Exhaustion and Parallel Imports : The Indian Perspective

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Abstract

The law relating to exhaustion of patent rights and parallel imports is contained in section 107A of the Patents Act, 1970. However, there are some unexplained nodes in the section which assists vagueness and ambiguity to seep in. These nodes are very crucial to be discussed as they not only affect the national picture but also tends to violate the laws of international realm (namely the TRIPS). This paper is aimed at pointing out those ambiguities and discussing them in detail. It opens with giving a brief idea about intellectual property (specifically patents) and then moves on to explain the 'doctrine of exhaustion' and 'parallel imports'. Finally the paper discusses the law relating to the topic and its loopholes and concludes with the suggestion prescribed to do away with the said ambiguities.

Introduction

We humans are known to be intellectual beings who have an inherent tendency for creativity and innovation and also the tendency to appreciate the same. Since time immemorial humans have been inventing and creating things which are aimed towards the betterment of life. However, in the ancient times there was no concept of intellectual property which could have been protected by the corresponding laws of the time. It wasn't before 1769 that the expression 'intellectual property' was coined. Intellectual property refers to the creations of the mind, such as inventions; literary and artistic works; designs; and symbols, names and images used in commerce.[1] These creations need to be protected and so the rights of the author or the holder of the protection grant. For this purpose the IP laws are formulated and the intellectual properties are protected by copyright, patent, trademark, etc.

Now, referring to patents, it is important to know that a patent is a set of exclusive rights given to the inventor provided his invention (the product; or the process; or both) is novel, involves an inventive step (i.e. it is not obvious) and must be capable of industrial application (i.e. it must be useful).[2] Such grant of patent confers upon the patentee (i.e. the patent holder) the exclusive right to make, use, sell and import the patented good.[3] However, this paper tends to deal with the concept of 'Exhaustion and Parallel Imports' with regard to the rights of the patentee in the Indian legal scenario as the 'doctrine of exhaustion' puts certain limitations on the exclusive rights of the patentee and has been not discussed much with the Indian perspective as it should have been.

Doctrine of Exhaustion

The 'Doctrine of Exhaustion' provides that once a patented item's initial authorized sale has been made, then it terminates all patent rights pertaining to that unit of the patented item.[4] In other words, after an IP owner has made a first sale of a commodity that embodies the owner's IP, the owner no longer has the right to prohibit sales of that particular commodity.[5] This principle is also commonly referred as the 'First Sale Doctrine', a doctrine which stands for the proposition that, in the absence of unusual circumstances, courts infer that a patent owner has

[1] http://www.wipo.int/about-ip/en/ Last visited on 31st July 2017 at 09:30 A.M.
[2] Article 27.1 of TRIPS
[3] Article 28 of TRIPS
[4] *Quanta Computer Inc. v LG Electronics Inc* (No. 06 - 937) 453 F. 3d 1364
[5] *Champion Spark Plug Co. v Sanders*, 331 U.S. 125 (1947); *Kirtsaeng v John WILEY & Sons, Inc.* 568 U.S. (2013)

given up exclusive rights concerning a patented article that the owner sells.[6] Were it not for such 'exhaustion' of rights, a purchaser of a patented article might be prevented from selling the said article or even 'using' it, since such 'sale' or 'use' implicates the exclusive rights of the patentee. The rationale underlying the theory of 'exhaustion' and the doctrine of first sale is that the patentee has already been rewarded through the first sale and should not be allowed to profit repeatedly on the same good by controlling its use, resale or distribution.[7]

However, the doctrine of Exhaustion is circumscribed by the following factors:

(a) It comes into play only when there has been a 'first sale' made by or with the authorization of the patentee.

(b) The buyer of the patented article does not acquire any right to manufacture etc. which remain to be the exclusive rights of the patentee.

Thus, it is to be inferred from the abovementioned points that there must be an absolute sale of the product upon full payment of the price of the product by the purchaser in order to invite the application of the Doctrine of Exhaustion. Also, that where such absolute sale is absent, the exhaustion doctrine cannot be applied.

Parallel Imports

Parallel imports are nothing but a natural consequence of the application of the doctrine of exhaustion. Essentially it is price arbitrage whereby once a patented article has been launched in a market of a country, an importer imports the patented goods, without the permission of the patentee, from another country where the goods are sold at cheaper rate and sells it at a price lower than that of the patent holder in the country of importation. This serves two purposes namely, the importer gets to enjoy the price differential; and the patented goods are available at a lower price. Such imports take place only when the patentee attempts price discrimination among different countries. Parallel imports are only possible in countries which recognize the concept of 'international exhaustion'. However, this concept of parallel imports is legal in certain countries and illegal in others. Such parallel import goods are sometimes referred to as grey market goods. Such imports in India are legal in India as it recognizes the concept of international exhaustion.

