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Patents — The Last Border Guard?

Intellectual Property

CHEAT SHEET

- ***A Wiley scheme.*** When textbook-makers John Wiley & Sons Inc. segregated prices by region, an enterprising Thai student resold cheaper foreign copies in the United States, and won in court.
- ***When copyright goes wrong.*** The Wiley case doomed the ability of businesses to use copyright to discriminate prices for identical products in different regions.
- ***A patently better option.*** While copyrights offer little use in this regard, patents offer owners two-fold protection from unauthorized importation.
- ***A segmentation solution.*** To preserve copyright and trademarks, businesses may consider differentiating their products domestically and abroad.

A country's national laws govern intellectual property rights — such as patents, trademarks, and copyrights — and determine their validity and infringement. For this reason, these rights have generally been regarded as territorial, as having a separate existence. This meant that a sale under a patent, trademark, or copyright in one country did not exhaust the corresponding right in another. Thus the sale of a product covered by an intellectual property right in one country, did not prevent the owner of that intellectual property right in a different country from blocking the importation of the product first sold abroad. The territoriality conferred by intellectual property rights has generally permitted the owners of those rights to segment the market, exploiting the rights differently in each country. Examples include adopting a local pricing strategy that allows the owner to maximize profits, without fear that the pricing differential will cause a product sold cheaply in one country to flow to another country where the product is higher priced. Not only does this market segmentation maximize the IP rights-holder's profits, but it also makes the product more widely available, since the rights-holder can price the product according to local conditions.

Copyright exhaustion

John Wiley & Sons Inc., a global publishing company specializing in academic publishing, used differential pricing in the marketing of textbooks, selling an American version printed and sold in the United States, and a foreign version manufactured and sold abroad at a relatively lower price. Supap Kirtsaeng, a Thai student studying in the United States, noticed this pricing differential and asked friends and family in Thailand to buy copies of foreign edition English language textbooks at Thai bookshops, where they were sold at low prices. These were mailed to the United States, where Kirtsaeng would resell them at a profit.

In 2008, Wiley sued Kirtsaeng for copyright infringement, in particular for violation of Wiley's exclusive distribution right under 17 USC §106(3) and its exclusive importation right under 17 USC §602. Kirtsaeng argued that the first sale doctrine of 17 USC §109(a), which provides "the owner of a particular copy . . . lawfully made under this title . . . is entitled, without the authority of the copyright owner, to sell or otherwise dispose of the possession of that copy," permitted Kirtsaeng's resale of textbooks lawfully acquired from the copyright owner. Wiley prevailed in the district court, which held that the first sale doctrine does not apply to foreign manufactured goods (even if they were made with the copyright owner's permission), and the Second Circuit affirmed. Four years later in 2012, Wiley found itself at the US Supreme Court, which characterized the question as whether “lawfully made under this title” restricts the scope of the §109(a) first sale doctrine geographically. The Supreme Court concluded that this language, considering the context and the common-law history of the first-sale doctrine, favors a non-geographical interpretation of the statute. This meant that the first sale doctrine applied to Wiley’s foreign sales of foreign editions, and thus Wiley could not stop Kirtsaeng for importing and selling them.

Kirtsaeng has severely limited a business’ ability to use copyright rights to discriminate prices geographically. Now, if the pricing difference of a copyrighted work is too great, purchasers in a lower-price country can exploit the price differential just as Kirtsaeng did, and undercut the copyright owner in higher priced countries. Kirtsaeng himself sold nearly US$1 million of textbooks on eBay, so the impact on the publishing and music industries alone could be substantial. In a post-*Kirtsaeng* world, businesses must make the products sufficiently different so the products sold in the lower price countries are less attractive to purchasers in higher price countries, or find some other way to avoid competing with itself.

What about patents?

In the aftermath of *Kirtsaeng*, many have questioned whether the Supreme Court’s broad interpretation of first sale would apply to patents as well as copyrights. Patents also support significant price differentials, particularly in the field of pharmaceuticals, where consumers have long recognized that many prescription medications are available in other countries at significantly lower prices. The Court of Appeals for the Federal Circuit recently had the opportunity to revisit the patent first sale doctrine in *Lexmark International, Inc. v. Impression Prods., Inc.* In Lexmark, Impression Products was purchasing used Lexmark printer cartridges, then refilling and reselling them. All of the spent cartridges that Impression acquired domestically were subject to a single use restriction. Some of the spent cartridges that Impression acquired abroad were subject to this restriction, and some were not.

