

THE WTO COMPATIBILITY OF A DIFFERENTIATED INTERNATIONAL EXHAUSTION REGIME

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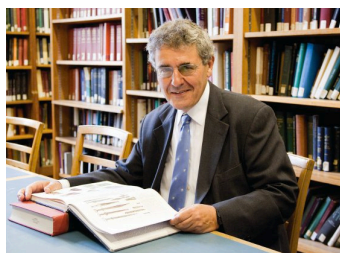
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**THE WTO COMPATIBILITY OF A DIFFERENTIATED INTERNATIONAL
EXHAUSTION REGIME PROPOSED BY THE EURASIAN ECONOMIC
COMMUNITY
A CONSULTANCY REPORT**

**JEROME H. REICHMAN, RUTH L. OKEDIJI, IOANNIS LIANOS, ROBIN JACOB & CHRISTOPHER
STOTHERS**

Table of Contents

I. INTRODUCTION	1
<i>A. Definition and Logic of the Exhaustion Principle</i>	2
<i>B. An Overview of the Different Types of Exhaustion</i>	3
II. SPECIFIC ISSUES CONCERNING THE PROPOSAL FOR DIFFERENTIATED APPLICATIONS OF THE EXHAUSTION DOCTRINE	5
<i>A. The Unresolved Controversy Surrounding International Exhaustion</i>	5
<i>B. Legal Sustainability of the Eurasian Proposal</i>	7
1. Problems Sounding in National Treatment and Most Favored Nation Under TRIPS	8
2. Other Relevant Issues under TRIPS	11
3. Justifying the Reasonableness of Sectoral Differentiation	13
III. THE APPLICABILITY OF THE GATT	17
<i>A. Parallel Application of the GATT and the TRIPS Agreement</i>	18
<i>B. The Obligations Imposed by GATT</i>	20
1. Article XI (1) GATT: Quantitative Restrictions and Measures Having Equivalent Effect	21
2. Article III: 4 GATT: National Treatment	23
3. Article I(1) GATT: Most Favoured Nation Clause (MFN)	28
<i>C. Justifications for Avoiding the Restrictions Under the GATT</i>	30
1. Article XX (d) GATT	30
2. Article XXIV GATT	39
<i>D. Enforcement</i>	42
IV. THE UNCERTAIN STATUS AND UNRELIABILITY OF STATE PRACTICE	43
<i>A. The U.S. Approach to Exhaustion</i>	43
1. Patents and Exhaustion	43
2. Trademarks and Exhaustion	46
<i>B. The EU Approach to Exhaustion</i>	51
1. A Free Circulation Right and/or “Exhaustion” as Regards Sales within the EU	51
2. Specific EU Legislation in the Case of IP Rights Which Are Either Pan-EU Rights or Parallel National Rights Granted Pursuant to National Laws Which Have Been Harmonised	57
3. Importations into the EU and Exhaustion – Trade Marks	58
4. The Essence of the EU Regime – The Choice of the Trade-mark Proprietor	59
<i>C. Approaches to Exhaustion in Other Jurisdictions</i>	65
V. CONCLUSIONS	67

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I. INTRODUCTION

Countries in the Eurasian region, like others, have historically established their own exhaustion regimes pursuant to national priorities and interests. Consequently, there has existed a diversity of exhaustion rules and practices in the region – ranging from ‘international’ exhaustion in Kazakhstan to ‘national’ exhaustion in Russia. Under its founding Treaty signed on May 29, 2014, the Eurasian Economic Union established a regional exhaustion regime for trademarks, but did not address other forms of intellectual property (IP). Recently, however, the Eurasian Economic Commission (EEC) has considered adoption of an international exhaustion regime applicable to all forms of knowledge goods protected by IP rights. Under this proposal, the transition to an all-encompassing international exhaustion regime will be marked by a differentiated approach that insulates qualifying foreign direct investors from the short-term economic loss arising from the increased competition that such a transition to international exhaustion is likely to occasion. As conceived, this proposed “differentiated” exhaustion regime will rely on international exhaustion as a baseline for all categories of intellectual property, with an exception for trademarks belonging to investors who localized their production in the Union before introduction of the international exhaustion principle. For these trademark owners a regional exhaustion regime will remain in place for a transitional period of time yet to be determined.

The concept of exhaustion generally in relation to IP law is well-established in the laws of many Member States of the World Trade organization (WTO).¹ Whether supplied explicitly by legislative provisions or established through judicial precedent in all countries that recognize it, exhaustion is a tool to advance certain public policy goals by limiting the scope of the exclusive

¹ As of June 26, 2014 there are 160 Member States of the WTO. With respect to patents, at least 76 members of the World Intellectual Property Organization (WIPO), who also are WTO Members, confirmed the existence of exhaustion in their national patent laws. *See* Exceptions and Limitations to Patent Rights: Exhaustion of Patent Rights, Standing Committee on the Law of Patents, Twenty-First Session, November 3-7, 2014, SP/21/7, at 2. [Hereinafter, WIPO SCP Report 2014].

rights granted to IP owners.² For some countries, exhaustion serves explicitly to regulate competitive conditions in the interest of consumer welfare.³ For other countries and regions, the public policy rationale is to facilitate trade and the free movement of goods.⁴ Practically speaking, most countries seem likely to reflect some combination of these two objectives in the national legal framework within which the goals of the IP system are administered.⁵

As will be seen in the body of this report, there are a wide variety of views about how exhaustion can be legally applied and an even wider variety of relevant state practices. The legality of virtually any set of these existing state practices is open to question and unreliable; while the range of legal options that would clearly withstand scrutiny under both intellectual property law and international trade law is relatively circumscribed. As a result, care must be exercised in implementing any proposed regime of differentiated exhaustion if the object is to avoid a WTO dispute settlement action for nullification or impairment of benefits under the Agreement Establishing the World Trade Organization of 1994.⁶

A. Definition and Logic of the Exhaustion Principle

The doctrine of exhaustion is potentially applicable to all categories of intellectual property rights (IPRs), although its operation can and does differ across IP subject matter. Exhaustion determines the point at which an intellectual property right holder's control over protected goods or services expires. The typical point of exhaustion for present purposes is the first sale, that is, the placing on the market of the IPR-protected good or service.⁷ The doctrine then enables the purchaser or transferee to use and dispose of that good or service without further restriction.⁸

² See, e.g., Ioannis Argoustis, *Parallel Imports and Exhaustion of Trade Mark Rights: Should Steps Be Taken Towards an International Exhaustion Regime?*, 34 E.I.P.R. 108-121 (2012) (reporting an estimated \$7 to \$10 billion dollars of parallel trade in the U.S. as of 2009, and substantial shares of varying market segments in the E.U.).

³ WIPO SCP Report 2014, above n. 1, (describing various policy objectives for exhaustion as reported by Member States)

⁴ *Id.* See also, VALENTINE KORAH, INTELLECTUAL PROPERTY RIGHTS AND THE EC COMPETITION RULES, 6 (2006) (stating that Article 30 of the EC Treaty “confirms that the authors of the Treaty thought that industrial and commercial property rights could have an equivalent effect to quantitative restrictions” on trade between Member States).

⁵ Like other limitations and exceptions, the doctrine of exhaustion is a tool to advance the public welfare by seeking an appropriate balance of interests between owners and consumers.

⁶ Marrakesh Agreement Establishing the World Trade Organization, Apr. 15, 1994, THE LEGAL TEXTS: THE RESULTS OF THE URUGUAY ROUND OF MULTILATERAL TRADE NEGOTIATIONS 4 (1999), 1867 U.N.T.S. 154, 33 I.L.M. 1144 (1994).

⁷ See generally Irene Calboli, *Trademark Exhaustion in the European Union: Community-Wide or International? The Saga Continues*, 6 MARQUETTE INTELL. PROP. REV. 48 (2002) (citing authorities).

⁸ The circumstances under which an IPR is considered “exhausted” in a country may also differ widely, with considerations of whether the product was advertised or sold, whether the “first sale” occurred directly by the owner or indirectly by a licensee, whether it occurred with or without the owner’s consent, and with or without remuneration. With regard to international exhaustion, an additional consideration is whether putting the product into circulation, directly or indirectly, was subject to a contractual restriction at the point of sale. See DANIEL GERVAIS, THE TRIPS AGREEMENT: DRAFTING HISTORY AND ANALYSIS (3RD ED.) 2008, at 198 (stating that “[t]he question which goods are “legitimate” is not answered in TRIPS.”).

Absent an exhaustion doctrine, the original intellectual property right holder could “perpetually exercise control over the sale, transfer or use of a good or service embodying an IPR,” and thus prolong economic control indefinitely at the expense of the free transfer of goods and services.⁹ Put simply, the termination of an IP owner’s control is a critical aspect of a well-functioning market economy.

It is important to emphasize that exhaustion concerns rights in the physical product that is purchased or transferred, not the intangible intellectual property rights embodied in that product. Some authorities conceptualize exhaustion as an “implied license” to use the purchased product, with the seller’s ability to limit that implied license contractually subject to competition law.¹⁰ The implied license justification for exhaustion, however, appears to be in tension with the idea that there are inherent limits on the exclusive rights of IP owners and that exhaustion constitutes just one of those limits.¹¹ For countries or regions in which the freedom of competition and freer trade are principal policy objectives animating efforts to craft an appropriately balanced IP system, the common-law implied license approach is arguably a less relevant juridical and policy premise for an exhaustion regime.¹²

B. An Overview of the Different Types of Exhaustion

The “Great Conventions” - the Paris Convention for the Protection of industrial Property¹³ and the Berne Convention for the Protection of Literary and Artistic Works -¹⁴ do not address the exhaustion of IP rights, nor do they impose any obligation or constraint on Members to do so.¹⁵ Just as states have historically maintained different policies and practices with respect to limitations and exception to IPRs,¹⁶ state practice with regard to exhaustion has largely been an

⁹ UNCTAD-ICTSD RESOURCE BOOK ON TRIPS AND DEVELOPMENT (2005) at 93 (hereinafter, UNCTAD-ICTSD RESOURCE BOOK)

¹⁰ NINO PIRES DE CARVALHO, THE TRIPS REGIME OF PATENTS AND TEST DATA (4th ed. 2014), at 140-41 (citing authorities).

¹¹ Christopher Heath, *Exhaustion and Patent Rights*, in PATENT LAW IN GLOBAL PERSPECTIVE (RUTH L. OKEDIJI AND MARGO A. BAGLEY, EDS, OUP 2014) 419, at 421 - 422.

¹² *Id.* at 423 (identifying the US first sale doctrine as “closer to the doctrine of implied license” and thus narrower than exhaustion, at least in its historical formulation in Germany). See also Irene Calboli, *Market Integration and (the Limits of) the First Sale Rule in North American and European Trademark Law*, 51 SANTA CLARA L. REV. 1241, 1242-46 (2011).

¹³ Paris Convention for the Protection of Industrial Property, Mar. 20, 1883, 21 U.S.T. 1583, 828 U.N.T.S. 305 [hereinafter Paris Convention].

¹⁴ Berne Convention for the Protection of Literary and Artistic Works, Sept. 9, 1886, 1161 U.N.T.S. 3 [hereinafter Berne Convention].

¹⁵ There are arguments that an “implied national exhaustion” rule exists in the Berne Convention. These are based on the fact that the rights in the Berne Convention are territorial in nature, and that certain provisions (e.g., Articles 13(3) and 16) make clear that acts deemed lawful in one country do not make them lawful per se in another, thus allowing countries to seize goods that may have been lawfully made in other Berne member countries.

¹⁶ Subject, of course, to some outer boundaries contained in the treaties, especially the national treatment rules.

exercise of sovereign discretion.¹⁷ Commentators have identified three types of exhaustion regimes: national exhaustion, regional exhaustion and international exhaustion.¹⁸ As noted earlier, there is no uniform policy justification for the exhaustion doctrine adopted by countries nor are there uniform rules on how the various types of exhaustion operate even within the same IP subject matter category.¹⁹ Nonetheless, a baseline exists for each type of exhaustion regime sufficient to distinguish between them at a very general level of abstraction.

Under a *national exhaustion* regime, an IP owner's exclusive rights are exhausted once the IP owner or licensee places the product in the ordinary stream of commerce (marketed or first sold) in the country in which the IP right is protected. Under this regime, the exhaustion of an owner's IP rights in one nation does not exhaust those rights in another nation. From a trade perspective, therefore, national exhaustion impedes the movement of goods and services more significantly than its counterparts;²⁰ it facilitates the IP owner's ability to segment geographic markets and to price differentiate within them, thus allowing "consumers in different countries to be played off against each other."²¹ The economic benefits from such a regime are contested.²²

In a regime of *regional exhaustion*, the IP right in the product is exhausted once the product is lawfully placed in the ordinary stream of commerce (marketed or first sold) anywhere in the region. The EU offers the best example of a regional exhaustion regime.²³ Finally, in a regime of *international exhaustion*, the IP right in the product is exhausted once the product is lawfully placed in the ordinary stream of commerce (marketed or first sold) anywhere in the world.²⁴

Under any of these regimes, the IP right, once exhausted, means that anyone may use, re-sell, rent, and, certainly in the case of international exhaustion, import the goods in question without the permission of the IP owner. International exhaustion thus facilitates parallel imports of

¹⁷ See, e.g., Calboli (2011), above n. 12; I. Argoustis, above n. 2. Even within the EC, countries maintained different exhaustion regimes with respect to Trademarks until adoption of the 1988 Trademarks Directive as they did also copyrights until the beginning of the TRIPS negotiations, and still do in relation to patents.

