

DOCTRINE OF EXHAUSTION

THE CANADIAN EXPERIENCE

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OVERVIEW

Have IP rights, particularly those respecting a patented invention been exhausted in respect of such an invention, once the patentee has sold or otherwise disposed of an article embodying the invention? Can a patentee maintain some kind of control – a “string” – attached to the article? That question has been posed in many jurisdictions. I give you here some notable decisions reflecting the Canadian experience.

CANADA IS A COMMON LAW COUNTRY – SORT OF

Canada is a bi-juridical country. Nine of its ten provinces and all of its three territories have their legal roots in the common law system. Quebec, the tenth province, has a civil law system, based originally on a pre-Napoleonic code which Quebec has substantially altered over time.

Most intellectual property is governed by federal law, in particular there are federal statutes respecting patents, trademarks, copyrights and designs. Provincial law governs “property and civil rights,” which includes matters such as contracts, torts, and trade secrets. Law students spend many a happy hour debating the fine lines separating the jurisdiction of the federal parliament as opposed to the provincial and territorial governing bodies. Much of the judicial interpretation of patent and trademark law is done from a common law perspective. Copyright law feels the influence of civil law in its interpretation.

BACK TO BASICS

Let's start with the Star Chamber and its star judge, Lord Coke. In the early 17th century he wrote that, once a horse has been sold the original owner cannot assert control over how that horse is used:

[If] a man be possessed of...a horse, or of any other chattel...and give or sell his whole interest...therein upon condition that the Donee or Vendee shall not alien[ate] the same, the [condition] is voi[d], because his whole interest...is out of him, so as he hath no possibility[y] of a Reverter, and it is against Trade and Traffi[c], and bargaining and contracting betwee[n] man and man: and it is within the reason of our Author that it should ouster him of all power given to him. – 1 E. Coke, Institutes of the Laws of England §360, p. 233 (1628).

This brings to mind the rather pathetic inscription on the front pages of some books to the effect that the purchaser agrees not to resell or lend out the book etc. Maybe there is a contract of sorts between the vendor and purchaser, but what about, as they say in first year law school, a *bona fide* purchaser for value without notice?

A situation somewhat like this was considered by the Supreme Court of Canada in *FBI Foods Ltd. v Cadbury Schweppes Inc.*, [1999] 1 SCR 147. This case involved a trade secret as to the formulation of a cocktail mix known as “Clamato”, popular in Canada. It is a variant of the tomato-based “Bloody Mary” mix but said to contain clam juice. (And here's the secret: this particular mix has no clam juice; it just tastes like it; as the Court remarked, hardly rocket science.)

Briefly, the facts of the case were that Cadbury had licensed a third party, Canning, to produce the mix and imparted the secret formula to Canning. Canning went bankrupt. Its assets were purchased by FBI who, without any consent from or agreement with Cadbury, went ahead and made the same cocktail preparation as had Canning. Cadbury sued.

The Supreme Court held that, where appropriate, contract law or tort law may apply, however the law respecting trade secrets should be considered *sui generis*. Disputes respecting trade secrets should be determined under the principles of equity so as to prohibit a person who, knowing that the information had been imparted in confidence, should not be permitted to continue to exploit the confidential information.

In other words, a “string” could, in equity, be attached to a trade secret so long as the party who intended to use that secret was aware that the information had been imparted to a previous party in confidence.

Unlike Lord Coke’s analogy to a horse, equity may recognize some residual right to control secret information imparted in confidence, at least where the prospective user was aware of such a confidence.

COPYRIGHT

Copyright is often filled with bizarre twists and turns.

Take, for example, the situation considered by the Supreme Court of Canada in *Théberge v Galerie d’Art du Petit Champlain*, [2002] 2 SCR 336. The plaintiff, Théberge, was a well known painter. He owned the copyright in his paintings. He sold posters bearing reproductions of his paintings printed on paper in ink. A clever technique had been developed in New Zealand whereby the ink could be lifted, intact, from the paper and transferred onto a canvas. The canvas-backed picture look more “realistic” and could be sold for a higher price than the paper-backed poster. A Quebec poster gallery acquired apparatus for such process and used it on posters including those of Théberge, who sued.

Unfortunately for our purposes, the Supreme Court did not use the word “exhaustion” in determining this case: However it held that, while there had been a “use” of the copyrighted work, there was no “reproduction” of the work, hence no copyright infringement.

The Canadian *Copyright Act*, RSC 1985, c. C-42, includes provisions respecting moral rights, derived from the European concept of “droit moral.” Section 14.1 of that *Act* provides that the author of a work possesses a moral right in respect of that work that cannot be assigned, although it may be waived. Section 28.2 of that *Act* provides that moral rights are infringed when the integrity of the work is compromised to the prejudice of the author’s honour or reputation.

