provides the basis for several proposals for preventing the importation of grey-market goods.

**Trademarks and “Materially Different” Goods**

The field of trademarks provides a means for patent holders, through the “materially different” goods, to create a cause of action that can prevent parallel importers from importing grey-market goods.\(^\text{146}\) This bar on importation is found in section 42 of the Lanham Act, which

\(^{138}\) See id. at 194.
\(^{139}\) See id. at 194-5.
\(^{140}\) See id. at 195.
\(^{141}\) See id. at 201.
\(^{142}\) Id.
\(^{143}\) Id., citing RIChARD DWORkIN, TAKING RIGHTS SERIOUSLY xi (Duckworth 1981).
\(^{144}\) Id.
\(^{145}\) See supra note 83.
\(^{146}\) Lawrence M. Friedman, Business and Legal Strategies for Combating Grey-Market Imports, 32 Int’l Law. 27, 49 (Spring 1998).
Prevents the importation of products that bear the name of the patent holder or a registered mark, if those products lead to customer confusion.\textsuperscript{147} U.S. courts have recognized that customer confusion can arise from products that are labeled with a trademark but are materially different from domestic products labeled with the same trademark. In Lever Bros. Co. v. United States\textsuperscript{148}, British soap, which was branded with the standard Lever brand but was manufactured to function with British water conditions, was imported into the United States, where American customers thought they were purchasing Lever brand soap at a discount but instead purchased a soap that did not produce the lather they expected.\textsuperscript{149} The D.C. Circuit held that Lever could rely on Section 42 to bar the importation of goods that they offered for sale abroad that had material differences from domestic goods, provided that they had the same trademark.\textsuperscript{150}

A material difference is defined as “any difference between the product and the grey-market good that ‘consumers would likely consider to be relevant when purchasing a product.’”\textsuperscript{151} Product composition, such as the differences in the Lever soap designed for different water conditions\textsuperscript{152}, along with differences in color or packaging, can constitute such material differences.\textsuperscript{153}

In order to take advantage of this statutory bar on importation, patent holders, when considering foreign distribution of their patented products, should manufacture, or direct licensees to manufacture, products intended for distribution to a particular jurisdiction to specifications different than specifications for products heading to other territories.\textsuperscript{154} This difference can be achieved through minimal changes, such as different ingredients or a different color.\textsuperscript{155}

\textbf{Contractual Restrictions}

Restrictions on downstream purchasers provide another avenue for patent holders to prevent the importation of grey-market goods. For example, the Japanese Supreme Court in BBS Aluminum implicitly recognized that territorial restrictions imposed on licensees and downstream purchasers could shield a jurisdiction from an influx of patented products sold at a price lower than what was offered by the patent holder.\textsuperscript{156}

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\textsuperscript{147} See 15 U.S.C. § 1124 (“[N]o article of imported merchandise which shall copy or simulate the name of any domestic manufacture, or manufacturer, or trader, or of any manufacturer or trader located in any foreign country which, by treaty, convention, or law affords similar privileges to citizens of the United States, or which shall copy or simulate a trademark registered in accordance with the provisions of this chapter or shall bear a name or mark calculated to induce the public to believe that the article is manufactured in the United States, or that is manufactured in any foreign country or locality other than the country or locality in which it is fact manufactured, shall be admitted to entry at any customhouse of the United States.”) (emphasis added).
\textsuperscript{148} 877 F.2d 101 (D.C. Cir. 1989).
\textsuperscript{149} Id. at 103.
\textsuperscript{150} See id. at 111.
\textsuperscript{152} See Lever 877 F.2d at 103.
\textsuperscript{153} See Societe Des Produits Nestle, 982 F.2d 642-3, see also Martin's Herend Imports v. Diamond & Gem Trading USA, 112 F.3d 1296, 1302 (5th Cir. Tex. 1997).
\textsuperscript{154} Friedman supra at 49.
\textsuperscript{155} Id.
\textsuperscript{156} See supra note 80.
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In the United States, an opening for remedies for a contract breach was provided for by the Quanta court, which did not state an opinion regarding the viability of such a claim.\textsuperscript{157} Quanta, on its surface, was textually silent on the issue of whether patent exhaustion applies to authorized international first sales.\textsuperscript{158} However, the implication was that while contractual restrictions on downstream purchasers could not be enforced in regards to the patent law, they could still give rise to contract remedies.\textsuperscript{159}