On the issue of the validity of the single use restriction, the Federal Circuit adhered to its prior holding in *Mallinckrodt, Inc. v. Medipart, Inc.,* that a patent owner, when selling a patented article subject to a single-use/no-resale restriction that is lawful and clearly communicated to the purchaser, does not by that sale give the buyer, or downstream buyers, the resale/reuse authority that has been expressly denied. Thus, whether the sale is domestic or foreign, the express restriction will be honored. On the issue of whether the first sale doctrine applies to foreign sales, the Federal Circuit adhered to its prior holding in *Jazz Photo Corp. v. International Trade Comm’n*, that the owner of a US patent, merely by selling or authorizing the sale of a US patented article abroad, does not authorize the buyer to import the article, sell, and use it in the United States. Thus, the Federal Circuit reached a directly opposite conclusion about patent rights, than the Supreme Court reached on copyright rights in *Kirtsaeng*. This different result stemmed from the fact that unlike copyright law, which has an express statutory first sale exception (17 USC §109(a)), patent law does not. This Federal Circuit noted that Congress made the infringement important, and exclusive rights provisions subservient to the express guarantee of the first sale clause, but did not create such an exhaustion with respect to patent rights, one of which is the right to import.

The Federal Circuit began its analysis in *Lexmark* by stating that the Patent Act differs from the Copyright Act. The Federal Circuit observed that in the copyright statute, Congress included a provision (17 USC §109(a)) giving a right of sale to certain article owners, and made the infringement, importation, and exclusive-rights provisions all subservient to that express guarantee. The Federal Circuit further noted that the Patent Act does not contain a congressionally prescribed exhaustion rule, let alone a provision that makes the express definition of infringement and the rights to exclude subservient to any congressionally expressed exhaustion rule.

Thus patents offer their owners two-fold protection from unauthorized importation. First, the owner of the patent can impose post sale restrictions on the patented articles for sale. Second, the sale of patented products abroad does not exhaust the patent owner’s right to block the importation of the patented product back into the United States.

Patents remain the best way to protect the domestic market from importation of products sold abroad

- Patent rights are not necessarily exhausted by foreign sales.
- Patents on even minor features are valuable because the foreign version of the product will certainly infringe, and narrow patents are harder to attack.
- Even design patents on the appearance of the product or its packaging can protect against the importation of foreign versions of the product.
- A simple design refresh or repackaging can support new design patents, even on mature products.
- Patents can also support post-sale restrictions that help protect the domestic market.

Strategies for implementing market segmentation

- Differentiate the products so that the foreign versions are less attractive to the domestic market.
- Introduce “material differences” between the foreign versions and the domestic version so that selling the materially different foreign versions would be found to be trademark infringement.
- Aggressively patent the product and its packaging so that importation of the foreign version is patent infringement.
- Implement a licensing (e.g., for software) or restrictive sale program to achieve some post sale control over the products.
- Separate legal ownership of domestic and foreign intellectual property to try to avoid exhaustion of intellectual property rights.

Trademarks

The basis for the protection of trademarks differs from the limited monopoly protection accorded to copyrights and patents. Trademark law protects consumers from confusion as to the source of goods and services, and trademark owners from the effects of unfair competition. Thus when someone imports genuine goods from another country, it is not necessarily an infringement — the public is not confused about the source of the goods, and the trademark owner is not facing unfair completion.

If the importer modifies the foreign-acquired goods before importing them, or if those goods are materially different from the goods being sold domestically, then the importation of the branded product may constitute infringement. However if the goods are unmodified, and identical to (or at least not materially different from) the domestically available product, it can be difficult to stop their importation, particularly if the foreign source is a corporate affiliate of the domestic brand owner.

If the product sold abroad is identical to that being sold domestically, trademarks are no more effective than copyrights in preventing the foreign products from being imported into the United States. However, if the products are materially different, trademarks can offer the business some protection. While standard for what is “materially different” is unclear — the Third Circuit has observed that “[b]ecause consumer preferences are as fickle and diverse as the human imagination, it is impossible to devise an exhaustive list of the types of differences between products that can be considered material.” Generally, “courts have applied a low threshold of materiality, requiring no more than showing that consumers would be likely to consider the differences between the foreign and domestic products to be significant when purchasing the product, for such differences would suffice to erode the goodwill of the domestic source.” In one instance the mere removal of a serial number used for quality control and anti-counterfeit purposes, largely invisible to the end customer, was a material difference. Although the standard is low, not all differences are material.

While developing different versions of a product for each market can complicate a business supply chain, the differences only have to be something that consumers would regard as “significant” when purchasing the product. With these differences, the business can use its trademarks to keep the foreign versions of the product from being imported.

