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## Did the Supreme Court endanger international distribution networks?

In its recent decision, *Kirtsaeng v. John Wiley & Sons, Inc.*, the U.S. Supreme Court charted new waters by establishing the groundwork for what may become the future of international distribution networks — international exhaustion.

Briefly, *Kirtsaeng* involves a relatively simple plan by a medical student to finance his education by importing and selling in the U.S. the foreign-published editions of various U.S. copyrighted textbooks.

The success of the plan was due primarily to the price difference between generally higher-priced U.S. published works and their cheaper foreign versions. The right to prohibit the importation of pirated works has been an international mainstay since the earliest bilateral copyright treaties.

Nevertheless, distribution rights have long been subject to numerous limitations. Most critically, these rights have been subject to principles of exhaustion. As embodied in Section 109(a) of the U.S. Copyright Act, copyright owners have no right to control the subsequent “sale or other transfer” of “a particular copy ... lawfully made under this title.” At the heart of *Kirtsaeng* was the question of how broadly this exhaustion principle applies. Could copyright owners defend their market segmentation regimes or does that ability end with the first legitimate sale of a copy of the work anywhere in the world?

Market segmentation is a strong feature of present copyright distribution schemes. It can be achieved by various methods, including platform restrictions such as the current coding system for motion pictures that ties access to region-specific codes (the reason you cannot buy a DVD in London — Region 2 — and play it on your U.S. machine which recognizes only Region 1 codes).

The easiest method to segment the market, however, is through the use of distribution agreements that support country- or region-specific pricing regimes. Such price differences largely reflect different standards of living. Price segmentation can, therefore, serve

the critical goal of allowing greater access to works in countries that cannot afford the prices charged in developed countries such as the United States and Europe. The Supreme Court's recent decision in *Kirtsaeng* makes such segmentation more difficult to secure.

In a nutshell, the court, in a 6-3 decision, held that the first-sale doctrine under Section 109(a) applies to all lawfully produced goods, even those manufactured abroad. It stated: “A publisher may find it more difficult to charge different prices for the same book in different geographic markets ... [W]e can find no basic principle of copyright law that suggests that publishers are especially entitled to such rights.”

With this decision, U.S. copyright law moves more firmly into the small but growing number of countries — including Hong Kong, Australia, Singapore and New Zealand — that favor the international exhaustion of intellectual property rights. Under international exhaustion principles, once a copyright owner has transferred ownership of a copy of his or her work, he or she no longer has the ability to control the further distribution and legitimate resale of that copy.

This lack of control under *Kirtsaeng* includes an inability to prohibit the unauthorized importation of foreign-distributed copies, so long as such copies were lawfully manufactured and sold — a decision not lost on one very enterprising and relieved young medical student.

There is obvious wriggle room in the doctrine. At least under U.S. law, distribution of works under licenses — the current practice for many digitally distributed works — still qualifies as outside the scope of exhaustion. However, even this promise of continued market segmentation may falter in the future. In 2012, the European Court of Justice in *Used-Soft GmbH v. Oracle International Corp.*, Case C-128-11, held that a clearly denominated software license agreement could qualify as an act of transfer sufficient to invoke exhaustion principles be-

### GLOBAL IP



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cause under any alternative treatment the “effectiveness” of exhaustion “would be undermined.”

More troubling for those who hope to limit exhaustion by moving into digital versions, *UsedSoft*, contrary to the recent U.S. District Court decision in *Capitol Records LLC v. Redigi, Inc.*, rejected any such limitation because it “would go beyond what is necessary to safeguard the specific subject-matter of the intellectual property concerned.”

Copyright is not the only area where differential pricing is under attack as an international market segmentation technique. To the contrary, patent holders have similarly used differential pricing as a critical factor in the equitable distribution of patented inventions.

Similar to copyright, such mechanisms not only allow for patented inventions to be priced to reflect market realities in different countries, they serve the critical role of assuring greater access to patented medicines and other essential inventions by keeping prices affordable to the relevant public.

Problematically, last month, the Indian patent appeals office upheld the Indian comptroller's grant of a compulsory license to an Indian company, Natco Pharma Ltd., to sell the generic version of Bayer AG's patented cancer drug

Nexavar because the use of the same global price meant the drug was not “reasonably available” to the Indian public. (For an in-depth discussion of the comptroller's decision, see my March 30, 2012, column, “Price wars undermine patent usefulness”).

The inconsistent treatment of global pricing regimes places renewed stress on intellectual property holders' ability to recoup development and distribution costs. The easiest response to international exhaustion under *Kirtsaeng* and its international cousins is to set a global price that eliminates any profit in the unauthorized importation of foreign distributed works.

Yet, as Natco demonstrates, any such global-pricing regime could result in the imposition of compulsory licenses to create country-specific pricing regimes to enhance access. Although it is unlikely any government would consider imposing a compulsory license for music or movies, educational texts such as those involved in *Kirtsaeng*, software and other technologies protectable under copyright could easily be subject to such licenses.

Post-*Kirtsaeng*, there are no quick solutions. Early efforts to protect previously profitable distribution networks will undoubtedly focus on technological measures, including encryption and digitization. Yet such solutions are merely short-term ones.

Instead, a more nuanced approach to exhaustion and market segmentation is required. To borrow a term from patents, for essential works — those unrelated to the arts and entertainment — country-specific differential pricing should remain a viable option, since it puts the need for affordable access ahead of author compensation concerns.

To achieve this result, however, will require legislation in the United States and a new standard internationally. The time to start working on it is now. The best place to begin may be the present negotiations for the Trans-Pacific Partnership. For more information see [ustr.gov/tpp](http://ustr.gov/tpp).