[6] *Glass Equipment Development Inc v Besten Inc* 174 F. 3d 1337

[7] Basheer and Kochupillai: Parallel Imports and Trips Compliance, JIPR Vol. 13, September 2008, p 487

National and International Exhaustion

National Exhaustion

Under national exhaustion (which is also known as 'domestic exhaustion') the IP owner (in this case the patentee) exhausts his rights in the patented product in the domestic market once it has made an authorized sale of such product in the domestic market. It is important to note that domestic exhaustion only extinguishes the right to use, offer for sale, and sell that particular product. It does not affect the patentee's right to manufacture; or import the patented product. Thus, anybody can sell the patented product in the domestic market parallel to the patentee.

The rationale underlying the doctrine is that the patentee has received the desired profit out of selling the patented product and once such authorized and complete sale is made, it is implied that the purchaser gets absolute ownership rights upon that product for which he had paid the price which became sufficient remuneration for the patentee for his product. Now the purchaser has the absolute right to re-sell the product or may transfer it in any manner as he may like. Thus, it is clear that the concept of national or domestic exhaustion is quite straightforward and is universally recognized.

Now the question that arises is whether the Indian Patent regime recognizes the concept of national or domestic exhaustion. The Patents Act, 1970 embodies the concept of international exhaustion but is curiously silent with regard to national exhaustion. The curious point involved in this question is the Patents Act when compared to other intellectual property laws such as the Trade Marks Act, 1999 it presents a very contrasting picture as there has been a statutory endorsement of exhaustion, both national and international, in the Trade Marks Act[8] whereas the Patents Act expressly provides only for the international exhaustion.[9] The question whether such omission was a deliberate attempt of the legislature or whether it was a mere oversight? A technical and literal reading of the statutory provision would put the concept of national exhaustion out of the scope of the patent law. This would further imply that when the law does not recognize national exhaustion then any purchaser of the patented product (who might have purchased it from a parallel importer) might end up getting sued by the patentee as he has the exclusive right to use the product and such right does not stand exhausted in India as the law of the nation does not recognizes national exhaustion. This would also go on to mean that the

[8] Section 30(3) of the Trade Marks Act, 1999
[9] Section 107A(b) of the Patents Act, 1970

recognition of international exhaustion is also useless in the Indian context as any parallel importer would not be able to sell the product in India as the patentee would have unexhausted rights in the country. This would ultimately frustrate the doctrine of exhaustion and would create a very absurd situation which would have been clearly not intended by the legislature of the country. What is required here is a more purpose driven interpretation of the statutory recognition of international exhaustion whereby implying that national exhaustion forms an inherent part of the patent regime in India so as to enable the proper application of the doctrine of exhaustion.

International Exhaustion

As opposed to the straightforward concept of national exhaustion, the concept of international exhaustion is far more complex and controversial. The main issue involved in the concept of international exhaustion is that of parallel imports. National exhaustion takes away the right to use, offer for sale, or sell the product from the patentee but does not interferes with the patentee's right to import or manufacture the product, whereas, international exhaustion directly extinguishes the exclusive right to import of the patentee and gives birth to the parallel importations. This means a country which recognizes the concept of international exhaustion would consider parallel imports as legal because when the rights of the patentee stands exhausted in any other country, they would also be considered exhausted in the country which recognizes international exhaustion. The patentee cannot prevent parallel imports in a country which recognizes the concept of international exhaustion.

India is a country which has enshrined the concept of international exhaustion under Section 107A(b) of the Patents Act,1970. Though the Act does not mentions the term 'exhaustion' but the language of the relevant provision makes it clear that the Indian law does not considers parallel imports as illegal.