If the ownership of the US mark is completely independent of the ownership of the foreign manufacturer/vendor, then the US trademark owner may help to exclude the foreign-manufactured products under § 526 of the Tariff Act. However, this does not apply where the mark owners are corporate affiliates or otherwise subject to common ownership or control.

The top 10 things in-house counsel need to know to protect their company’s intellectual property globally:

1. Promptly file a patent application before any disclosure of an invention outside of the company.
2. Where inventors are from different countries, make sure to properly acquire rights under the local laws.
3. Where inventors are from different countries, make sure to follow local laws regarding local filing and foreign filing licenses (many countries have laws parallel to 35 USC 184, which require a license before filing foreign patent applications on inventions made in the United States).
4. Consider the entire cost of obtaining and maintaining a patent when making foreign filing decisions, and not just the cost of filing.
5. Enhance your IP portfolio with design patents on the products and their packaging.
6. Register the company’s brands and logos wherever the products are marketed, making use of International Trademark Registrations under the Madrid Protocol where appropriate.
7. Register the distinctive, non-functional features of the product and its packaging as a trademark to obtain potentially perpetual protection for those features.
8. When marketing a single version of a product in multiple countries, make sure that the proprietary markings such as “patent pending,” “patented,” and “®” are correct for each

country where the product will be shipped.
9. Consider imposing post sale restrictions on the products. While these didn't work with respect to copyright rights in Kirtsaeng, they were approved with respect to patent rights in Lexmark.
10. Differentiating the products and product packaging distributed in different geographic markets helps prevent exhaustion of intellectual property rights, protecting the business from competing with its own products.

The future of marketing segmentation

Kirtsaeng's application of the first sale doctrine to foreign sales was obviously a blow to businesses such as publishers and software companies, who relied on copyrights to prevent their products from being sold abroad at cheaper prices. However, the effect is even more far reaching because *Kirtsaeng* also prevents businesses from relying on the copyright for packing purposes, instructions, and product manuals in order to prevent their products getting sold abroad. After *Kirtsaeng*, the only way a business can use copyrights to prevent their products from being imported and sold is to sell a different version abroad than in the United States. This way the copyright on the US version is not exhausted by the product sold abroad. If a business is going to differentiate in foreign and domestic products, the business might as well include differences that make the foreign version less desirable in the United States to reduce the likelihood that purchasers will try to bring the product back to the United States. A business might also try separating the ownership of the foreign and the domestic copyright, which might prevent the sale of the work abroad by the foreign copyright owner from being a first sale that prevents the US copyright owner from enforcing the US copyright.

Product differentiation is also the most effective way to use trademark rights to block importation of legitimate product sold abroad. The greater the differences, the greater the chances a court will conclude that consumers would be confused by the sales of the foreign version of the product in competition with the domestic version.

Lexmark gives continued vitality after *Kirtsaeng* to using patents to maintain foreign pricing differentials. While this could change after Supreme Court review, for the time being a business can use patent rights to prevent the importation of products sold abroad. This is good news for companies whose products are protected by patents. It also suggests a strategy for companies whose products are not yet protected by patents: a business should seek any patent protection available, including design patents on the appearance of the product or its packaging. Unlike the typical patent scenario, where the broadest scope of protection is needed to encompass possible competitor design-arounds, the patent need only cover the businesses own product, because it is the re-importation of the business' own product that the patent must prevent. Even a mature product can be redesigned or repackaged in a way that can support a design patent.

Conclusion

A business needs to be able to tailor the marketing of its products to adapt to local markets, and often this includes pricing differentials. However, the greater the pricing differential, the greater the chances that a product sold abroad at a lower price will find its way back to the United States to compete with the business. The most effective way to combat unauthorized importation of products sold abroad remains making the foreign version of the product different from the domestic version. Not only do the differences in the products make the foreign version harder to sell, but then copyright and trademark rights can be used to combat these sales. However, where this is not practically or economically feasible, the business may still have options. While the Supreme Court in Kirtsaeng removed copyright as a tool to combat such unauthorized importation, the Federal Circuit in Lexmark has indicated that patents can be used to block importation of even identical products sold abroad. This is good news for businesses whose products are already covered by a patent, and for business whose products are not covered by a patent, it is an incentive to seek patent protection, even if it requires a minor redesign of the product or its packaging.

Further Reading

Kirtsaeng v. John Wiley & Sons, Inc., 568 US Docket No. 11-697, 133 S. Ct. 1351, 185 L. Ed. 2d 392, 106 U.S.P.Q.2d 1001, (2013).