¹⁸ See, e.g., ICTSD-UNCTAD, above n. 9.

¹⁹ Thus, for example, the application of a national exhaustion regime to patent rights differs even among countries adopting a common law implied license approach. See Heath, *supra* n. 11, at 424-434 (comparing the UK implied license approach to the US first sale approach).

²⁰ See Heath, *supra* note 11 at 482 (observing that "a consistently applied rule of domestic exhaustion would make a mockery of international trade"); Calboli (2002) above n. 7. 48-49.

²¹ Hanns Ullrich, *Technology Protection According to TRIPS: Principles and Problems*, in FROM GATT TO TRIPS, 357, 385 (FRIEDRICH-KARL BEIER & GERHARD SCHRICKER EDS., 1996)

²² UNCTAD-ICTSD RESOURCE BOOK, above n. 9, at 116 (citing sources); GERVAIS, above note 18 at 200-201 (noting the debate); Heath, *supra* note 11 at 474 (summarizing the legal reasons against international exhaustion); J.D. Sarnoff, *The Patent System and Climate Change*, (2001) 16 VA. J. OF LAW AND TECHNOLOGY 301, 359 (noting costs of international exhaustion); CHRISTOPHER STOTHERS, *PARALLEL TRADE IN EUROPE*, (OUP 2007) at 17-24 (summarizing the policy debate).

²³ See, *infra* Part IV.B discussing the EU regional exhaustion regime.

²⁴ Calboli (2011), above n. 12, at 1245-46.

genuine goods, limiting the possibility of segmenting geographic markets with price discrimination.

In practice, however, the lines between these various types of exhaustion are neither rigid nor unequivocal. Some countries employ so-called "mixed" regimes, employing national exhaustion for some types of IP and international exhaustion for others.²⁵ In the case of copyright law, some jurisdictions even apply the chosen exhaustion regime differently among the various exclusive rights that the copyright owner holds in any given product.²⁶ In the case of trademarks, both the regimes of the U.S. and the E.U. are replete with compromises and contradictions.²⁷

The empirical evidence on the effect of such mixed exhaustion regimes remains indeterminate, and in some cases, including in the U.S., a complex mix of legislative provisions, judicial opinion and enforcement practice undermines the stability of any given exhaustion regime. This may be true for many other WTO members, but only a careful study can adequately establish the reality on the ground. There is nonetheless growing recognition in some quarters that, in light of the public interest goals that inform IP law and analogous welfare considerations in favor of free trade, exhaustion rules that admit a more liberal flow of goods and services across borders and that foster competitive markets should be the norm for the international trade framework and not the exception.²⁸

II. SPECIFIC ISSUES CONCERNING THE PROPOSAL FOR DIFFERENTIATED APPLICATIONS OF THE EXHAUSTION DOCTRINE

A. The Unresolved Controversy Surrounding International Exhaustion

From the perspective of international trade law, states may choose to recognize that exhaustion of an intellectual property right occurs when a good or service is first sold or marketed outside its own territorial borders. This trade law perspective, which emphasizes the importance of free competition, encourages states to adopt a regime of international exhaustion, which makes market segmentation and price discrimination become more difficult, because parallel imports may flow from any country where an IPR-protected product is first put on the market.²⁹ This approach is arguably more consistent with the free-trade paradigm underlying the

²⁵ WIPO SCP Report 2014 above n. 1 at 3, noting four countries that reported having a "mixed" exhaustion regime with respect to patents, and another four countries that could not state precisely what kind of regime, among the three, was practiced.

²⁶ KORAH, *supra* at 10 (noting that the ECJ has extended the doctrine of exhaustion to a variety of IPRs but not to performing or rental rights) (citations omitted).

²⁷ See generally Calboli (2011), above n. 12.

²⁸ See, e.g., Thomas Cottier, *The Exhaustion of Intellectual Property Rights—A Fresh Look*, 39 I.I.C. 755-757 (2008); see also Enrico Bonadio, *Parallel Imports in a Global Market: Should a Generalized International Exhaustion Be the Next Step?*, 33 E.I.P.R. 153-61 (2011).

²⁹ UNCTAD-ICTSD RESOURCE BOOK, above n. 9, at 93.

General Agreement on Tariffs and Trade (GATT) (1994)³⁰ and the General Agreement on Trade in Services (GATS) (1994)³¹ than a regime of national or regional exhaustion.³²

However, the classic intellectual property paradigm, as embodied in the Paris Convention of 1883 and the Berne Convention of 1886, may be viewed as favoring the intellectual property owners' right to segment markets and to practice price discrimination under the territoriality and "independence" of rights doctrines embodied in these conventions.³³ No internationally agreed approach to the doctrine of exhaustion could be found to resolve this conflict during the Uruguay Round of Multilateral Trade Negotiations in the 1990s.³⁴ As a result, Article 6 of the TRIPS Agreement provided that, for purposes of dispute settlement under "this Agreement," and subject to the provisions of Articles 3 (national treatment) and 4 (Most Favored Nation), "nothing in this Agreement shall be used to address the issue of the exhaustion of intellectual property rights."³⁵

This provision was further elaborated by the Doha Ministerial Declaration on TRIPS and Public Health of 2001, in Paragraph 5(d), which provides as follows:

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, subject to the MFN and national treatment provisions of Articles 3 and 4.³⁶

Although most commentators read this provision broadly, at least one considers that Article 5(d) is confined only to "the protection of public health."³⁷

³⁰ General Agreement on Tariffs and Trade 1994, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1A, THE LEGAL TEXTS: THE RESULTS OF THE URUGUAY ROUND OF MULTILATERAL TRADE NEGOTIATIONS 17 (1999), 1867 U.N.T.S. 187, 33 I.L.M. 1153 (1994) [hereinafter GATT 1994].

³¹ General Agreement on Trade in Services, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1B, THE LEGAL TEXTS: THE RESULTS OF THE URUGUAY ROUND OF MULTILATERAL TRADE NEGOTIATIONS 284 (1999), 1869 U.N.T.S. 183, 33 I.L.M. 1167 (1994) [hereinafter GATS].

³² See above n. 28. In practice, however, the European Court of Justice has moved the treatment of trademarks in the opposite direction. See, e.g., Irene Calboli, *Review the (Shrinking) Principle of Trademark Exhaustion in the European Union (Ten Years Later)*, 16 MARQUETTE INTELL. PROP. L. REV. 257 (2012).

³³ See especially DE CARVALHO, above n. 10, at 138-164. But see, Heath, *supra* n. 11, at 478-479 (disputing de Carvalho's thesis as a misinterpretation of the intention and wording of Art.4bis of the Paris Convention.)

³⁴ DANIEL GERVAIS, THE TRIPS AGREEMENT: DRAFTING HISTORY AND ANALYSIS, (4TH ED., 2012) at 222.

³⁵ Agreement on Trade-Related Aspects of Intellectual Property Rights, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1C, THE LEGAL TEXTS: THE RESULTS OF THE URUGUAY ROUND OF MULTILATERAL TRADE NEGOTIATIONS 320 (1999), 1869 U.N.T.S. 299, 33 I.L.M. 1197 (1994) [hereinafter TRIPS Agreement]., Article 6.

³⁶ WT/MIN(01)/DEC/2, 20 November 2011.

³⁷ DE CARVALHO, above n. 10, at 149. But see GERVAIS, above n. 34 at 227 (describing the Doha Declaration as providing a "broad interpretation" of TRIPS Article 6.)

It is undisputed that these provisions did nothing to resolve pre-existing controversies concerning the legality of international exhaustion as such in the period before the Agreement Establishing the WTO of 1994. Since then, the academic literature and most of the commentators generally assume that states may, with impunity, freely choose among national, regional, and international regimes of exhaustion, subject to certain limitations.³⁸ However, at least one authority on international intellectual property law contends that a regime of international exhaustion continues to violate the obligations of international patent law as embodied in the Paris Convention and the TRIPS Agreement, notwithstanding the moratorium on dispute resolution that Article 6 of TRIPS otherwise imposed on this issue.³⁹

To fully elaborate this argument, which rests largely on the independence of patents doctrine in Art. 4*bis* of the Paris Convention, as well as on a close reading of Articles 2.1 and 2.2 of the TRIPS Agreement, would require more space and time than we can devote to it in this Report. For reasons that are puzzling, this author also distinguishes between applications of the international exhaustion doctrine to patents, which he deems noncompliant with TRIPS, and applications to trademarks, which he claims allowable, thereby apparently ignoring the independence of trademarks doctrine in Paris Convention Article 6(3). Nevertheless, for present purposes, it is well to remember that, in the absence of any authoritative resolution of this issue, the legitimacy of a regime of international exhaustion, despite widespread recognition by most of the respected scholars we have consulted, remains open to question by at least one authority.

B. Legal Sustainability of the Eurasian Proposal

Assuming, as we do, that international exhaustion remains a viable option that states can legitimately invoke under both international trade law and international intellectual property law, we must consider whether the Eurasian proposals for differentiated application of that doctrine are legally sustainable, and if so under what conditions. Here it is useful to approach the question from the angle recently suggested by a leading authority and negotiator during the Uruguay Round, Prof. Thomas Cottier.⁴⁰

Cottier enthusiastically advocates the use of international exhaustion as a form of trade regulation that would mitigate the tensions between global competition policy and the tendency of intellectual property rights to promote market segmentation under regimes of both national and regional exhaustion. Indeed, from his point of view, both national and regional doctrines of exhaustion are inherently forms of quantitative restrictions that are contrary to GATT Art. XI and in need of “particular justification.”⁴¹ He says WTO Members should “start with the

³⁸ See, e.g., GERVAIS, above n. 34; UNCTAD-ICTSD, above n. 9.

³⁹ See DE CARVALHO, above n. 10, at 148-159.

⁴⁰ See above n. 28

⁴¹ Cottier, above n. 28 at 757. See also Bonadio, above n. 28.

equivalent of international exhaustion in patent law and operate specific limitations, including safeguard clauses or trade restrictions introduced under the Doha Waiver on essential drugs.”⁴²

Like all the other leading commentators, Cottier assumes that states may freely distinguish between the forms of intellectual property rights for purposes of devising their exhaustion regime.⁴³ Current state practice comports with this view. Indeed, according to Professor Daniel Gervais, “it is not infrequent to apply national exhaustion to patents but international exhaustion in the field of trademarks and copyright.”⁴⁴ The United States Supreme Court has recently found international exhaustion applicable to copyright law, but not to either patent or trademark laws.⁴⁵

The literature and our own analysis thus makes the Eurasian switch to international exhaustion look justifiable from the perspective of competition policy and casts the proposed exceptions within an analytical framework worth pursuing. In this vein, let us first consider potential boundaries sounding in the TRIPS Agreement itself and then in other related laws, especially GATT (1994) and GATS, although—as we will see—there is no satisfactory way to separate these regimes from one another in practice.

1. Problems Sounding in National Treatment and Most Favored Nation Under TRIPS

The longstanding rule of national treatment enshrined in the Great IP Conventions⁴⁶ was codified in Article 3 of the TRIPS Agreement. It provides in relevant part “Each Member shall accord to the nationals of other Members treatment no less favourable than that it accords to its own nationals with regard to the protection of intellectual property, subject to the exceptions already provided in, respectively, the Paris Convention (1967), the Berne Convention (1971)”⁴⁷ According to the WTO Appellate Body,

. . . in drafting the *TRIPS Agreement*, the framers of the *WTO Agreement* saw fit to include an additional provision on national treatment. Clearly, this emphasizes the fundamental significance of the obligation of national treatment to their purposes in the *TRIPS Agreement*. Indeed, the significance of the national treatment obligation can hardly be overstated. Not only has the national treatment obligation long been a cornerstone of the Paris Convention and other international intellectual property conventions. . . . So, too, has the national treatment obligation long been a cornerstone of the world trading system that is served by the WTO. As we see it, the national treatment obligation is a fundamental

⁴² Cottier, above n. 14 at 757

⁴³ See also GERVAIS above n. 32; ICTSD-UNCTAD, above n.15.

⁴⁴ GERVAIS, above n.8 at 201.

⁴⁵ See *Kirtsaeng v. John Wiley & Sons, Inc.*, 133 S. Ct. 1351 (2013); see, e.g., Irene Calboli, *The United States Supreme Court’s Decision in Kirtsaeng v. Wiley & Sons: An “Inevitable” Step in Which Direction?*, 45 I.I.C. 75-90 (2014).

⁴⁶ See Paris Convention, above n. 13, Arts. 2(1), 6; Berne Convention, above n. 14, Art. 5(1)

⁴⁷ TRIPS Agreement, above n.35, Art. 3.

principle underlying the *TRIPS Agreement*, just as it has been in what is now the GATT 1994.⁴⁸

The Appellate Body, like the Panel, thus established that GATT jurisprudence on national treatment could be invoked when interpreting the same obligation under the TRIPS Agreement, especially in light of the similarity in wording between the provisions.⁴⁹ As is more fully elaborated in Part III below, GATT jurisprudence on Article XX dealing with exceptions, and on “the fundamental thrust and effect” of a measure would specifically apply to help analyse the existence of less favourable treatment of foreign nationals.

