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# The reimportation loophole

**The recent US Supreme Court ruling limiting copyright protection for reimported goods could cause some biotechnology exporters to lose domestic profits.**

*Breffni Baggot*

How would you react if one of your company's products was exported at a sharp discount to a foreign sales distributor and then began reappearing in your domestic market—at cut-rate prices? For biotechnology companies, this kind of nightmare may become a reality because of a recent US Supreme Court ruling<sup>1</sup>. The implication of this decision for so-called gray-market goods—products exported out of the country that are later reimported for domestic sale—threatens to undermine the worldwide market for biotechnology products. While it is important to note that the ruling only applies to US-made imports, not goods manufactured outside the US, if your management is planning to sell abroad and your legal department is unaware of the potential threat posed by the ruling, now is the time to call their attention to it.

## Bad hair day for importers

The case started out as a suit by L'anza Research (Azusa, CA)—a company that sells hair-care products overseas—to prevent another company from buying those products abroad and reselling them in the United States. At issue was whether a copyright owner, once it has placed a copyrighted item in the stream of commerce by selling it, has exhausted its exclusive statutory right to control the item's distribution.

In this case, it was the labels on L'anza products that were copyrighted under Federal law. In the United States, L'anza products are sold only through authorized distributors, such as beauty salons and barber shops. L'anza also sells its products to overseas distributors at a discount of 35–40% because those distributors do not benefit from the firm's US advertising. The company, of course, does not authorize its foreign distributors to import the products into the US.

In 1994, L'anza discovered its products being sold at a drugstore in Carmel, CA. A distributor in Malta had bought them and sold them to Quality King Distributors (Ronkonkoma, NY), which brought them

back into the United States to be sold. L'anza sued for a copyright violation, and a Federal judge in Los Angeles awarded it \$132,616 and enjoined Quality King from importing L'anza products for resale.

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The case made its way to the Ninth Circuit Court of Appeals, where L'anza Research won. Quality King's claim that once a copyrighted product is sold the copyright holder cannot keep a buyer from reselling the product was rejected.

## Supreme Court reversal

The issue before the US Supreme Court concerned the priority of two sections of the Copyright Act: §602's policy of providing authors a legal monopoly on the fruits of their efforts<sup>2</sup>, and §109's "first-sale" doctrine<sup>3</sup>. The first-sale doctrine provides that a copyright holder exhausts its monopoly upon the first sale of the copyrighted article and, therefore, has no monopoly to restrict later sales.

The US Supreme Court reversed the decision of the Ninth Circuit Court of Appeals and held that the Copyright Act does not protect companies that export their products from having them shipped back by another firm for sale in the US. Public policy arguments made before the court suggested that it is unwise to allow importation of US-made goods at prices that prevent domestic distributors from competing in the domestic market. The court considered such arguments irrelevant to interpretation of the Copyright Act.

## Potential effects

While the effect of the decision remains to be seen, the ruling opens the door for overseas distributors to purchase US-made products,

ship them back to the United States, and undercut domestic prices while still making a profit. The fact that discount merchandising chains applauded the ruling in favor of Quality King Distributors suggests that these retailers might now seek out gray-market distributors so that they can resell them at the lowest possible cost.

Although the L'anza case involved copyrighted labels on shampoo bottles, §602(a) was originally aimed at traditional copyrighted works, such as films, sound recordings, and books. If the marketing practices for exports in biotechnology are similar to those described in L'anza, there may be a similar incentive for the development of a gray market to undercut domestic pricing. As a result, US biotechnology companies run the risk of having their own domestic markets eroded by competition from cheaper reimported versions of their own products. In the long term, if it is important for US manufacturers to maintain wide price disparities between their domestic and international markets, they may find it necessary to begin manufacturing their export-only products outside this country. As two of the Justices noted, the importation of goods made outside the United States could perhaps be barred under §602(a) notwithstanding L'anza: These goods would not be "lawfully made under this title" under §109.

## Conclusions

Given the possible effects of the court's ruling, a legislative initiative to undo the decision, by amending §602(a), is likely. These proposed changes to the Copyright Act would seal this loophole for foreign distributors that import less expensive computers, pharmaceuticals, and other products after buying them at a discount. Whether that initiative will succeed, especially in an election year, is another matter. Until then, biotechnology companies should review their distribution agreements to see if they can provide the protection that the Copyright Act cannot.

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1. *Quality King Distributors, Inc., Petitioner v. L'anza Research International, Inc.* (No. 96-1470 US Supreme Court, March 9, 1998).  
2. 17 US Code § 602 (1997).  
3. 17 US Code § 109 (1997).