Lexmark Int'l, Inc. v. Impression Prods., Inc., — F.3d — (February 12, 2016).

976 F.2d 700 (Fed. Cir 1992).

264 F.3d 1094 (Fed. Cir. 2001).

35 USC §271.

See, *Original Appalachian Artworks, Inc. v. Granada Electronics, Inc.*, 816 F.2d 68, 73 (2d Cir. 1987)(Finding that genuine Cabbage Patch dolls for the Spanish market, because of the Spanish language "birth certificate" and "adoption papers", caused confusion among US customers and constituted infringement.); see, also, *Societe Des Produits Nestle, S.A. v. Casa Helvetica, Inc.*, 982 F.2d 633, 636 (1st Cir. 1992); *Iberia Foods Corp. v. Romeo*, 150 F.3d 298, 302-03 (3d Cir. 1998); *Martin's Herend Imports, Inc. v. Diamond & Gem Trading USA, Co.*, 112 F.3d 1296, 1302 (5th Cir. 1997).

Iberia Foods Corp. v. Romeo, 150 F.3d 298, 302-03 (3d Cir. 1998).

Bourdeau Bros. Inc. v. International Trade Commission, 444 F3d 1317, 78 USPQ2d 1221 (Fed. Cir. 2006).

Zino Davidoff SA v. CVS Corp., 571 F3d 238, 91 USPQ2d 1038 (2d Cir. 2009).

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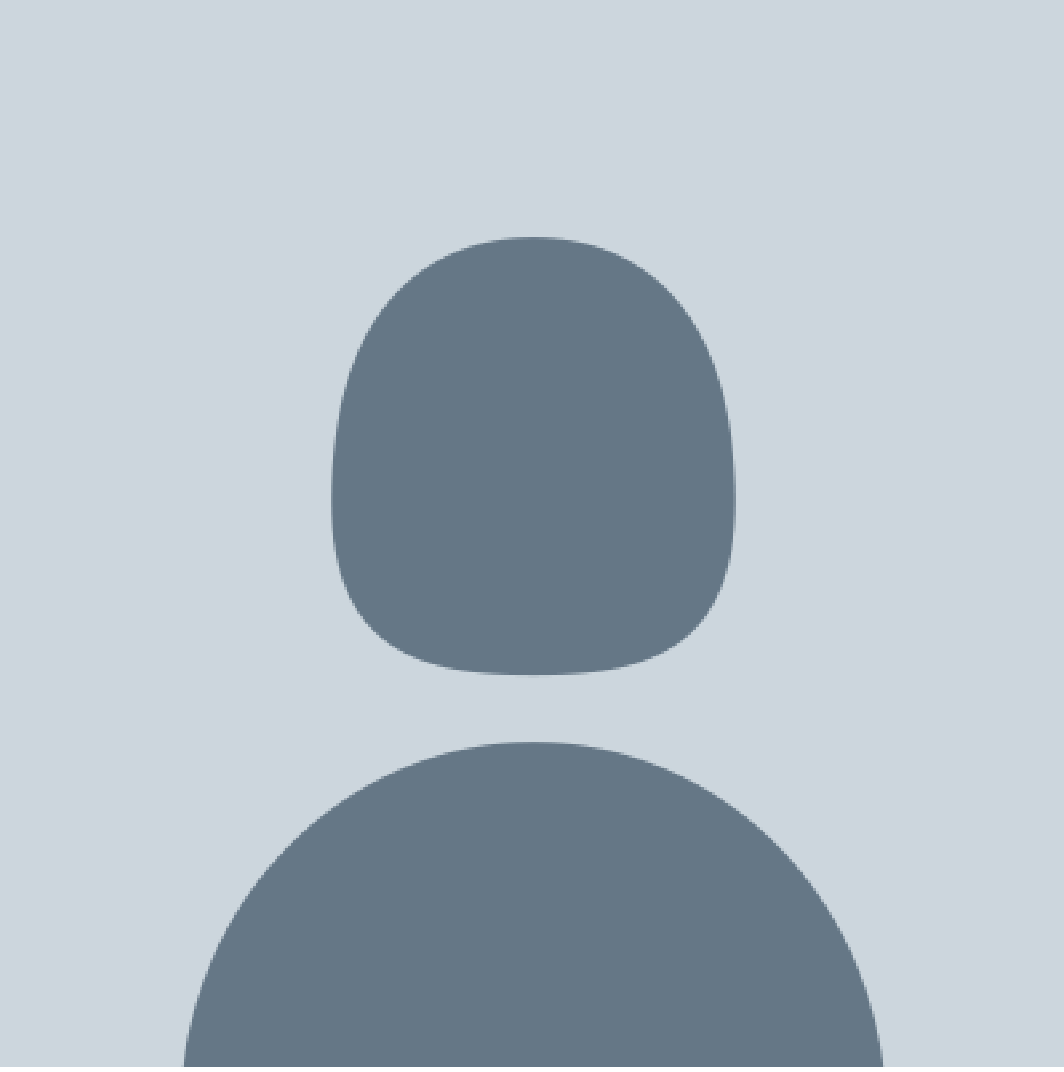