Unlike national treatment, the Most-Favoured-Nation (MFN) obligation is entirely new to international intellectual property relations. Borrowed from trade law, the rule is clearly stated in TRIPS Article 4: “any advantage, favour, privilege or immunity granted by a Member to the nationals of any other country shall be accorded immediately and unconditionally to the nationals of all other Members.”⁵⁰ It is critical to note that the TRIPS MFN provision lacks any exceptions allowing discriminatory privileges to free trade agreements, custom unions or otherwise in the context of regional integration, unlike GATT XXIV.⁵¹

However, Article 4 of TRIPS does recognize exceptions for any privileges or advantages derived from international agreements in force prior to the TRIPS Agreement, so long as such agreements are notified to the TRIPS Council and “do not constitute an arbitrary or unjustifiable discrimination against nationals of other Members.”⁵²

Accordingly, in evaluating possible exceptions to a general regime of international exhaustion, under both TRIPS Article 6 and GATT Article XX, WTO members can choose from diverse options “provided that the regime is non-discriminatory and applied outside customs unions in the same manner to all” WTO Members.⁵³ Moreover, such options, if discriminatory at all, must at least be *justifiable*.⁵⁴

The WTO Appellate Body has taken a particularly expansive view of “discrimination” in the United States – Section 211 Omnibus Appropriations Act of 1998 dispute (also known as the *Havana Club* case).⁵⁵ In analyzing the particular measure in dispute between the U.S and the EU, the Appellate Body held that the contested U.S. legislative provision and accompanying

⁴⁸ United States- Section 211 Omnibus Appropriations Act of 1998, WT/DS176/AB/R, 2 January 2002, paras. 240-242, at p. 69.

⁴⁹ *Id.* at para. 242.

⁵⁰ TRIPS Agreement, above n. 35, Art. 4.

⁵¹ GATT, above n. 30, Art. XXIV. See below, Part III.

⁵² TRIPS Agreement, Art 4 (d).

⁵³ Cottier, above n. 28, at 577.

⁵⁴ *Id.*

⁵⁵ United States- Section 211 Omnibus Appropriations Act of 1998, WT/DS176/AB/R, 2 January 2002.

regulations dealing with trademarks owned by Cuban nationals was a violation of the national treatment and most-favored-nation obligations of the TRIPS Agreement.⁵⁶ Like the exhaustion principle, “neither the TRIPS Agreement nor the Paris Convention (1967) required WTO Members to adopt any particular “ownership regime.”⁵⁷ Nevertheless, according to the Appellate Body,

To fulfill the national treatment obligation, less favourable treatment must be offset, and thereby eliminated, in every *individual* situation that exists under a measure. Therefore, for this argument by the United States to succeed, it must hold true for all Cuban original owners of United States trademarks, and not merely for some of them.⁵⁸

Even the possibility that “an extra hurdle” existed for non-nationals and not for nationals placed the former in a less favorable position and thereby constituted a violation of the national treatment obligation⁵⁹ under both the Paris Convention and the TRIPS Agreement.⁶⁰

With regard to the MFN principle, the Appellate Body used the same arguments in its analysis of the national treatment rule to conclude that the MFN rule was also violated by the U.S. measure,⁶¹ despite the fact that the measure as written *could* apply to non-Cubans.⁶² This reasoning in *Havana Club* is consistent with the later Panel decision in *European Communities—Protection of Trademarks and Geographical Indications for Agricultural Products and Foodstuffs*, which held that certain regulatory requirements needed to obtain protection for GI’s located in third countries imposed an “extra hurdle” on foreigners that violated the national treatment provision.⁶³

We believe the WTO’s jurisprudence in the *Havana Club* case and other relevant TRIPS jurisprudence, limits the adoption of an international exhaustion regime to one that is facially

⁵⁶ *Id.* See also, *European Communities—Protection of Trademark and Geographical Indications for Agricultural Products and Foodstuffs*, Panel Report WT/DS/74/R, March 15, 2005, adopted April 20, 2005.

⁵⁷ WT/DS176/AB/R, para. 243. See also, *id.*, para. 169.

⁵⁸ WT/DS176/AB/R, para. 286.

⁵⁹ *Id.*, paras. 265-269 (“The United States may be right that the likelihood of having to overcome the hurdles of both Section 515.201 of Title 31 CFR and Section 211(a)(2) may, echoing the panel in *US – Section 337*, be *small*. But, again echoing that panel, even the possibility that non-United States successors-in-interest face two hurdles is *inherently less favourable* than the undisputed fact that United States successors-in-interest face only one.” *Id.* at para. 265.

⁶⁰ *Id.* at para. 269 (“[W]e conclude that, by applying the “extra hurdle” imposed by Section 211(a)(2) only to non-United States successors-in-interest, the United States violates the national treatment obligation in Article 2(1) of the Paris Convention (1967) and Article 3.1 of the *TRIPS Agreement*.”).

⁶¹ *Id.* at paras. 306-319.

⁶² *Id.* at para. 317 (“The fact that Section 515.201 of Title 31 CFR *could* also apply to a non-Cuban foreign national does not mean, however, that it would offset *in each and every case* the discriminatory treatment imposed by Sections 211(a)(2) and (b) on Cuban original owners.”)

⁶³ *European Communities—Protection of Trademarks and Geographical Indications for Agricultural Products and Foodstuffs*, above n. 54, paras 7.139-140 (finding the two conditions for recognition of foreign GI’s in the EU a “significant extra hurdle”).

neutral, and that there can be no *de jure* or *de facto* geographical distinctions. As provided in TRIPS itself, “For the purposes of Articles 3 and 4, “protection” shall include matters affecting the availability, acquisition, scope, maintenance and enforcement of intellectual property rights as well as those matters affecting the use of intellectual property rights specifically addressed in this Agreement.”⁶⁴ Moreover, in *Canada—Patent Protection for Pharmaceutical Products*,⁶⁵ the Panel stated unequivocally that both direct and indirect discrimination may become the subject of a TRIPS complaint:

Discrimination may arise from explicitly different treatment, sometimes called ‘de jure discrimination’, but it may also arise from ostensibly identical treatment which, due to differences in circumstances, produces differentially disadvantageous effects, sometimes called ‘de facto discrimination.’⁶⁶

In other words, the Eurasian proposal as designed and implemented must pass scrutiny as to both its facial terms and its practical, on the ground effects or consequences. If national exhaustion in the same IP category or sector allows patent or trademark owners a demonstrably advantageous shelter from free competition not available to those exposed to international exhaustion, it is hard to see why a geographical criterion for invoking these advantages would not constitute a per se violation of TRIPS Article 4. In other words, if the Eurasian Community extends the advantages of one regime to imports from some countries and the disadvantages of the other regime to another group of countries the end result is discriminatory on its face. As some authorities have noted, under TRIPS Articles 3 and 4, “Members must not apply different exhaustion rules to nationals of different Members.”⁶⁷

2. Other Relevant Issues under TRIPS

Whether a differentiated exception to the international exhaustion doctrine could legally be made with regard to products or industrial sectors raises a somewhat more complicated problem, disregarding for the moment any question of “investment” as a corollary justification. A distinction cast in terms of product sectors alone would initially raise questions about violating TRIPS Article 27.1, which forbids discrimination for patented products and processes on the basis of “the field of technology.”⁶⁸ One WTO panel has extended this constraint to scope of

⁶⁴ TRIPS Agreement, above n. 33, Art. 3, Note 3.

⁶⁵ WT/DS114/R, adopted on April 7, 2000.

⁶⁶ *Id.* at para. 7.94.

⁶⁷ UNCTAD-ICTSD, above n. 9, at 108. GERVAIS, above n.32 at 201. In the *Canada—Patent Protection for Pharmaceutical Products* case, above n. 62, the Panel identified two elements of *de facto* discrimination: 1) a discriminatory effect based on different treatment and 2) a discriminatory purpose based on the objective characteristics of the disputed measure. (para. 7.94). Whether, under GATT jurisprudence, both components are required and must be analyzed in a dispute remains unclear.

⁶⁸ TRIPS Agreement, above n.35, Art. 27.1.

protection issues under Article 30, and not merely eligibility issues, on the grounds that it constitutes a structural limitation that allows only “reasonable differentiation.”⁶⁹

Obviously, one may object that Article 27.1 has been suspended by TRIPS Article 6 with regard to exhaustion.⁷⁰ However, there is some evidence in the legislative history that TRIPS Art. 27.1 was intended to incorporate the principles of GATT Art. XI, which forbids quantitative restrictions, directly into the TRIPS Agreement.⁷¹ Even if that proposition were not demonstrably established, the law of GATT Articles XI and XX could be applied by analogy to the issue at hand, notwithstanding the suspension of TRIPS Article 6,⁷² unless TRIPS were regarded as a *lex specialis* that was separate and immune to applications of the GATT.⁷³ Apart from the questionable validity of this *lex specialis* argument (although it has its adherents),⁷⁴ in this case it would not necessarily be dispositive if Article 27.1 were interpreted either as a kind of mirror image of GATT Art. XI or if the same principles had legislatively been transplanted from GATT into TRIPS Article 27.1.

Given these premises, one might ask whether a naked sectoral or product distinction—without further justification—would survive a quantitative restriction test under GATT, as well as an MFN test under TRIPS Article 6? As previously indicated, the MFN test might depend on whether the distinction ended up benefitting the nationals of one geographical set of countries as distinct from other countries under a *de facto* test of discrimination, as occurred in the *European Communities—Protection of Trademarks and Geographical Indications for Agricultural Products and Foodstuffs*, case referenced earlier.⁷⁵

If the MFN clause is not triggered, leading authorities seem little concerned about differentiated exhaustion based on product sectors alone. On the contrary, international intellectual property scholars mostly claim that governments can freely choose among the products they subject to this regime.⁷⁶ The latest to join this chorus is the *Max Planck’s Declaration on Regulatory Space under TRIPS*.⁷⁷ As will be seen, however, these assertions often ignore the implications of trade law and policy.⁷⁸

⁶⁹ WTO *Canada –Patent Protection of Pharmaceutical Products*, above n. 65.

⁷⁰ See above n. and accompanying text.

⁷¹ See especially DE CARVALHO, above n. 6, at 149, 294. For further elaboration of GATT Article XI, see Part III below.

⁷² See, e.g., Cottier, above n. 28.

⁷³ See, e.g., UNCTAD-ICTSD, above n. 9 (recognizing but not supporting a *lex specialis* thesis).

⁷⁴ See, e.g., Honda Giken Kogyo; ECJ 17-Jul-2014.

⁷⁵ See above n.63 and accompanying text.

⁷⁶ See, e.g., GERVAIS, above note 34; UNCTAD-ICTSD, above n.9.

⁷⁷ Max Planck Declaration on Regulatory Space under the TRIPS Agreement, April 15, 2014, para. 5.1, available at .

⁷⁸ As a member of the Steering Committee that drafted the Max Planck’s Declaration, Prof. Reichman contested the breadth of these assertions to no avail, but he remains skeptical for the reasons set out below.

A tenable interpretation of TRIPS Article 27.1 would suggest that some reasonable or justifiable differentiation between fields of technology is acceptable, as distinct from impermissible discrimination.⁷⁹ While this distinction flows from one reading of the WTO *Canada Pharmaceutical Products* case, that decision does not support the view that a naked sectoral distinction without more would be “reasonable.” If, moreover, there are grounds for contending that Article 27.1 of TRIPS was deliberately intended to transplant the principles of GATT Article XI into the TRIPS Agreement,⁸⁰ or that it reflects analogous GATT principles,⁸¹ the non-justiciability of TRIPS Article 27.1 with respect to exhaustion under Article 6 would not necessarily suspend the application of GATT Article XI, not to mention GATT Art. XX. As for the “*lex specialis*” view of TRIPS, clearly the panel in the WTO *Trademark and Geographical Indications* case did not subscribe to that thesis when it relied primarily on the GATT’s own national treatment jurisprudence in interpreting TRIPS Article 3, rather than on Article 2(1) of the Paris Convention as incorporated into TRIPS by Article 2.1 of that same Agreement.⁸²

3. Justifying the Reasonableness of Sectoral Differentiation

On its face, Article 6 of the TRIPS Agreement identifies the beneficiaries of protection as nationals who own IP rights, and does not directly address rules bearing on countries of origin. Nevertheless, it is worth emphasizing that, in the view of a leading trade law expert, TRIPS Art. 6 does not render the criteria of GATT Arts. XI and XX “nonoperational” with respect to a regime of international exhaustion.⁸³ On the contrary, rules of GATT (1994) and GATS “may inform future policies on the subject.”⁸⁴ In this context, the tests of “necessity” and “proportionality,” with particular regard to “less intrusive means to bring about legitimate policy goals,”⁸⁵ are particularly relevant as further elaborated in Part III, below.

Applying these criteria to the Eurasian proposal summarized above, there is a need to justify a product or sectoral differentiation in terms that might be deemed acceptable under GATT and GATS. Here we should stress the importance of inducing foreign direct investment (FDI) in the local production of manufactured goods as a defensible justification for shielding certain firms from the full competitive rigor of a shift from national to regional exhaustion, at least during a pre-determined transitional period of time. Moreover, United States law does recognize that investment in local industry can sometimes give the state more leeway in designing its customs

⁷⁹ WTO *Canada –Patent Protection of Pharmaceutical Products*, above n. 18; see, e.g., Jerome H. Reichman & Rochelle Cooper-Dreyfuss, *Harmonization Without Consensus: Critical Reflections on Drafting a Substantive Patent Law Treaty*, 57 DUKE L.J. 85, 111-113 (2007).