Section 107A(b): The Indian Regime on Parallel Imports

Section 107A(b) of the Patents Act, 1970 reads:

"Importation of patented products by any person from a person who is duly authorized under the law to produce and sell or distribute the product shall not be considered as a infringement of patent rights"

Though the section does not use the expressions such as 'exhaustion', 'international exhaustion', or 'parallel imports' but the language of the section makes it explicitly clear that the concept of

parallel importations are well recognized and legalized in the country. However, there are certain ambiguous points in the section which are required to be discussed. The following questions arise when we make a literal reading of the said provision:

1. Which 'law' is applicable under this section i.e. law of the importing country or that of the exporting country?
2. Whether the expression 'patented product' refers to the products patented in the importing country or that in the exporting country?
3. Does the section tend to exclude the event of 'first sale' from its scope?
4. Whether the expression 'produce and sell or distributed' be interpreted to mean 'produce and sell plus produce and distribute' or as 'produce and sell, or distribute'?
5. Who is to be considered as 'duly authorised under the law to produce and sell...'?

Thus, it is clear that the said provision has raised certain questions which need a detailed discussion.

Which 'law' to apply?

The first question that is raised is regarding the expression *'duly authorized under the law…'* as used in the said section. As it is understood that in case of parallel importation there must be two parties involved in the entire transaction and they are:

a) The importing country; and
b) The exporting country

So the question that is put up here is whether the person who is duly authorized to produce, sell or distribute is subjected to which law i.e. the law of the importing country or the law of the exporting country. If we consider that the expression 'law' that is being discussed about refers to the law of the importing country then it will give rise to an absurd situation i.e. the exporter should be subjected to the laws of the importing country inspite of the fact that the exporter should not be obliged to be so as it is not situated in the importing country and moreover it should be subjected to the laws of the country in which it is situated. Therefore, the expression 'law' as used in this section is referring to the laws of the exporting country and not that of the importing country.

Patented Product

The next important question is what does the expression 'patented product' refers to? Does it refer to the products patented in the importing country or does it refers to the products patented

in the exporting country? If it is interpreted to mean that the product is patented in the importing country only then there will be yet another absurdity that the exporter who is situated in a country that does not confers patent on the product is authorized under the law of that country to produce, sell or distribute the product which enjoy patent in the importing country. This proposition does not satisfy the test of logic and reasoning. Again, if the provision is interpreted to mean that the product is patented in the exporting country only then there would be no case of exhaustion of rights in the importing country as the importing country does not recognizes patent rights for the product and thus there would also not be any scene of parallel imports. Therefore, after understanding both the situations, the said expression must be understood as referring to the product patented both in the importing and the exporting country.

Compulsory First Sale

The entire theory of exhaustion and the doctrine of first sale is based on the premise that there must be a first authorized sale by the patentee in order to attract the application of the doctrine. But when we look into the language of section 107A(b) we find that *prima facie* there is no requirement of such 'first sale' is present. The section simply puts it that the exporter must be authorized under the law to produce, sell or distribute the product and in that case any importer from India may import the patented product from the manufacturer who is not the patentee but the one who was duly authorized under the law to produce the product. Let us consider a hypothetical case:

There is a drug 'XYZ' invented by 'A' which has been patented in India. But when there was a patent application filed in Bangladesh, the same was denied as the country did not recognize patents on pharmaceutical products. 'A' did not sold any unit of the product in Bangladesh following the denial of patent. However, 'B' a pharmaceutical company in Bangladesh wanted to manufacture the generic version of the same drug and was duly authorized to do so by the concerned authorities of Bangladesh. Given the circumstances, 'C' a company in India taking shelter of Section 107A(b)imported the drug from Bangladesh that were manufactured by 'B' and started selling it in India.

Considering the above hypothetical the rights of 'A' in India as conferred by Section 48 of the Patents Act would stand drastically affected. This could clearly not have been desired by the legislature while not incorporating the concept of 'first sale' in the section expressly. Thus, the section has to be interpreted in a manner that there can be no parallel imports from a country

where the product does not enjoys patent rights; and also that the event of 'first sale' is an inevitable part of the provision.

Produce and sell or distribute

The next ambiguous point involved in section 107A(b) is that how should the expression *'…produce and sell or distribute…'* shall be interpreted. Should it be interpreted to mean 'produce and sell plus produce and distribute' or to mean 'produce and sell, or distribute'. It is submitted that in the light of abovementioned interpretations and the reasons ascribed therein it only seems logical to accept the latter interpretation i.e. the term 'distribute' must be independent of the term 'produce'. Also, it is important to note that there must be a wider understating of the expression 'distribute' in order to include the event of resale of patented products by the purchasers who bought the product first hand, and subsequent reselling by the purchasers of the resold product. This has to be so because according to the interpretation offered in this paper the expression 'sell' has been used in conjunction with the expression 'produce' thus, restricting the scope of the term only to sales made by producers only who must be duly authorized by law.