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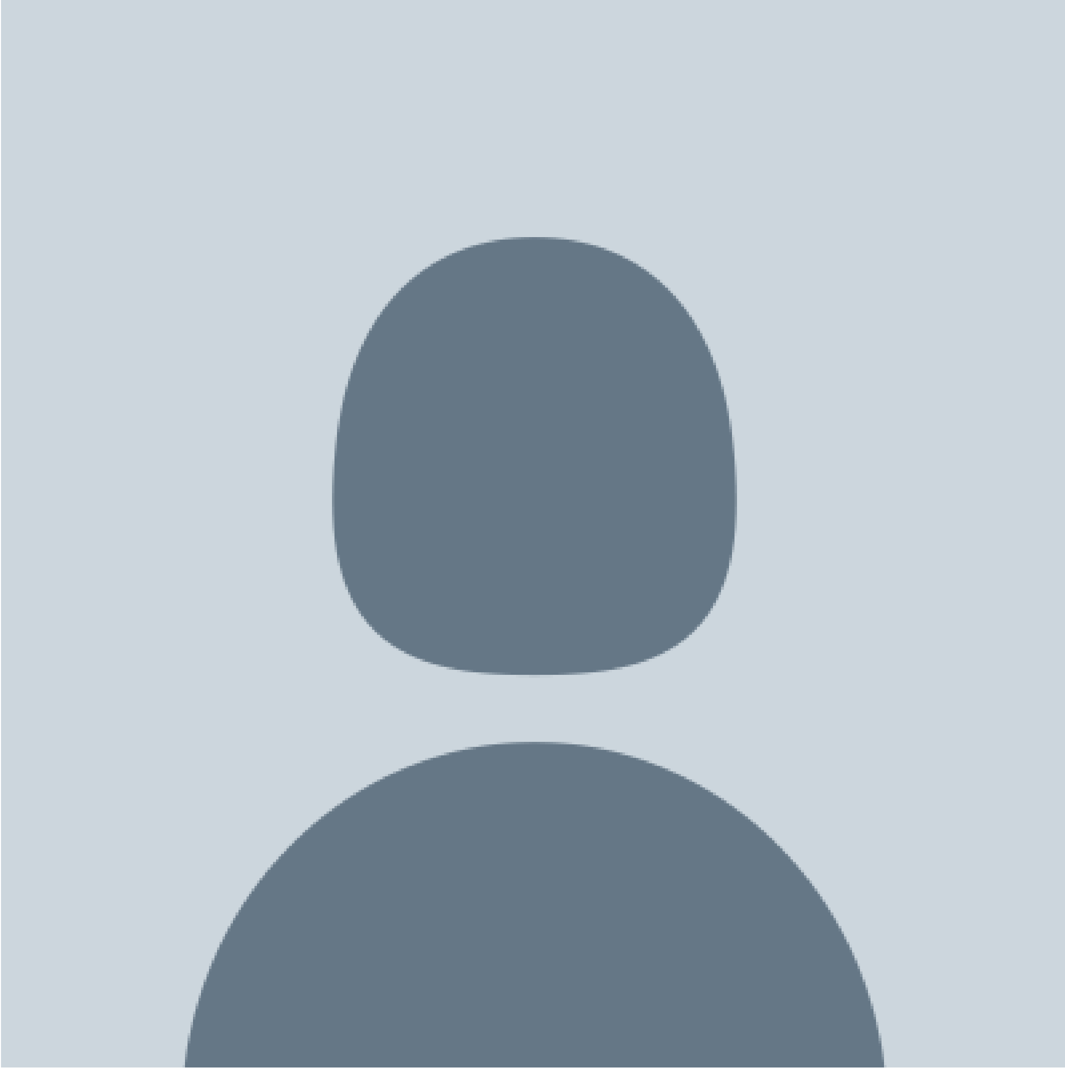

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