⁸⁰ See DE CARVALHO, above n. 2, at XX.

⁸¹ Cottier, above n. 28.

⁸² *European Communities*, above n. 54.

⁸³ Cottier, above n. 28, at 577.

⁸⁴ *Id.*

⁸⁵ *Id.*

procedures;⁸⁶ however, the procedures adopted in application of such a standard cannot create extra hurdles for foreigners or otherwise violate the MFN or national treatment rules.

The benefits of attracting FDI to both developing countries and countries in transition are widely acknowledged in the literature.⁸⁷ Increasingly, this concern has been factored into components of numerous Free Trade Agreements—both bilateral and regional—which seek to protect foreign investors in local enterprises from the risks of confiscation or expropriation under the normal rules governing the protection of aliens under public international law.⁸⁸ Lately, these investment protection treaties (or components thereof) have been invoked to buttress investment in products protected by international intellectual property rights against adverse interpretations of domestic international intellectual property standards that might otherwise weaken or indirectly “expropriate” the foreign producers’ expected returns. For example, Eli Lilly has sued Canada under the investment provisions of NAFTA for nullifying the value of certain pharmaceutical patents on the grounds of Canada’s “promise of the patent” doctrine of utility.⁸⁹

While commentators have expressed skepticism about this claim to freeze extant national IP laws on grounds of ‘investment protection,’ the legal arguments advanced by Eli Lilly may presage the kind of arguments investors not subject to the proposed shelter from international exhaustion could collectively mount against the Eurasian proposal. By the same token, invoking the need to stimulate foreign investment protection as a defense to sectoral differentiation of exhaustion is not certain to suffice, as there is no explicit carve-out for distinguishing between categories or levels of investment in either the TRIPS Agreement’s national treatment and MFN rules or the Great Conventions.

Nevertheless, the need for, and benefits of, foreign investment in the local production of manufactured goods in the Eurasian market could arguably justify strengthening the investors’ expected returns from its intellectual property rights against a sudden increase of parallel imports

⁸⁶ See § 337 of the Tariff Act of 1930, 19 U.S.C. § 1337. In making a § 337 case, a complainant must show proof of a domestic industry, requiring a “economic” prong and a “technical” prong. “The economic prong can be satisfied by demonstrating that there exists in the United States with respect to the products protected by the intellectual property right being asserted: significant investment in plant and equipment; significant employment of labor or capital; or substantial investment in its exploitation, including engineering, research and development, or licensing.”) See <http://www.itctla.org/resources/faqs#domestic-industry>.

⁸⁷ See e.g., KEITH E. MASKUS, *INTELLECTUAL PROPERTY RIGHTS IN THE GLOBAL ECONOMY* (2000); KEITH E. MASKUS, *PRIVATE RIGHTS AND PUBLIC PROBLEMS: THE GLOBAL ECONOMICS OF INTELLECTUAL PROPERTY RIGHTS IN THE 21ST CENTURY* (2012).

⁸⁸ RESTATEMENT OF THE LAW (THIRD) – THE FOREIGN RELATIONS LAW OF THE UNITED STATES §712 (State Responsibility for Economic Injury to Nationals of Other States) (1987).

⁸⁹ See Jerome H. Reichman, *Compliance of Canada’s Utility Doctrine with International Minimum Standards of Patent Protection*, PROCEEDINGS OF THE ANNUAL MEETING OF THE AMERICAN SOCIETY OF INTERNATIONAL LAW (forthcoming 2014); Ruth L. Okediji, *Is Intellectual Property Investment? Eli Lilly v. Canada and the International Intellectual Property System*, 35 (4) U. PENN. J. INT’L L., 1121 (2014).

under a regime of international exhaustion. That level of increased competition was not foreseen at the time when the existing investments were initially made, and it could discourage future investment in local production by foreign firms of particular interest to the participating countries.

Such a tailor-made exception to a regime of international exhaustion arguably finds some support in Article 5(A) of the Paris Convention itself, which allows Member states to characterize the failure of patentees to invest in local production as a form of actionable abuse.⁹⁰ The government of India has recently invoked this concept of abuse to justify the grant of a compulsory license for a patentee's failure to locally produce a cancer drug imported from abroad and sold at prices most patients could not afford.⁹¹

Such a concession to existing foreign investors in local production of goods might also be roughly compared to prior user rights available under many, if not most, domestic patent laws. Innovators who failed to become the first to file for patents under those laws may qualify for prior user rights, which allow them to continue using an innovation patented by another who filed first, subject to certain conditions, including in some cases the payment of royalties. But the prior user may not be driven out of the market by the patentee's injunction.⁹² By the same token, those who invested in local production for the European market under a regime of national exhaustion may arguably deserve a similar immunity from a later, more rigorous regime of free competition under a doctrine of international exhaustion that was not contemplated at the time the initial investments were made.

Analogies to prior user rights are, however, weaker if the investment in local production were to be made after a regime of international exhaustion had been put in place and with knowledge of it.⁹³ Moreover, and for what it is worth, the same commentator who questions the legality of international exhaustion under the WTO TRIPS Agreement has also questioned the legality of prior user rights,⁹⁴ which are otherwise well-established in the domestic patent laws and have recently been introduced into the patent reforms of U.S. law.⁹⁵

⁹⁰ Paris Convention, Art. 5(A), imported into TRIPS by Art. 2.1. of that Agreement.

⁹¹ *Natco Pharmaceutical vs. Bayer Corporation*, 2012 (50) PTC 244 (PO, Mum). However, cases involving pharmaceuticals benefit from a layer of immunities from scrutiny added by Art. 5(d) of the Doha Ministerial Declaration on TRIPS and Public Health of 2001, above n. 34.

⁹² See generally, UNITED STATES PATENT AND TRADEMARK OFFICE REPORT TO CONGRESS ON THE PRIOR USER RIGHTS DEFENSE (2012).

⁹³ Cf. the *WTO §110(5)(B)* case, where a questionable amendment to an earlier exception to the exclusive public performance rights of U.S. copyright law had been made with knowledge of the limits potentially imposed by the three-step test codified in Article 13 of the TRIPS Agreement.

⁹⁴ See DE CARVALHO, above n. 6, at 383-386.

⁹⁵ See Leahy-Smith America Invents Act, Pub. L. No. 112-29, 125 Stat. 284 (2011), § 273.

That said, the potential economic importance of FDI in local production for the Eurasian market may transcend these technical legal arguments and conceivably constitute both a “necessary” and “proportional” exception to a newly instituted regime of international exhaustion in that market. This tailor-made justification could, in turn, be strengthened if it were expressly limited in time and characterized as a transitional measure necessitated by the very competition policy underlying the shift to international exhaustion in the first place.

Here it is well to remember that states may exceed the minimum standards of the TRIPS Agreement, and they may also apply the standards differently within their own state practice.⁹⁶ In so doing, they may increase or decrease the value of any given set of IP rights, provided that the end result constitutes a good faith implementation of the TRIPS Agreement and does not unduly discriminate against the nationals of other Member States.

Moreover, Articles 8.2 and 40 of the TRIPS Agreement continue to reserve competition law and policy to domestic regulation, while Article 8.2 allows members, when formulating their laws and regulations, to adopt measures “necessary...to promote the public interest in sectors of vital importance to their socio-economic and technological development.”⁹⁷ Similarly, Article 7 mandates that the protection and enforcement of intellectual property rights should operate “to promote the transfer and dissemination of technology, to the mutual advantage of producers and users of technological knowledge and in a manner conducive to social economic welfare and to a balance of rights and obligations.”⁹⁸

These safeguard provisions cannot be ignored under the authority of recent Appellate Body decisions,⁹⁹ as they were in the *WTO-Canada Pharmaceutical Products* Report;¹⁰⁰ and they could greatly strengthen the case for the proposed Eurasian concessions, especially if limited in time and characterized as transitional measures. Nevertheless, these and other arguments set out above (and more fully developed in Part III) are directed at a set of issues that, as Cottier recognizes, are novel, unsettled, and therefore of uncertain legal outcomes.¹⁰¹

What does seem certain is that, notwithstanding these justifications, if the application of the proposed concessions leads in practice to *de facto* discrimination favoring one group of

⁹⁶ See TRIPS Article 1.1 (Members shall give effect to the provisions of this Agreement. Members may, but shall not be obliged to, implement in their law more extensive protection than is required by this Agreement, provided that such protection does not contravene the provisions of this Agreement. Members shall be free to determine the appropriate method of implementing the provisions of this Agreement within their own legal system and practice.)

⁹⁷ TRIPS Agreement, above n. 33, Arts. 8 and 40.

⁹⁸ *Id.*, Art. 7. See generally Peter K. Yu, *The Objectives and Principles of the TRIPS Agreement*, 46 HOUSTON L. REV. 979 (2009) (Symposium Issue).

⁹⁹ See generally, Bryan Mercurio, *Treaty Interpretation in WTO Dispute Settlement: The Outstanding Question of the Legality of Local Working Requirements* (with Mitali Tyagi), 19 MINN. J. OF INT’L LAW, 275 (2010).

¹⁰⁰ Above n. 63.

¹⁰¹ See Collier, above n.28.

geographically distinct nationals over others, the WTO's Appellate Body may likely reject them, in keeping with its sweeping defense of national treatment and MFN principles in the *Havana Club* case.¹⁰² Moreover, even if these arguments were to successfully avoid an adverse dispute resolution at the WTO, they are unlikely to avoid protests and pressures from non-exempted interests and their governments, with some risks of retaliatory actions. Questions and concerns are also likely to be raised in public forums, especially at the WTO Council for TRIPS. Nevertheless, barring an adverse judgment for damages in a WTO dispute, the Eurasian authorities may judge the benefits of such concessions to outweigh the corresponding costs.

One should also remain aware that WTO complaints sounding in non-violatory acts of nullification and impairment of benefits under Article 64 of the TRIPS Agreement are currently subject to a moratorium agreed by the Council of Ministers.¹⁰³ However, there is talk at the Council for TRIPS about the possibility of lifting this moratorium in the future. Meanwhile, such complaints are actionable under GATT (1994)¹⁰⁴ and should be factored into any assessment of potential liability for a differentiated exhaustion regime.

III. THE APPLICABILITY OF THE GATT

Part III will more thoroughly examine the compatibility of a system of differentiated international exhaustion with the GATT agreement, while exploring the varying options of differentiated international exhaustion detailed above.

The following issues are addressed:

1. Can GATT rules apply cumulatively to the TRIPs agreement, and what would be the role in that regard of Article 6 of TRIPS? In other words, is it possible for exhaustion rules and their enforcement to fall within the scope of the GATT prohibitions?
2. In case a positive answer is given to the above question, we will examine the compatibility of the differentiated international exhaustion approach with the principle of the general elimination of quantitative restrictions and equivalent measures under Article XI of the GATT 1994, as well as with the principle of Most-Favoured-Nation treatment

¹⁰² See above notes 55 - 60 and accompanying text.

¹⁰³ See TRIPS Agreement, above n. 33, Art. 64. See WTO Ministerial Decision of 7 December 2013, TRIPS Non-violation and Situation Complaints, WT/MIN(13)/31 or WT/L/906 ("We take note of the work done by the Council for Trade-Related Aspects of Intellectual Property Rights pursuant to our Decision of 17 December 2011 on 'TRIPS Non-Violation and Situation Complaints' (WT/L/842), and direct it to continue its examination of the scope and modalities for complaints of the types provided under subparagraphs 1(b) and 1(c) of Article XXIII of GATT 1994 and make recommendations to our next Session, which we have decided to hold in 2015. It is agreed that, in the meantime, Members will not initiate such complaints under the TRIPS Agreement.")

¹⁰⁴ See GATT (1994), above n.30, Art. XXIII. See also GATS, above n. 31, Art. XXIII.

(MFN) (under Article I of the GATT 1994) and the principle of National Treatment on Internal Taxation and Regulation (under Article III of the GATT 1994).

3. Should we find that a differentiated international exhaustion regime is prohibited by any of the above articles, we will explore if it is possible to justify these prohibitions by reference to other provisions of the GATT, in particular Articles XX (d) and XXIV of the GATT 1994.

A. Parallel Application of the GATT and the TRIPS Agreement

As explained above, Article 6 of the TRIPS agreement leaves the issue of the legality of parallel imports open and allows Member States to opt for any exhaustion system and for any type of intellectual property right, provided that the application of the exhaustion doctrine chosen does not conflict with Articles 3 and 4 of the TRIPS agreement. The non-regulation of the exhaustion regime by the TRIPS agreement nevertheless leaves open the possibility of applying the provisions of GATT to these issues, as Article 6 of TRIPS may be interpreted as implicitly invoking the application of the GATT and an assessment of the regime governing parallel imports under the principles of that agreement. Indeed, as has been convincingly argued by some authors, “Article 6 of the TRIPS Agreement precludes a mandatory regulation of the issue in question only under the provisions of the TRIPS Agreement but not under the provisions of other multilateral agreements, such as the GATT 1994”¹⁰⁵.