Producers duly authorized under the law

A very important question which has created much controversy is that who is/are to be considered as persons duly authorized under the law to produce and sell the patented product. The common understanding should be that it is the patentee or manufacturers authorized by him to produce the patented product be considered as persons authorized under the law to produce and sell. However, the deliberate omission of any such reference to the patentee or persons authorized by him from the language of the section makes it prone to create confusion. If we consider the hypothetical mentioned above then we can clearly get a picture of the entire problem surrounding this section. This would also make the patent grant redundant in India and thus would run a risk of violating TRIPS.

Violation of TRIPS

It is submitted that TRIPS permits the member States to impose certain limitations on the exclusive rights of the patentee as conferred by Article 28 to the extent that such limitation relates in some way to the concept of 'exhaustion'.[10] This is evident from the provisions of TRIPS itself.

[10] Basheer and Kochupillai: Parallel Imports and Trips Compliance, JIPR Vol. 13, September 2008, p 487

Article 28(1)(a) of the agreement states that:

> *"A patent shall confer on its owner the following exclusive rights: where the subject matter of a patent is a product, to prevent third parties not having the owner's consent from the acts of: making, using, offering for sale, selling, or importing for these purposes that product."*

But the footnote (6) to the expression 'import' used in the Article clarifies thus:

> *"This right [i.e. the right of importation], like all other rights conferred under this Agreement in respect of the use, sale, importation or other distribution of goods, is subject to the provisions of Article 6."*

Article 6 in turn provides that:

> *"…nothing in this Agreement shall be used to address the issue of the exhaustion of intellectual property rights."*

The meaning of Article 6 of TRIPS is clearly expressed in Article 5(d) of the Doha Declarations on the TRIPS Agreement and Public Health which states:

> *"The effect of the provisions in the TRIPS Agreement that are relevant to the exhaustion of intellectual property rights is to leave each Member free to establish its own regime for such exhaustion without challenge…"*

Thus, it is clear that member States of TRIPS may impose limits to the exclusive rights of importation to the extent that such limits are related to the idea of exhaustion. It is important noting that S.48 of the Patents Act derives its power from Article 28 of the TRIPS Agreement whereas S.107A derives its power from Article 30 and Article 6 of the TRIPS Agreement read in light of Article 5(d) of the Doha Declarations. But if there has been no exhaustion of the patent rights (as would be in the case of the abovementioned hypothetical because there was no patent granted in Bangladesh and therefore there was no 'first sale' made in that country) and still the provisions of S.107A(b) is made applicable then it contravenes S.48 of the Patents Act and ultimately goes against Article 28 of the TRIPS Agreement. Therefore, the application of S. 107A(b) can only be invited when there has been exhaustion of the patent rights in the exporting country as otherwise it would be very difficult to argue that such provision is a 'limited exception' falling under the scope of Article 30 of the TRIPS Agreement[11] which states:

[11] Ibid.

> *"Members may provide limited exceptions to the exclusive rights conferred by a patent, provided that such exceptions do not unreasonably conflict with a normal exploitation of the patent and do not unreasonably prejudice the legitimate interests of the patent owner, taking account of the legitimate interests of third parties."*

Thus, raising a question mark upon the validity of S.107A(b) which is undesirable. So it becomes clear that in order to invite the application of this provision the following conditions must be fulfilled:

a) There must be a patent granted in the exporting country;
b) The rights of the patentee must stand exhausted owing to the first sale; and
c) The exporter must be authorised under the law of the exporting country to export the concerned product.

It is equally important to take note that the production or manufacturing rights will always be reserved with the patentee till the time patent subsists and therefore, the expression *'...person authorized under the law to produce and sell'* as used in section 107A(b) must be interpreted so as to mean that it refers only to the patentee or persons authorized by him to manufacture the concerned goods.

Conclusion

Thus, it is to be concluded that the Indian legal regime on the subject of international exhaustion and parallel imports has certain inherent ambiguities which have neither been discussed much about nor has there been clear interpretation on the subject. However, till the time the provision is not properly amended, there must be harmonious construction of the same. Thus, the term *'law'* must be interpreted to mean the law of the exporting country; the expression *'distribute'* must be understood to be independent of the term *'produce'*; the phrase *'...person authorized under the law to produce...'* shall be construed that it refers to the patentee who always retains the exclusive right to manufacture or any other person duly authorized by the patentee to manufacture. Moreover, it is essential to note that there can be no legal parallel imports in India from a country where there is no patent granted to the inventor.