Restrictions on downstream purchasers, such as the restriction on purchasers barring combination of purchased products with third party products in Quanta\textsuperscript{160}, are examples of restrictions that could leave no recourse in the patent law.\textsuperscript{161} Direct restrictions, which occur when a purchaser acquires a product directly from the patent holder without any licensees acting as intermediaries, by definition triggers patent exhaustion, since the sale of the patented product has occurred under the authorization of the patent holder.\textsuperscript{162}

On the other hand, indirect restrictions occur under licenses, such as the patent license in Quanta, where the licensee has not purchased products itself but rather the right to make patented products, and as a result, an authorized sale has not occurred until the licensee sells the patented product in a situation approved by the patent holder in the license.\textsuperscript{163} If a sale allowed by the license has occurred, then the patent holder’s rights in the products have been exhausted; if the sale has not been allowed by the license, patent remedies are still available.\textsuperscript{164} Examples of such licenses are field of use restrictions, where a licensee is only allowed to use or sell products embodying the patent in a particular defined field, and any sale outside of such fields are not authorized and do not trigger patent right exhaustion.\textsuperscript{165} Territorial restrictions also fall under this category, where licensees are given the exclusive right to sell patented products in a designated jurisdiction but are not allowed to sell outside of the assigned jurisdiction.\textsuperscript{166}

**Recognition and Antitrust Problems**

Despite the freedom to contract offered by Quanta’s opening to contractual restrictions, other nations may not offer the same approval of contractual restrictions on downstream products.

\textsuperscript{157}See Quanta 553 U.S. at 637 n. 7 (“We note that the authorized nature of the sale to Quanta does not necessarily limit LGE’s other contract rights. LGE’s complaint does not include a breach-of-contract claim, and we express no opinion on whether contract damages might be available even though exhaustion operates to eliminate patent damages. See Keeler v. Standard Folding Bed Co., 157 U.S. 659, 666, 15 S. Ct. 738, 39 L. Ed. 848, 1895 Dec. Comm’r Pat. 294 (1895) (“Whether a patentee may protect himself and his assignees by special contracts brought home to the purchasers is not a question before us, and upon which we express no opinion. It is, however, obvious that such a question would arise as a question of contract, and not as one under the inherent meaning and effect of the patent laws.”)."

\textsuperscript{158}See supra note 49.

\textsuperscript{159}Tu Thanh Nguyen, *Patent Holders’ Contractual Restrictions on Downstream Purchasers in the United States and European Union through Quanta Prism*, 12 J.W.I.P. 89, 96 (March 2009).

\textsuperscript{160}See supra note 43.

\textsuperscript{161}See Nguyen supra at 98.

\textsuperscript{162}See id.

\textsuperscript{163}See id.

\textsuperscript{164}See id.

\textsuperscript{165}See id. at 97, citing General talking Pictures Corp. v. Western Electric Co., 304 U.S. 175, 181 (1938), (“Patent owners may grant licenses extending to all uses or limited to use in a defined field.”).

The Andean Community, for example, requires the governments of its Member States to regulate and approve contracts on the importation of patents. At one time, the Community mandated that any license for the exploitation of patents that included territorial restrictions or similar restrictions be rejected by the national offices of Member States. The Andean community has since relaxed its stance by giving the national offices of Member States the power to allow such territorial restriction in special cases.

Another problem with territorial restrictions lies with antitrust law. Generally, vertical territorial restraints in a patent license are permitted, “absent some special competitive abuse.” In regards to licenses for intellectual property, there is often a variety of substitutes to protected products to preclude market power, and whatever market power is derived “does not necessarily offend antitrust laws.” Licensing has many pro-competitive benefits, and contractual restrictions allow licensors more freedom to achieve efficient distribution if their intellectual property.

However, if a license restraint is likely to have an anticompetitive effect and that restraint does not produce enough pro-competitive benefits, an antitrust violation can be found. If there is doubt as to whether there a restraint is predominantly pro- or anti-competitive, a factual inquiry into the market conditions will be made to determine if a restriction violates antitrust law. For example, if territorial restrictions between a licensor and several global manufacturers, who compete with each other on the global market, limit those manufacturers to separate territories and prevent them from competing against each other, an anticompetitive effect will be found. Patent holders who create such an arrangement risk having their contractual provisions challenged as horizontal market allocation schemes.