Such an interpretation of the relations between Article 6 of TRIPS and the GATT relies on the following reasoning:

- Articles 3 and 4 of the TRIPS agreement focus on prohibitions of discrimination based on the criterion of the nationality of the IP holder. However, discriminatory treatment that is based on the criterion of the origin of the products is not dealt with by the TRIPS Agreement provisions. Hence, it would make sense for the latter type of discrimination to fall under the scope of the GATT, as it should apply to all discriminatory measures that are based on the criterion of the origin of the products, in as much as the TRIPS Agreement does not exclude explicitly the operation of GATT 1994. In other words, it makes no sense to claim that Article 6 TRIPS preempts the application of GATT.
- It is true that, at first sight, the objectives of the TRIPS may seem to conflict with those of the GATT 1994. While the GATT promotes trade liberalization and the erosion of any barriers to trade, the TRIPS agreement aims to enhance the international protection of intellectual property rights by defining minimum standards of protection that all the

¹⁰⁵ L.G. GRIGORIADIS, TRADEMARKS AND FREE TRADE: A GLOBAL ANALYSIS (SPRINGER, 2014), at 105.

Member of the TRIPs Agreement should ensure. Yet, as has been recognized by some authors, “there is much in common between the approaches of the (two) agreements to trade regulation” and “some of the most basic GATT principles, such as transparency, non-discrimination, national treatment, fair trade are found in the TRIPs agreement”.¹⁰⁶ Furthermore, the Preamble to the TRIPs Agreement refers to GATT 1994.¹⁰⁷ In addition, Article XVI (3) of the WTO Agreement provides that “in the event of a conflict and a provision of any of the Multilateral Trade Agreements, the provision of this Agreement shall prevail to the extent of the conflict”,¹⁰⁸ thus indicating that it is compatible with the WTO Agreement for the individual agreements annexed to that Agreement to apply in parallel. Otherwise there would be no reason to have such a provision regulating conflicts.¹⁰⁹

- This reading of the WTO Agreement is also compatible with the approach followed so far with regard to the cumulative application of GATT and GATS, or the agreement on Safeguards and GATT.¹¹⁰ The fact that the WTO Agreement is recognized as a “Single Undertaking” requires that “all WTO obligations are generally cumulative and Members must comply with all of them simultaneously”.¹¹¹ As is explained by Marceau and Trachtman, “(t)he principle of effective interpretation within the WTO Single Undertaking calls for the harmonious interpretation and application of all WTO provisions.”¹¹²
- Conflicts between the different obligations imposed by the several Agreements that are part of the WTO may occur. Situations of “conflict” have been defined as following: “technically speaking, there is a conflict when two (or more) treaty instruments contain obligations which cannot be complied with simultaneously [...] Not every such divergence constitutes a conflict, however [...] Incompatibility of contents is an essential condition of conflict.”¹¹³ This narrow definition of conflict makes even more sense if one considers the interaction between separate agreements that are concluded between the

¹⁰⁶ W. J. Davey & W. Zdouc, *The Triangle of TRIPs, GATT and GATS*, in T. Cottier & P.C. Mavroidis (eds.), *INTELLECTUAL PROPERTY: TRADE, COMPETITION, AND SUSTAINABLE DEVELOPMENT* (Michigan U press:, 2003), 53, 54.

¹⁰⁷ S.K. Verma (1998) *Exhaustion of Intellectual Property Rights and Free Trade – Article 6 of the TRIPS Agreement*, *INTERNATIONAL REVIEW INTELLECTUAL PROPERTY AND COMPETITION LAW* 534, 553-558.

¹⁰⁸ Above n.

¹⁰⁹ GRIGORIADIS above n. 105, 106.

¹¹⁰ Appellate Body Report, *Canada – Certain Measures Concerning Periodicals*, WT/DS31/AB/R, adopted 30 July 1997, DSR 1997:I, 449; Appellate Body Report, *Korea – Definitive Safeguard Measures on Imports of Some Dairy products*, WT/DS98/AB/R, adopted 12 January 2000.

¹¹¹ Appellate Body Report, *Korea – Definitive Safeguard Measures on Imports of Some Dairy products*, WT/DS98/AB/R, adopted 12 January 2000, para. 74.

¹¹² G. Marceau & J.P. Trachtman, *A Map of the World Trade Organization Law of Domestic Regulation of Goods: The Technical Barriers to Trade Agreement, the Sanitary and Phytosanitary Measures Agreement, and the General Agreement on Tariffs and Trade*, *JOURNAL OF WORLD TRADE* 48(2):351-432, 419.

¹¹³ *ENCYCLOPEDIA OF PUBLIC INTERNATIONAL LAW* (Amsterdam: Elsevier Science 1984), p. 468.

same parties, which one should presume were not meant to be inconsistent with each other, in the absence of any evidence to the contrary.¹¹⁴

- One could argue that there is no conflict between Article 6 TRIPS and the provisions of the GATT 1994. So long as Article 6 TRIPS is interpreted as recognizing full policy discretion in the Member States to adopt an exhaustion regime that may not render the simultaneous fulfillment of the obligations imposed by all other WTO Agreements impossible. Neither a literal, nor a contextual, nor a teleological interpretation of Article 6 supports such broad understanding of the regulatory discretion provided in the Member States. On the contrary, Article 6 of the TRIPS Agreement subjects the regulatory discretion of the Member States to the respect of the National Treatment and MFN obligations imposed by that Agreement.
- The WTO Agreement contains some limited conflict rules, such as the one included in the General Interpretative Note to Annex 1A of the WTO Charter, stipulating that “in the event of conflict between a provision of the General Agreement on Tariffs and Trade 1994 and a provision of another agreement in Annex 1A to the Agreement establishing the World Trade Organization [...] the provision of the other agreement shall prevail to the extent of the conflict”. Yet, this provision does not regulate the conflicts that may exist between GATT and TRIPS, as TRIPS is not covered by Annex 1A.
- In the unlikely event that Article 6 of TRIPS would be interpreted as being in conflict with a provision of the GATT, one may not refer to this General Interpretative Note, although it may be possible to rely on the principle of *lex specialis derogat generali*. Yet, the determination of which of the two agreements, TRIPS or GATT constitutes *lex specialis* remains unclear, in view of the fact that the TRIPS Agreement imposes obligations on the Members that seem to be different from, and additional to, the obligations on members under the GATT. This follows from the fact that the TRIPS Agreement does not regulate discrimination based on the criterion of the origin of the goods¹¹⁵ and from the fact that GATT may apply in parallel with the TRIPS, notwithstanding Article 6 of TRIPS as demonstrated above.¹¹⁶

B. The Obligations Imposed by GATT

¹¹⁴ W. JENKS, *The Conflict of Law-Making Treaties*, in 30 BRITISH YEARBOOK OF INTERNATIONAL LAW, 401-453.

¹¹⁵ For a similar interpretation with regard to GATT 1994 and the TBT Agreement, that led the Appellate Body to find that the TBT was not an exclusive *lex specialis* to GATT, see Appellate Body Report, *EC-Asbestos*, WT/DS135/AB/R, para. 80.

¹¹⁶ For a similar view, see GRIGORIADIS (2014), above n. 105, at 105; C. Freytag (2001) *Parallelimporte nach EG- und WTO-Recht* (Patente und Marken versus. Handelsfreiheit). Duncker & Humblot, Berlin, 241. But see MCEJ Bronckers, *The Exhaustion of Patent Rights under World Trade Organization Law*. JOURNAL OF WORLD TRADE 137-159 (1998).

GATT contains a number of restrictions on national regulation, some of which may conflict with a regime of differentiated international exhaustion.

1. Article XI (1) GATT: Quantitative Restrictions and Measures Having Equivalent Effect

Of particular relevance for our analysis is Article XI (1) GATT, which prohibits quantitative restrictions and measures having equivalent effect that impede the free movement of goods between Member States of the GATT Agreement. According to this provision,

“(n)o prohibitions or restrictions other than duties, taxes or other charges, whether made effective through quotas, import or export licenses or other measures, shall be instituted or maintained by any contracting party on the importation of any product of the territory of any other contracting party or on the exportation or sale for export of any product destined for the territory of any other contracting party”.

The exercise of the exclusive right provided by trademark law to oppose parallel imports coming from another jurisdiction (in case of domestic exhaustion regime) or from a jurisdiction which is not part of the union of nations to which the importing country belongs (in case of regional exhaustion) could be said to constitute a measure equivalent to a quantitative restriction, as it reduces the volume of parallel imports (the construction reached by the EU under the corresponding wording of the EEC Treaty)¹¹⁷.

A similar conclusion may be reached with regard to a regime of differentiated international exhaustion to the extent that it enables trademark holders to oppose parallel imports, originating from jurisdictions for which the regime of international exhaustion does not apply (i.e. differentiated geographic international exhaustion) or in case the trademark is owned by undertakings that have made significant investments in the territory of the Eurasian Economic Union (i.e., differentiated international exhaustion for the purpose of protecting investors).

¹¹⁷ Indeed, the WTO jurisprudence adopts a broad definition of what constitutes “other measures”, according to Article XI(1) GATT. See Panel Report, *Japan - Trade in Semi-Conductors*, adopted on 4 May 1988, L/6309 - 35S/116, para. 104 (“this wording was comprehensive: it applied to all measures instituted or maintained by a contracting party prohibiting or restricting the importation, exportation or sale for export of products other than measures that take the form of duties, taxes or other charges”). The term “restriction” is also very broad and covers “all measures instituted or maintained by a [Member] prohibiting or restricting the importation, exportation, or sale for export of products other than measures that take the form of duties, taxes or other charges” [Panel Report, *India – Quantitative Restrictions on Imports of Agricultural, Textile and Industrial products*, adopted on April 6, 1999, WT/DS90/R, para. 5.128] or “any form of *limitation* imposed on, or in relation to importation” [Panel Report, *India – Measures Affecting the Automotive Sector*, adopted on December 21, 2001, WT/DS146/R, WT/DS175/R, para. 7.265]. In *India – Measures Affecting the Automotive Sector*, the panel highlighted “the need to identify not merely a condition placed on importation, but a condition that is limiting, i.e. that has a limiting effect” [para. 7.270]. In the context of Article XI, that limiting effect must be on importation itself. Consequently, Article XI(1) GATT can apply to any measure restricting trade, such as any type of exhaustion regime, but pure international exhaustion.

Although Article XI (2) of the GATT provides certain exceptions concerning the trade of certain product categories, no such exception refers to parallel trade.

One may also refer to the recent WTO case involving *Argentina – Measures Affecting the Importation of Goods*, in which the WTO panel assessed certain trade restrictive requirements (TRR) imposed by Argentina in order to limit imports with the purpose to help control its trade balance and implement a “managed trade” policy, basically implementing an import substitution programme¹¹⁸. These restrictive trade requirements included requirements imposed to economic operators to undertake investments in the form of irrevocable capital contributions, when their level of imports exceeds that of their exports, requirements to reach a higher level of local content in their products by substituting imports with products that are produced or could be produced in Argentina, requirements to undertake investments in order to commence manufacturing processes in Argentina or to increase or improve manufacturing capacity. The European Union, among other Contracting parties to the WTO, complained arguing that each of the TRRs is inconsistent with Article XI:1 of the GATT 1994, since each one prohibits or restricts the importation of goods into Argentina. In particular, the EU alleged that the investment requirement is to be inconsistent with Article XI:1 because it is imposed as a condition to import. The Panel noted the following:

“(t)he required increase of local content, either by purchasing from domestic producers or by developing local manufacture, has a direct limiting effect on imports, because the measure is designed to force the substitution of imports in line with policies set by Argentina” and that

“[...] (t)he investment [...] requirements have a limiting effect on imports because the right to import is linked to making capital investments [...]”¹¹⁹.

The Panel further noted that

“[...] the TRRs may result in costs unrelated to the business activity of the particular operator. Extra costs as a general matter will discourage importation and, thus, will have an additional limiting effect on imports. While the circumstances in the present case are different, the fact that a measure may constitute a restriction on importation within the meaning of Article XI:1 of the GATT 1994 when it acts to discourage importation by penalizing it and making it prohibitively expensive, was analysed by the panel in *Brazil – Retreaded Tyres*. We agree with the panel's analytic approach in that case”¹²⁰.

¹¹⁸ Report of the Panel, *Argentina – Measures Affecting the Importation of Goods*, adopted on August 22, 2014, WT/DS438/R, WT/DS444/R, WT/DS445/R.

¹¹⁹ Report of the Panel, *Argentina – Measures Affecting the Importation of Goods*, adopted on August 22, 2014, WT/DS438/R, WT/DS444/R, WT/DS445/R, paras 6.258 & 6.259.

¹²⁰ Report of the Panel, *Argentina – Measures Affecting the Importation of Goods*, adopted on August 22, 2014, WT/DS438/R, WT/DS444/R, WT/DS445/R, para. 6.261.

The Panel observed that the well-established GATT case law concluded that “the very *potential* to limit trade is sufficient to constitute a 'restriction [...]'”¹²¹ and that “Article XI:1, like Articles I, II and III of the GATT 1994, protects competitive opportunities of imported products, not trade flows”¹²², thus concluding that the measure in question infringed Article XI(1) GATT¹²³.

Article XX (d) does provide for a general exception from the prohibition of measures equivalent to quantitative restrictions when these are necessary to secure compliance with laws or regulations that are not inconsistent with the provisions of this Agreement including those relating to the protection of patents, trademarks and copyrights. However, this provision cannot override the prohibition of parallel imports by virtue of the exercise of a trademark right if it constitutes a measure infringing Article XI(1) GATT, albeit potentially justified, as discussed further below. Consequently, a prohibition of parallel imports by virtue of a regime of national, regional or differentiated international exhaustion of rights constitutes, as a non-tariff barrier, a quantitative restriction to international trade within the meaning of Article XI (1) of the GATT¹²⁴.