Accordingly, Théberge made a second claim: he argued that his moral rights had been infringed by the “lifting” of his work from paper to canvas. A judge of the Supreme Court (originally from Quebec), writing for the minority, gave support to this argument. Another judge (from Ontario – a common law province), writing for the majority, at paragraphs 15 to 19 of his decision, appears to have held that the facts do not support the assertion that the activity of transferring substrates prejudiced the honour or reputation of the author.

Thus, from a viewpoint of exhaustion of copyright, it can be taken that if you sell the work, the purchaser can use the work with some caveat that, at least in some circumstances, the author’s honour and reputation should not be compromised. As a contrast, a sculptor who produced replicas of Canada geese which were hung in a popular shopping centre did persuade a Trial Judge to enjoin the owners of the shopping centre from tying red ribbon to the necks of the geese during Christmas time.

An attempt to use copyright to control the marketing of “grey goods” was considered by the Supreme Court of Canada in *Euro-Excellence Inc. v Kraft Canada Inc.*, 2007 SCC 37. Kraft through various entities that it controls makes the well-known Toblerone chocolate bars. The triangular packaging of the bars displayed things like the Alps, which the shape of the bar is said to resemble. Kraft Belgium made

and packaged the bars in Europe. Kraft Canada made and packaged the bars in Canada. The design on the packaging of both bars (allowing for food and drug regulations) was virtually identical. Euro-Excellence was importing into Canada and selling Toblerone bars made in Europe by Kraft Belgium. Kraft Canada complained to Kraft Belgium about “grey goods” competition. Together they developed a plan whereby Kraft Belgium registered copyright in the package in Canada as owner and gave Kraft Canada an exclusive licence in Canada. When this was done, Kraft Canada sued Euro-Excellence for infringement of Kraft Canada’s copyright interest as exclusive Canadian licensee.

In a convoluted decision in which many of the nine judges of the Supreme Court wrote on various aspects of the case, no clear consensus can be determined.. Among the many matters addressed a bare majority of the Court held that since Kraft Belgium was the owner of copyright and produced and packaged the bars in Europe which were imported into Canada by Euro-Excellence, the owner of copyright cannot be held liable for infringement in Canada even where it has appointed an exclusive Canadian licensee. In other words, nice try, but no exhaustion.

On another front, the Canadian book distributing industry has long been the beneficiary of a powerful lobbying group Often a Canadian company is given exclusive rights to distribute certain books in Canada. Specific provisions of the Copyright Act, section 27.1, prohibit the importation into Canada of books printed outside Canada without the consent of the Canadian copyright owner or licensee. In other words, where there is an exclusive Canadian distributor the doctrine of exhaustion does not apply to books printed outside Canada, even if lawfully printed in the country of origin; such books are an infringement. The Canadian distributor is deemed to be a licensee of the copyright in the book.

TRADEMARKS

For whatever undisclosed reasons trademark rights were not raised as an issue in the *Kraft* case.

However, in an earlier case decided the Supreme Court of Canada – *Consumers Distributing Co. v Seiko Time Canada Ltd.*, [1984] 1 SCR 583 – the Supreme Court did have to deal with trademark issues involving imported watches bearing Seiko trademarks. Seiko made watches in Japan and appointed Seiko Canada as the exclusive distributor of those watches in Canada. A Canadian discount store – Consumers – brought legitimate Seiko branded watches from jobbers and wholesalers outside Canada, imported them into Canada, and sold them to the public at a discount. Seiko Canada sued.

The Supreme Court held that Consumers could not be enjoined from selling the legitimate watches bought from others outside Canada, however Consumers had to remove literature accompanying those watches which instructed the purchaser to return the watch to Seiko for repair or replacement under guarantee since Consumers had made no arrangement with Seiko that its Canadian customers could do so. No problem, said Consumers; we will give the purchaser our own guarantee.

In a case involving the export of legitimate goods from Canada the Federal Court and Federal Court of Appeal had to deal with a situation where a Canadian purchased legitimate soft drinks bottled in Canada bearing the Coca-Cola trademarks at wholesale in Canada and exported them to the Philippines, where they were resold in competition with the local Philippine Coca-Cola bottler. Coca-Cola sued the Canadian exporter in Canada arguing that the licence given to its Canadian bottler was restricted to Canada only. There are several reported decisions in this case, all of an interlocutory nature, dealing with injunctions and striking out pleadings. The most significant is the decision of the Federal Court of Appeal in *Coca-Cola Ltd. v Pardhan* (1999), 85 CPR (3d) 489, where the Court upheld the decision of the Trial Judge to strike out the claim. It held that there had been no infringing “use” of the trademark in buying and exporting goods legitimately produced in Canada. In respect of “exhaustion” it can be argued that even if a trademark licensee’s rights are restricted to Canada, Canadian Courts cannot prevent the export of the goods by a legitimate purchaser who has no knowledge of any terms of a licence respecting the trademarks.