PROPOSAL

168 See id. at 158 (“Article 18.- All contracts on importation of techniques, patents and marks, must be examined and subjected to the approval of the corresponding organism in the respective member country which must evaluate the effective contribution of the imported technique through an estimate of its possible profits, the price of the assets benefited with the techniques, or other specific forms of evaluation of the effect of the imported technique.”), see also Andean Community, Decision 486, art. 57-8 (September 14, 2000), available at http://www.comunidadandina.org/ingles/normativa/d486e.htm, (last visited Nov. 11, 2010).
169 See Decision 24, 10 I.L.M. at 160-1 (“Article 25.- The contracts granting license for exploitation of… patents in the territory of the member countries cannot include restriction clauses such as a. Prohibition to export or sell, in specific countries, those products manufactured under license of the respective… patent… f. Others with similar effects.”).
170 Andean Community, Decision 291, art. 14 (March 21, 1991), available at http://www.comunidadandina.org/ingles/normativa/d291e.htm, (“Except in special cases that have been duly judged by the competent national agency of the recipient country, clauses prohibiting or limiting in any way the export of the products manufactured using the respective technology, shall not be accepted.”).
171 See Abbott supra at 614.
172 Department of Justice at 1121.
173 See id.
175 See id. at 1133-4.
176 See id. at 1134-5.
177 See id.
The United States Supreme Court’s impending decision in Costco v. Omega, along with a potential grant of certiorari in Fujifilm v. Benun, could soon give rise to the application of international patent rights exhaustion under United States law. Ultimately, a switch from the national exhaustion doctrine to its international counterpart is ideal. In regards to copyright law, the Quality King decision, which imposed international copyright exhaustion to products manufactured in the United States, appears to give an incentive to copyright owners to manufacture their products elsewhere in order to retain their United States resale rights. A decision in favor of broader international copyright exhaustion, which would cover products made outside of the United States, should eliminate what appears to be an unintended consequence of both code and case law that favors international manufacturing over domestic manufacturing.

Patent holders in the United States should be aware that if such a result occurs, parallel importation could increase should the Supreme Court choose to standardize copyright and patent exhaustion in Benun. However, while the progress of international economic integration could render a broad international exhaustion of patent rights desirable, in the current setup of the international economy, allowing parallel importation would give patent owners an incentive to avoid markets that require lower prices. By targeting markets with higher prices, trade of those goods to jurisdictions with lower prices will decrease, thus creating a stunting effect on international trade that could negate whatever benefits that arise from parallel importation.

Regional exhaustion of patent rights through free trade zones could serve as an intermediary between the national exhaustion schemes and international harmonization. However, the problems experienced in the regional harmonization of European intellectual property laws forebode similar obstacles for similar efforts. The problem is furthered when members of a free trade area have intellectual property schemes that differ not just in regards to specific provision but also in regards to overall systems. Therefore, while the regional approach may eventually arrive at harmonization, the process could create inefficient or non-ideal solutions.

Therefore, a modified international exhaustion regime, limited by the parties’ right and freedom to contractually disclaim importation rights, presents the most efficient solution to the lack of harmonization. Patent owners can employ trademark law to bar importation of goods that are materially different from domestic goods, as long as those material differences are tailored towards consumers in foreign jurisdictions. There are also various contract provisions that can limit downstream purchasers from selling or offering to sell patented articles outside of an agreed-upon territory. While problems with the contractual approach exist in regards to prohibitions on specific provisions and antitrust law, international exhaustion as a default rule instead of an absolute rule provides international distributors with somewhat increased bargaining power while still giving patent owners a measure of control over how their products are distributed. Such a balance is ultimately preferable over situations where, due to a more


\[\text{See supra notes 138-40.}\]

\[\text{See supra notes 141-4.}\]

\[\text{See supra notes 151-3.}\]

\[\text{See supra note 166.}\]

\[\text{See supra note 168-70.}\]

\[\text{See supra note 171-7}\]
absolute default legal rule, parties at either end of the bargaining table are placed at an inherent legal disadvantage.