2. Article III: 4 GATT: National Treatment

A prohibition of parallel imports by virtue of a regime of national, regional or differentiated international exhaustion of rights may also be inconsistent with the national treatment obligation contained in Article III:1 and 4 of GATT. According to this provision,

“1. The contracting parties recognize that internal taxes and other internal charges, and laws, regulations and requirements affecting the internal sale, offering for sale, purchase, transportation, distribution or use of products, and internal quantitative regulations requiring the mixture, processing or use of products in specified amounts or proportions, should not be applied to imported or domestic products so as to afford protection to domestic production. [...]

4. The products of the territory of any contracting party imported into the territory of any other contracting party shall be accorded treatment no less favourable than that accorded to like products of national origin in respect of all laws, regulations and requirements

¹²¹ Panel Report, *China – Measures Related to the Exportation of Various Raw Materials*, July 5th, 2011, WT/DS394/R, WT/DS395/R, WT/DS398/R, para. 7.1081.

¹²² Panel Report, *Argentina – Measures Affecting the Export of Bovine Hides and the Import of Finished Leather*, adopted on December 19, 2000, WT/DS155/R para. 11.20

¹²³ Report of the Panel, *Argentina – Measures Affecting the Importation of Goods*, adopted on August 22, 2014, WT/DS438/R, WT/DS444/R, WT/DS445/R, para. 6.265.

¹²⁴ GRIGORIADIS above n.105, 107; C. Freytag (2001) *Parallelimporte nach EG-und WTO-Recht* (Patente und Marken versus. Handelsfreiheit). Duncker & Humblot, Berlin, 241-242.

affecting their internal sale, offering for sale, purchase, transportation, distribution or use.”

The prohibition of discrimination covered by this provision has been interpreted in several GATT and WTO cases. In *Japan-Alcoholic Beverages*, the Appellate Body declared that the main purpose of Article III GATT is to prohibit protectionism, which is defined objectively, by examining the application of the measure in question, and without reference to the subjective intent of the Member State adopting the allegedly discriminatory measure.¹²⁵ As the Appellate Body explained in *EC-Asbestos*, “in endeavouring to ensure ‘equality of competitive conditions’, the ‘general principle’ in Article III seeks to prevent Members from applying internal taxes and regulations in a manner which affects the competitive relationship, in the marketplace, *between the domestic and imported products involved*, so as to afford protection to domestic production.”¹²⁶ The protectionist purpose of the measure may be discerned “from the design, architecture and the revealing structure of a measure.”¹²⁷ In order to prove a violation of Article III: 4, the complaining Member must prove that the measure at issue is a “law, regulation, or requirement affecting their internal sale, offering for sale, purchase, transportation, distribution, or use”; that the imported and domestic products for which the measure afford protection are “like products,” and that the imported products are accorded “less favourable” treatment than that accorded to like domestic products.

Although there is little doubt that trademark rules constitute regulation affecting the sale, offering of sale, purchase and use of the products, in view of its exclusionary effect against parallel imports, should a regime of domestic, regional or differentiated international exhaustion be chosen, the two other conditions for the implementation of Article III: 4 need to be examined in depth. A regime of domestic exhaustion will inevitably afford less favourable treatment to imported products, as opposed to “like” products produced in the territory of the importing Member State. According to the Appellate Body in *EC- Asbestos*, “a determination of ‘likeness’ under Article III: 4 is, fundamentally, a determination about the nature and extent of a competitive relationship between and among products.”¹²⁸

It is important here to note that “when origin is the only factor distinguishing between imported and domestic products, there is no need to conduct a likeness analysis on the basis of the traditional likeness criteria established in the GATT [jurisprudence] In these cases,

¹²⁵ Appellate Body Report, *Japan – Alcoholic Beverages*, II, WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, adopted 1 November 1996, para. 16.

¹²⁶ Appellate Body Report, *European Communities – Measures Affecting Asbestos and Asbestos-Containing Products*, WT/DS135/AB/R, adopted 5 April 2001, paragraph 98.

¹²⁷ R.E. Hudec *GATT/WTO Constraints on National Regulation: Requiem for an Aims and Effects Test*, INTERNATIONAL LAWYER (1998) 619-649.

¹²⁸ Appellate Body Report, *European Communities – Measures Affecting Asbestos and Asbestos-Containing Products*, WT/DS135/AB/R, adopted 5 April 2001, para. 99.

imported and domestic products may be considered to be alike under Article III:4”¹²⁹. For instance, in a regime of domestic exhaustion, and to a certain extent for a regime of regional or differentiated international exhaustion based on a geographic criterion, the application of the exhaustion principle will focus on the origin of the product. The only distinguishing feature between an imported product and a domestic one, in terms of the application of the exhaustion principle, would be its origin. If this is the case, then the imported and domestic products will be considered as "like" for the purposes of Article III:4 of the GATT 1994. The determination of likeness will nevertheless be necessary, should a differentiated international exhaustion regime based on an investment protection clause be chosen. For this reason, it becomes important to examine the jurisprudence of the WTO on “likeness”

One may refer to the well-known concept of cross-elasticity of demand in order to describe the existence of a competitive relationship between two products: that is, if the price of one product increases (in a small but significant non transitory way), consumers shift consumption to the other product. Although the concept of “likeness” under Article III: 4 does not extend to “*all* products which are in *some* competitive relationship”¹³⁰, “there is a spectrum of degrees of ‘competitiveness’ or ‘substitutability’ of products in the marketplace”, and “it is difficult, if not impossible, in the abstract, to indicate precisely where on this spectrum the word ‘like’ in Article III: 4 of the GATT 1994 falls.”¹³¹

The Appellate Body referred to the criteria mentioned by the Working Party *Border Tax Adjustment* report in order to analyze “likeness”: “(i) the properties, nature and quality of the products; (ii) the end-uses of the products; (iii) consumers' tastes and habits – more comprehensively termed consumers' perceptions and behaviour – in respect of the products; and (iv) the tariff classification of the products”¹³². According to the Appellate Body, “these four criteria comprise four categories of “characteristics” that the products involved might share: (i) the physical properties of the products; (ii) the extent to which the products are capable of serving the same or similar end-uses; (iii) the extent to which consumers perceive and treat the products as alternative means of performing particular functions in order to satisfy a particular want or demand; and (iv) the international classification of the products for tariff purposes”¹³³.

¹²⁹ Report of the Panel, *Argentina – Measures Affecting the Importation of Goods*, adopted on August 22, 2014, WT/DS438/R, WT/DS444/R, WT/DS445/R, para. 6.274.

¹³⁰ Appellate Body Report, *European Communities – Measures Affecting Asbestos and Asbestos-Containing Products*, WT/DS135/AB/R, adopted 5 April 2001, para. 100.

¹³¹ Appellate Body Report, *European Communities – Measures Affecting Asbestos and Asbestos-Containing Products*, WT/DS135/AB/R, adopted 5 April 2001, para. 99.

¹³² Appellate Body Report, *European Communities – Measures Affecting Asbestos and Asbestos-Containing Products*, WT/DS135/AB/R, adopted 5 April 2001, para. 101.

¹³³ Appellate Body Report, *European Communities – Measures Affecting Asbestos and Asbestos-Containing Products*, WT/DS135/AB/R, adopted 5 April 2001, para. 101.

However, even if two products are "like", that does not mean that a measure is inconsistent with Article III: 4 without more. This is because the Appellate body performs (since *Korea – Various Measures on Beef* a two-step test): first, examining whether the like domestic and imported product are treated differently, and, second, determining whether this differential treatment amounts to “less favourable treatment”.¹³⁴ A complaining Member must therefore establish that the measure accords to the group of “like” *imported* products “less favourable treatment” than it accords to the group of “like” *domestic* products. Discriminating between the like domestic and the like imported products would not be considered as falling within the scope of the Article III: 4 prohibition unless this differential treatment is no “less favourable” for like imported products.

Hence, a regulation that would favour imported like products, in comparison with domestic like products, would be considered as perfectly compatible with Article III: 4 GATT. Reverse discrimination is not subject to the prohibition of Article III: 4. As the Appellate Body noted in *EC- Asbestos*,

“(t)he term ‘less favourable treatment’ expresses the general principle, in Article III:1, that internal regulations ‘should not be applied ... so as to afford protection to domestic production’. If there is ‘less favourable treatment’ of the group of ‘like’ imported products, there is, conversely, ‘protection’ of the group of ‘like’ domestic products. However, a Member may draw distinctions between products which have been found to be ‘like’, without, for this reason alone, according to the group of ‘like’ *imported* products ‘less favourable treatment’ than that accorded to the group of ‘like’ *domestic* products.”¹³⁵

Indeed, “whether or not like imported products are treated less favourably than like domestic products should be assessed instead by examining whether a measure modifies the conditions of competition in the relevant market to the detriment of imported products”, different treatment not being sufficient nor necessary to prove less favourable treatment. In other words, the differential regulatory treatment should be “predicated, either intentionally or unintentionally, on the foreign character of the class of products affected by the regulation.”¹³⁶ WTO panels have acknowledged that “the words ‘treatment no less favourable’ called for *effective equality of*

¹³⁴ Appellate Body report, *Korea – Various Measures on Beef*, WT/DS161/AB/R and WT/DS169/AB/R, paras 133-149.

¹³⁵ Appellate Body Report, *European Communities – Measures Affecting Asbestos and Asbestos-Containing Products*, WT/DS135/AB/R, adopted 5 April 2001, para. 100.

¹³⁶ G. Marceau & J.P. Trachtman (2014), *A Map of the World Trade Organization Law of Domestic Regulation of Goods: The Technical Barriers to Trade Agreement, the Sanitary and Phytosanitary Measures Agreement, and the General Agreement on Tariffs and Trade*, JOURNAL OF WORLD TRADE 48(2):351-432, 363.

opportunities for imported products in respect of laws, regulations and requirements affecting the internal sale, offering for sale, purchase, transportation, distribution or use of products”¹³⁷.

Turning to the regime of domestic exhaustion, this doctrine enables the trademark owner in the importing jurisdiction to block imports of goods that have been put already on the market of another State by him or with his consent. Hence, the trademark owner may exploit fully his trademark twice, in the exporting State and in the importing State. However, if he has already put the product on the market of the importing State, he is precluded, because of the principle of domestic exhaustion, from exercising again his right to exclude parallel imports. It is clear in this configuration that the product imported through parallel trade, and thus put on the market in a foreign State, will be put at a disadvantage, as its import and commercialisation would not be possible, because of the exercise of the trademark, in comparison with a competing product produced and commercialized in the importing State (like domestic product), which will be commercialized without any problem, as the trademark owner has already put this product on the market and thus exhausted its IP right in the importing State market. This is the case even if the product is sold by a distributor without the consent of the trademark owner.

A similar finding may be made with regard to regional exhaustion, which also offers an unequal *de facto* treatment between domestic products produced in the importing State (or a union of States to which participates the importing state) and products produced in a third country. Although, in this case there might be the further issue of the differential treatment between foreign products, depending on whether these are produced in a State member of the Union, or a third State, which may raise concerns as to the application of the MFN principle, from the point of view of Article III: 4, the situation is comparable to that identified with regard to domestic exhaustion. Some foreign products, imported through the grey market, would be offered a less favourable treatment than like domestic products, in view of their total exclusion from the market.

A differentiated international exhaustion regime will face similar challenges. If it is based on a geographic criterion, that is, a regime of international exhaustion applied to products originating from some jurisdictions, while a domestic or regional exhaustion regime applies to products originating from other jurisdictions, the regime will favour domestic products for the same reasons as those stated above. First, it will exclude parallel imports (products originating in jurisdictions that do not benefit from an international exhaustion regime) from the market of the importing state. Second, it will offer an unequal treatment favouring the commercialization of domestic products as well as products originating from the States participating in the Union.

¹³⁷ Report of the Panel, *Argentina – Measures Affecting the Importation of Goods*, adopted on August 22, 2014, WT/DS438/R, WT/DS444/R, WT/DS445/R, para. 6.288 (emphasis added).

A differentiated international exhaustion regime based on the investor principle will be confronted with the same problem. The criterion for the application of the more preferential regime to the trademark owner, leading to the exclusion of parallel imports, would be that of investing significantly in the territory of the importing State, in case of domestic exhaustion or that of the Union of importing States, in the case of regional exhaustion. In essence, that criterion favours domestic products, as it is clear that the category of domestic producers satisfies this criterion more easily than foreign producers. Indeed, all domestic producers satisfy this criterion, because they are established in the territory of the importing member State or Union of States, while only some of the foreign producers may satisfy this criterion, as it is highly likely that there might be foreign producers that have not made any investments in the territory of the importing state or Union of states and they do not dispose of any productive facilities in this territory. Such a criterion will also be considered essentially protectionist, as it favours industry established in the importing state's territory or that of the Union of states to which it participates at the expense of industry established abroad. Indeed, in *Argentina – Measures Affecting the Importation of Goods*, the panel noted, with regard to requirements of a higher degree of local content for imported products that “(g)overnment measures providing incentives for the use of domestic over imported input products have been found to be inconsistent with Article III:4 by several panels”¹³⁸. One might expect that a similar conclusion may be reached with regard to an investment protection related criterion, applying an exception to the principle of international exhaustion for the products of trademark proprietors that have significant investments in the EEU, and thus modifying the conditions of competition between domestic and imported products, in view of the reasons mentioned above.