PATENTS

Now we come to patents, the heart of the matter. No Court has squarely addressed the issue of exhaustion, but there are decisions of interest.

In the case of *AlliedSignal Inc. v DuPont Canada Inc.* (1995), 61 CPR (3d) 417, the Federal Court held that DuPont, who manufactured a specialty film in Canada, had infringed AlliedSignal's Canadian patent in so doing. In assessing damages, the Federal Court awarded damages to AlliedSignal, not only in respect of sales it lost in Canada, but also for sales lost in the United States, where DuPont had exported some of its film. The Canadian patentee's right to recover damages was not exhausted at the Canadian border.

The unlimited right to use a patented process was the subject of an unusual case where Ford Motor Company had installed a set of machines to manufacture highly curved, wrap around, automobile windshields popular in the late 1960's and early 1970's. Subsequently Libbey-Owens_Ford was granted a Canadian patent which claimed both apparatus and a process for making such windshields. Ford denied infringement of the apparatus claims and said that it was exempt from infringement of the process claims under section 58 of the *Patent Act*. That section exempted from infringement any person who "acquired" the "invention" before a patent issued and allowed use of the "specific article, machine, or composition of matter" previously acquired. The Trial Judge held that Ford had an unlimited right to use the process.

The Supreme Court of Canada in *Libbey-Owens-Ford Glass Company v Ford Motor Company of Canada Ltd*, [1970] SCR 833 held that the right to use the process was restricted to use on the apparatus acquired before the patent issued. It relied on the fact that the patent contained both apparatus and process claims but there could be only one invention thus the process was bound up with the apparatus

whether the apparatus infringed or not. (Not the clearest or reasoning but, hey, Supreme Courts everywhere can be fuzzy headed)

From an exhaustion point of view it can be argued that the Court was looking for some way to limit the exemption rights to a specific set of machinery.

The most significant decision of the Supreme Court of Canada respecting exhaustion does not mention that word. It is *Monsanto Canada Inc. v. Schmeiser*, [2004] 1 SCR 902.

Monsanto produces a very effective herbicide which it sells under the trademark Roundup. It kills almost any plant with which it comes into contact thus farmers used it as a weed killer whenever possible. If, however, it comes into contact with the farmer's crop trouble happens. The aim was to develop a genetically modified crop that was Roundup-resistant. Monsanto did this and obtained a patent for the gene that was within each resistant plant. In this case the plant was canola, an oil seed crop developed in Canada (Canola = Canada's oil). Monsanto sold Roundup-resistant canola seed containing this gene to farmers, subject to a technical use agreement (TUA) which obliged the farmers not to save seed or sell or give any seed to others (a practice known as "brown-bagging") or to propagate crops for seed. All the seed must be rendered into oil. (Don't worry; none of the genetically modified material is present in the oil.)

Percy Schmeiser, a canola farmer in Saskatchewan, a Canadian prairie province, was found to be growing a significant amount of canola containing Monsanto's patented gene. He did not buy seed from Monsanto. He said that he got the seed from a small patch of canola growing in a corner of his farm the previous year which, to his surprise, was Roundup-resistant. He had various explanations as to how seed for that small patch came to be on his land: it blew in from a neighbour's farm; seed may have rolled in from a broken bag falling off a truck, etc. None of these explanations was accepted by the trial Judge, who held that however the seed for the small patch found its way to Schmeiser's land, Schmeiser knew

that the seed from that patch contained Monsanto's patented gene. Schmeiser then knowingly planted that seed the next year and grew a commercial crop. Not only that, but Schmeiser had sprayed the commercial crop with Roundup to get rid of weeds, thus using the benefit of the gene.

The Supreme Court held that Schmeiser had "used" the patented gene and thus infringed the patent.

From this decision it can be inferred that however the seed was obtained, the rights of Monsanto were not "exhausted" and were infringed by the reproduction of plant material containing the patented gene, although the Supreme Court did not express the matter in those terms.

OK – SO WHERE ARE WE NOW?

There is no Canadian decision that address the question of exhaustion directly. However, we can take from *Théberge*, for instance, that where ownership in an article has been transferred from the intellectual property rights owner to another person, that person can "use" the specific piece of property as they will (subject to *droit moral* prejudicing the author's honour or reputation). The same applies to exemptions from patent infringement that may be restricted to certain machinery only. Shades of Lord Coke's horse.

However, where what has been transferred is an article capable of reproduction, such as a book or seed, the right to reproduce the article acquired does not necessarily flow simply by the acquisition of one such article. A purchaser of a book cannot reproduce it. Acquisition of seed does not carry with it a right to propagate seed. A person cannot acquire an unlimited right to use a process on any equipment whatsoever.

Use-yes-reproduce-no.

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