In contrast, an undifferentiated international exhaustion regime will be compatible with Article III: 4 as it does not establish any differential treatment between parallel imports and like domestic products. In both cases, the trademark owner would not be able to oppose the commercialization of the product, if it has been put into commerce by him or with his consent in another jurisdiction and the trademark owner has thus exercised his IP right only once.

3. Article I(1) GATT: Most Favoured Nation Clause (MFN)

As indicated above, a regional exhaustion and a differentiated international exhaustion regime (either one based on an investment protection clause or one based on a purely geographical criterion of differentiation) may infringe Article I of the GATT (the so called MFN clause). According to this provision,

“(w)ith respect to customs duties and charges of any kind imposed on or in connection with importation or exportation or imposed on the international transfer of payments for

¹³⁸ Report of the Panel, *Argentina – Measures Affecting the Importation of Goods*, adopted on August 22, 2014, WT/DS438/R, WT/DS444/R, WT/DS445/R, para.

imports or exports, and with respect to the method of levying such duties and charges, and with respect to all rules and formalities in connection with importation and exportation, and with respect to all matters referred to in paragraphs 2 and 4 of Article III, any advantage, favour, privilege or immunity granted by any contracting party to any product originating in or destined for any other country shall be accorded immediately and unconditionally to the like product originating in or destined for the territories of all other contracting parties”.

Although stated explicitly in Article I(1) the MFN principle can also be found in a number of other provisions of the GATT [Articles II, III(7), IV, V(2), (5) & (6), IX (1), XIII(1), XVII (1), and XX(j)]. The principle relies on the equality of competitive opportunities that needs to be recognized for all traders, irrespective of the jurisdiction in which they are established. Hence, if trade liberalization was conceded to a specific State, the same benefit must be extended to all other States members of the WTO.

The MFN clause forms an inherent part of the non-discrimination principle by completing the national treatment clause of Article III. As some authors have noted, “(w)hile MFN prevented discrimination as between foreign products, the national treatment principle prevented discrimination as between domestic and imported products.”¹³⁹ While it is not clear if the concept of “like product” should be interpreted the same way in Article I(1) as for Article III, it is expected that both definition would rely on the concept of substitutability or the competitive relation between the products to compare.

The interpretation of the MFN clause by the Appellate Body has been broad in order to include *de facto* as well as *de jure* discrimination:

“[T]he words of Article I:1 do not restrict its scope only to cases in which the failure to accord an “advantage” to like products of all other Members appears *on the face* of the measure, or can be demonstrated on the basis of the words of the measure. Neither the words “*de jure*” nor “*de facto*” appear in Article I:1. Nevertheless, we observe that Article I:1 does not cover only “in law”, or *de jure*, discrimination. As several GATT panel reports confirmed, Article I:1 covers also “in fact,” or *de facto*, discrimination”.

[...] Article 1:1 requires that “*any advantage*, favour, privilege or immunity granted by any Member to *any product* originating in or destined for any other country shall be accorded immediately and unconditionally to the like product originating in or destined for the territories of *all other Members*.” (emphasis added) The words of Article I:1 refer not to *some* advantages granted “with respect to” the subjects that fall within the defined scope of the Article, but to “*any advantage*”; not to *some* products, but to “*any product*”;

¹³⁹ D. McRae (2012), *MFN in the GATT and the WTO*, ASIAN JOURNAL OF WTO & INTERNATIONAL HEALTH LAW AND POLICY, 7(1): 1-24, 6.

and not to like products from *some* other Members, but to like products originating in or destined for "*all other* " Members.”¹⁴⁰

By reserving a differential treatment to the products originating from some States (as opposed to others), regional exhaustion as well as a differentiated international exhaustion based on geographic criteria seem to be incompatible with the MFN principle. Regional exhaustion discriminates *de jure* and *de facto* between parallel imports originating from a State member of the Union of states in which the importing state participates and parallel imports originating from all other states. Differentiated international exhaustion based on geographic criteria also infringes the MFN principle, as it differentiates between parallel imports originating in jurisdictions that are offered an exemption from the principle of domestic (or regional) exhaustion and parallel imports originating from all other jurisdictions.

The breadth of the obligation imposed by Article I(1) of the GATT, which refers to “any advantage” and “any product,” reinforces the belief of the authors that regional and differentiated international exhaustion based on geographical criteria should be excluded. The same conclusion may be reached with regard to a system of differentiated international exhaustion based on an investment protection principle to the extent that such regime provides a differential treatment to parallel imports (foreign products) from companies that invested in the importing jurisdiction in comparison with parallel imports (foreign products) from companies that have not invested in the importing jurisdiction. Although the differential treatment is not offered to each category of parallel imports because they originate in different Member States, the text of Article I (1) seems broad enough to also cover differential treatment provided to *any product* originating in any other country. Such treatment should in principle be accorded immediately and unconditionally to a like product originating in *all other Members*. As will be discussed below, GATT Article XXIV offers an exception to MFN which benefits regional exhaustion regimes.

C. Justifications for Avoiding the Restrictions Under the GATT

Prohibitions on parallel imports by virtue of the abovementioned doctrines may be justified on the basis of Article XX (d) GATT and Article XXIV GATT. We will explore each of the possibilities separately.

1. Article XX (d) GATT

Article XX (d) introduces an exception from every obligation resulting from the GATT, enabling States to take import-restrictive measures when these are necessary to secure compliance with laws or regulations which are not inconsistent with the provisions of the

¹⁴⁰ Appellate Body report, *Canada – Certain Measures Affecting the Automotive Industry*, WT/DS139/AB/R, WT/DS142/AB/R adopted on May 31, 2000, paras 78-79.

Agreement, including those relating to the protection of patents, trademarks and copyrights, and the prevention of deceptive practices. Furthermore, such measures should not be applied “in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade”.

The application of this provision entails that a measure applying differentially to domestic and imported goods, and even if it may afford protection to domestic production, may be exempted from the prohibition under the GATT, if it satisfies the conditions of Article XX(d), that is, when it is “necessary” to secure compliance with the protection of trademarks, provided this is compatible with the provisions of the WTO Agreement and does not constitute an arbitrary or unjustifiable discrimination or a disguised restriction on international trade. With regard to the necessity of the measure, this concept was first addressed in *Korea – Various Measures on Beef*, where the Appellate Body held the following:

“[...] Clearly, Article XX (d) is susceptible of application in respect of a wide variety of ‘laws and regulations’ to be enforced. It seems to us that a treaty interpreter assessing a measure claimed to be necessary to secure compliance of a WTO consistent law or regulation may, in appropriate cases, take into account the relative importance of the common interests or values that the law or regulation to be enforced is intended to protect. The more vital or important those common interests or values are, the easier it would be to accept as ‘necessary’ a measure designed as an enforcement instrument [...] There are other aspects of the enforcement measure to be considered in evaluating that measure as ‘necessary’. One is the extent to which the measure contributes to the realization of the end pursued, the securing of compliance with the law or regulation at issue. The greater the contribution, the more easily a measure might be considered to be ‘necessary’. Another aspect is the extent to which the compliance measure produces restrictive effects on international commerce, [...] that is, in respect of a measure inconsistent with Article III: 4, restrictive effects *on imported goods*. A measure with a relatively slight impact upon imported products might more easily be considered as ‘necessary’ than a measure with intense or broader restrictive effects.

In sum, determination of whether a measure, which is not ‘indispensable’, may nevertheless be ‘necessary’ within the contemplation of Article XX(d), involves in every case a process of weighing and balancing a series of factors which prominently include the contribution made by the compliance measure to the enforcement of the law or regulation at issue, the importance of the common interests or values protected by that law or regulation, and the accompanying impact of the law or regulation on imports or exports.”¹⁴¹

¹⁴¹ Appellate Body Report, *Korea – Various Measures on Beef*, WT/DS161/AB/R and WT/DS169/AB/R, adopted on December 11, 2000, paras 162-164.

In *United States – Section 337* the Panel also added in the assessment of the necessity of the measure the consideration of the extent to which a less WTO-inconsistent measure is “reasonably available”.

“[a] contracting party cannot justify a measure inconsistent with another GATT provision as “necessary” in terms of Article XX(d) if an alternative measure which it could reasonably be expected to employ and which is not inconsistent with other GATT provisions is available to it. By the same token, in cases where a measure consistent with other GATT provisions is not reasonably available, a contracting party is bound to use, among the measures reasonably available to it, that which entails the least degree of inconsistency with other GATT provisions”¹⁴².

In principle, the WTO members have the right to determine for themselves the level of enforcement of their domestic laws. Yet one should keep in mind that the TRIPS agreement imposes a degree of harmonization of intellectual property that member states must attain, including in the area of trademark law (Art. 16-21 TRIPs). Yet, it is also true that Article 6 TRIPs leaves discretion to the States to choose the legal regime that regulates the exhaustion of IP rights, including trademarks, which means that with regard to measures relating to the application of the exhaustion regime, Member States may benefit from a wide degree of regulatory discretion. Consequently Article XX (d) may be invoked in order to protect the effectiveness of any regime of exhaustion of IP rights they chose. As the Appellate Body noted in *EC–Asbestos*, when examining the application of the necessity test and the existence of a less WTO-inconsistent reasonable alternative, one may need to examine “whether there is an alternative measure that would achieve the *same end* and that is less restrictive of trade than a prohibition” (emphasis added).¹⁴³ The complaining Member has the burden of showing that there are less WTO-inconsistent reasonable alternatives that would achieve the same goal pursued by the State that has allegedly violated WTO law.¹⁴⁴

Furthermore, an alternative measure cannot be considered reasonably available “where it is merely theoretical in nature, for instance, where the responding Member is not capable of taking it, or where the measure imposes an undue burden on that Member, such as prohibitive costs or substantial technical difficulties”.¹⁴⁵ According to the Appellate Body in *Brazil –Tyres*,

¹⁴² Report by the Panel, *United States - Section 337 of the Tariff Act of 1930* (L/6439 - 36S/345) adopted on 7 November 1989, para. 5.26.

¹⁴³ Appellate Body Report, *European Communities – Measures Affecting Asbestos and Asbestos-Containing Products*, WT/DS135/AB/R, adopted on April 5, 2001, para. 172.

¹⁴⁴ Appellate Body Report, *United States – Measures Affecting the Cross-Border Supply of Gambling and Betting Services* (DS 285), adopted on April 7, 2005, paras 306-311.

¹⁴⁵ Appellate Body Report, *United States – Measures Affecting the Cross-Border Supply of Gambling and Betting Services* (DS 285), adopted on April 7, 2005, para. 308..

“the capacity of a country to implement remedial measures that would be particularly costly, or would require advanced technologies, may be relevant to the assessment of whether such measures or practices are reasonably available alternatives to a preventive measure, such as the Import Ban, which does not involve ‘prohibitive costs or substantial technical difficulties’”.¹⁴⁶ The Appellate Body has developed the “material contribution” test in order to assess the necessity of the measure, requiring that “the measure is apt to make a material contribution to the achievement of its objective.”¹⁴⁷ That is,

“[t]o be characterized as necessary, a measure does not have to be indispensable. However, its contribution to the achievement of the objective must be material, not merely marginal or insignificant, especially if the measure at issue is as trade restrictive as an import ban. Thus, the contribution of the measure has to be weighed against its trade restrictiveness, taking into account the importance of the interests or the values underlying the objective pursued by it.”¹⁴⁸

The chapeau of Article XX (d) further requires that there must be no “arbitrary” discrimination between countries where the same conditions prevail; second, there must be no “unjustifiable” discrimination between countries where the same conditions prevail; and, third, there must be no “disguised” restriction on international trade. These concepts have been defined as following by the jurisprudence of the Appellate Body:

“ ‘[a]rbitrary discrimination’, ‘unjustifiable discrimination’ and ‘disguised restriction’ on international trade may, accordingly, be read side-by-side; they impart meaning to one another. It is clear to us that ‘disguised restriction’ includes disguised *discrimination* in international trade. It is equally clear that *concealed* or *unannounced* restriction or discrimination in international trade does *not* exhaust the meaning of ‘disguised restriction’. We consider that ‘disguised restriction’, whatever else it covers, may properly be read as embracing restrictions amounting to arbitrary or unjustifiable discrimination in international trade taken under the guise of a measure formally within the terms of an exception listed in Article XX. Put in a somewhat different manner, the kinds of considerations pertinent in deciding whether the application of a particular measure amounts to ‘arbitrary or unjustifiable discrimination’, may also be taken into account in determining the presence of a ‘disguised restriction’ on international trade.

¹⁴⁶ Appellate Body Report, *Brazil – Measures Affecting Imports of Retreaded Tyres*, WT/DS332/AB/R, adopted on December 3, 2007, para. 171.

¹⁴⁷ Appellate Body Report, *Brazil – Measures Affecting Imports of Retreaded Tyres*, WT/DS332/AB/R, adopted on December 3, 2007, para. 150.

¹⁴⁸ Appellate Body Report, *Brazil – Measures Affecting Imports of Retreaded Tyres*, WT/DS332/AB/R, adopted on December 3, 2007, para. 210.

The fundamental theme is to be found in the purpose and object of avoiding abuse or illegitimate use of the exceptions to substantive rules available in Article XX.”¹⁴⁹

In principle, if any of these three conditions is not satisfied, it will not be possible to justify the measure under Article XX (d) GATT. Hence, if the measure at issue is a means of unjustifiable and arbitrary discrimination, it is not necessary to examine also whether the measure was applied in a manner that constitutes a disguised restriction on international trade¹⁵⁰.

Turning to the analysis of exhaustion rules and their possible justification under Article XX(d), it seems that the necessity requirement will be satisfied by any exhaustion regime chosen, domestic, regional, differentiated international exhaustion based on geographic criteria, differentiated international exhaustion based on investment protection criteria, international exhaustion, in view of the broad regulatory space Article 6 TRIPS provides to the Contracting parties as to the choice of exhaustion regime. Furthermore, according to Article 1 (1) of the TRIPs Agreement, “Member [the Contracting Parties] may, but shall not be obliged to, implement in their law more extensive protection than is required by this Agreement, provided that such protection does not contravene the provisions of this Agreement”. Hence, the parties are free to decide on the degree of protection of the economic value of trademarks by allowing the trademark owner to oppose parallel imports under certain conditions.

One may argue that a domestic or a regional exhaustion regime or an international exhaustion regime that is based on geographic criteria may be a particularly optimal choice in case of excluding parallel imports at the border, because of facilitated enforcement of the ban by the customs authorities, a particularly effective enforcement system, given the weakness of the judicial system of a specific Contracting party. Indeed, according to the interpretation given to the necessity test under Article XX (d) GATT, summarized above, the capacity of a country to implement remedial measures that would be particularly costly or would face substantial technical difficulties should be considered as a relevant factor in order to justify the existence of reasonable available alternatives. Banning parallel imports at the border makes a material contribution to the achievement of the objective, which is the protection of the exclusionary rights of the IP holder, should the States make the choice of granting this extra degree of protection from parallel imports, as is their right in view of Article 6 TRIPs.

Yet, a different view may be taken as to the necessity of protecting the right of the IP holder to benefit from the exercise of her IP right in a second market, once she has put the products on the market in the State from which the product has been imported. Grigoriadis notes the following:

¹⁴⁹ Appellate Body Report, *US – Gasoline*, WT/DS2/AB/R, adopted on April 29, 1996, page 25.

¹⁵⁰ Appellate Body Report, *US – Shrimp*, WT/DS58/AB/R, adopted on October 12, 1998, para. 184.

“This is the case only where the recognition of the principle of national exhaustion of rights or of the principle of regional exhaustion of rights has been dictated by the extent of protection granted by the Contracting Party for the economic value of trademarks, an issue on which the Contracting Parties are free to decide. [in view of Article 1(1) TRIPs] Otherwise, prohibitions on parallel imports cannot be considered to be necessary for the effective implementation of the Contracting Party’s trademark law. Parallel imported goods are goods that are genuine and that have been legally put on the market for the first time. Any inadequacies in the administrative or jurisdictional mechanisms of the Contracting Parties to combat the phenomenon of counterfeiting and piracy do not suffice to justify a situation in which the owner of a trademark is entitled to oppose any importation of goods bearing the trademark carried out by a third party. Besides, Article 6 of the TRIPs Agreement does not contain a provision that establishes a minimum standard, so that an ability of trademark owners to oppose parallel imports could be considered to be covered by the provision of Article 1 (1) of the TRIPs Agreement. In the light of the foregoing considerations, the adoption of the regimes of national exhaustion of trademark rights and of regional exhaustion of trademark rights is contrary to Article XX (d) of the GATT 1994, so long as it is motivated by protectionist considerations in favour of domestic undertakings/industry.”¹⁵¹

It may be argued that a similar conclusion applies to a regime of differentiated international exhaustion based on a geographic criterion, and even more strongly, to a regime of differentiated international exhaustion based on an investment protection criterion. In the latter case, it is clear that the measure aims to protect domestic industry, as it effectively protects trademark owners that are established or have an important presence, in the sense of productive facilities, in the territory of the importing state. The *Argentina – Measures Affecting the Importation of Goods* case could have provided the opportunity to examine more thoroughly the possibility to justify a trade restriction requirement that would have created incentives for suppliers investing in the jurisdiction adopting the measures¹⁵². However, although the panel considered that such requirements were infringing Article XI(1) GATT, it did not address the possibility to justify such measures under Article XX(d).

With regard to the application of the other conditions— the absence of a unjustifiable and arbitrary discrimination or a disguised restriction to international trade—it is necessary to examine, at least for the first two conditions, if the same conditions prevail in the specific contracting parties, the exporting and the importing state, as discrimination is otherwise possible should the legal framework or the economic conditions prevailing in the two jurisdictions be different. There cannot be discrimination unless a differential treatment is provided to similar situations. Providing differential treatment to different situations does not constitute discrimination, and certainly not “arbitrary” or “unjustifiable” discrimination. The fact that each

¹⁵¹ GRIGORIADIS, above n. 105, 113-114.

¹⁵² Report of the Panel, *Argentina – Measures Affecting the Importation of Goods*, adopted on August 22, 2014, WT/DS438/R, WT/DS444/R, WT/DS445/R.

of the two jurisdictions has chosen a different type of exhaustion regime may be relevant as to the non-existence of a different legal framework in each jurisdiction. Similarly, differing economic conditions, for instance the fact that the exporting jurisdiction is a developing country, while the importing jurisdiction a developed country, may also justify the restriction of parallel trade, should the sentence “countries where the same conditions prevail” be understood as meaning countries with similar or comparable economic performances.

The assessment of these different criteria and their application to the measure in question depends on a variety of factors and it is not possible at this stage to predict with certainty the outcome of the balancing test. It appears, however, that international exhaustion would seem to be the less WTO-inconsistent measure, followed by a regime of differentiated international exhaustion based on geographic criteria or a regional exhaustion. The situation is more open for a regime of differentiated international exhaustion based on investment protection criteria and domestic exhaustion.

An argument in favour of a broad application of Article XX (d) even to situations of domestic or regional exhaustion may be made in view of the interpretation of Article XX (d) prior to the entry into force of the WTO agreement. Under the GATT 1947, it was generally accepted that article XX (d) could apply and save prohibitions on imports. In *United States – Imports of certain Automotive Spring Assemblies*, the United States attempted to justify a breach of Article XI (1), in this case an order by the International Trade Court (ITC) excluding the import of automotive spring assemblies that were found to infringe two US patents, in application of Section 337 of the United States Tariff Act of 1930, on the basis of Article XX (d)¹⁵³. The Panel considered whether or not the exclusion order was “applied in a manner which would constitute ... a disguised restriction on international trade”, noting that that “the Preamble of Article XX made it clear that it was the application of the measure and not the measure itself that needed to be examined”.¹⁵⁴

The Panel then considered whether the ITC action, in making the exclusion order, was “necessary” in the sense of paragraph (d) of Article XX to secure compliance with United States patent law and examined in this connection “whether a satisfactory and effective alternative existed under civil court procedures which would have provided the patent holder [...] with a sufficiently effective remedy against the violation of its patent by foreign producers”.¹⁵⁵ The Panel found that such private enforcement action and the remedy it could lead to “would not have been sufficient” to protect the specific patent rights because, in practice, it would have been

¹⁵³ Report of the Panel, *United States – Imports of certain Automotive Spring Assemblies*, adopted on May 26, 1983, L/5333 - 30S/107.

¹⁵⁴ Report of the Panel, *United States – Imports of certain Automotive Spring Assemblies*, adopted on May 26, 1983, L/5333 - 30S/107, para. 56.

¹⁵⁵ Report of the Panel, *United States – Imports of certain Automotive Spring Assemblies*, adopted on May 26, 1983, L/5333 - 30S/107, para. 59.

effective only in relation to the automotive spring assemblies produced by the infringing undertaking and supplied to parties joined in the court action. That remedy “would not have been effective against other possible foreign infringers of the United States patent and potential users of the infringing product in the United States”, which in view of the relatively simple manufacturing process used to produce automotive spring assemblies, and the possibility that foreign producers infringing the patent would be able to produce, without major difficulties, would have increased the likelihood that such automotive parts could be imported for use in the United States. Hence, the panel considered that the United States civil court action would not have provided a satisfactory and effective means of protecting the patent rights of the IP holder against importation of the infringing product and that the exclusion order procedure could be considered as “necessary” for the protection of the IP right¹⁵⁶. The panel nevertheless noted the following:

“[...] the substance of patent infringement cases could vary considerably, for example as regards the characteristics of the product which was the subject of the infringement and the simplicity or complexity involved in its manufacture. There might also be variations in the degree of difficulty which might be encountered in joining in a court action all possible users of the product which had been manufactured in violation of the patent, in the serving of process and enforcement of court judgments depending, among other things, on the legal and judicial court system in the country of the manufacturer infringing the patent.

The Panel did not, therefore, exclude the strong possibility that there might be cases, for example, involving high-cost products of an advanced technical nature and with a very limited number of potential users in the United States, where a procedure before a United States court might provide the patent holder with an equally satisfactory and effective remedy against infringement of his patent rights. In such cases the use of an exclusion order under Section 337 might not be necessary in terms of Article XX(d) to secure compliance with laws and regulations (i.e. United States patent law) which were not inconsistent with the General Agreement”.¹⁵⁷

Finally, some of the criteria for the application of Section 337 actions were found irrelevant by the panel and thus not necessary for the effective protection of the infringed IP right, in particular the requirement in subsection (a) of Section 337 that the plaintiff proves a substantial injury to a United States industry which was efficiently and economically operated.

¹⁵⁶ Report of the Panel, *United States – Imports of certain Automotive Spring Assemblies*, adopted on May 26, 1983, L/5333 - 30S/107, para. 60.

¹⁵⁷ Report of the Panel, *United States – Imports of certain Automotive Spring Assemblies*, adopted on May 26, 1983, L/5333 - 30S/107, paras 65-66.

One may doubt as to the relevance of this case law, which concerns a case of infringement of IP rights, and the broad interpretation it offers of the necessity test under Article XX(d) to the situation of an exclusion of parallel imports, that is imports that are perfectly legal, do not infringe the substance of the IP right involved but just concern the question of the appropriability of revenue streams from additional sales of the product covered by the IP right in the market of the importing state.

In *United States – Section 337 of the tariff Act 1930*, the panel noted that the Panel that “a contracting party cannot justify a measure inconsistent with another GATT provision as ‘necessary’ in terms of Article XX(d) if an alternative measure which it could reasonably be expected to employ and which is not inconsistent with other GATT provisions is available to it” and “in cases where a measure consistent with other GATT provisions is not reasonably available, a contracting party is bound to use, among the measures reasonably available to it, that which entails the least degree of inconsistency with other GATT provisions”¹⁵⁸ Although the panel examined the criterion of necessity, the report does not provide any discussion of the three conditions included in the chapeau of Article XX(d) and in any case does not provide any clear guidance on the application of Article XX(d) to a prohibition of parallel imports following the institution of a regime of domestic, regional or differentiated international exhaustion.

Yet, what this case law may indicate is that had the contracting states wished to render the choice of regional or domestic exhaustion incompatible with Article XX (d), they could have revised the text of that provision, or drafted that of Article 6 TRIPs accordingly, in view of the interpretation of Article XX (d) by the panel prior to the implementation of the GATT 1994. By having not done so, and by having maintained as such the text of Article XX (d), as well as by recognizing in Article 6 TRIPs that Member States are free to choose the exhaustion regime that fits better to their objectives, the Contracting States seem to have recognized that Article XX (d) may enter into play and justify restrictions to parallel trade and that it cannot be true that the only regime compatible with the GATT Agreement is that of pure international exhaustion.¹⁵⁹

Nonetheless, the Court of Justice of the EU has interpreted Articles 28 and 30 of the TFEU (formerly Articles 30 and 36) in a way that does accommodate a regime of regional exhaustion, precisely because the main objective of the free movement of goods provisions of the TFEU is to achieve the integration of the EU Internal Market, which is a different objective

¹⁵⁸ Report by the Panel, *United States – Section 337 of the tariff Act 1930*, adopted on November 7, 1989, L/6439 - 36S/345, para. 5.26

¹⁵⁹ For a similar interpretation on the basis of the principle “*in dubio mitius*,” according to which: “the limitation of sovereign competence of a country in a matter regulated by an International Agreement cannot be presumed but, such a limitation requires the consent of the country”, see GRIGORIADIS, above n. 105, 115-116. The author notes that in order for XX (d) of the GATT to be interpreted as allowing the Contracting Parties to accept only international exhaustion of trademark rights, “a consent of the Contracting Parties must have been given for the limitation of their sovereign competence in the issue of the legal treatment of parallel imports of trademarked goods,” yet “[s]uch consent, however, does not exist, as confirmed by Article 6 of the TRIPs Agreement.”

that the trade liberalization aimed by the WTO. That said, it should however be recognized that the regime of international exhaustion seems more WTO-consistent than any other regime, and accordingly the choice of another regime, such as domestic, regional differentiated international exhaustion carries a certain risk of this not being justified under Article XX(d) GATT.

2. Article XXIV GATT

Even if regional exhaustion may be considered as compatible with Article XX (d), it remains possible for the exclusion of parallel imports following the imposition of a system of regional exhaustion or of differentiated international exhaustion on the basis of a geographic criterion to infringe Article I (1) GATT (MFN clause), in view of the discrimination introduced between foreign products that do not benefit from exhaustion and foreign products that benefit from the exhaustion regime. In this case, a further possibility for justification is provided for by Article XXIV GATT. This provision introduces an exemption to the most-favoured-nation principle by establishing the legality of the so-called regional economic unions (customs unions or free trade area¹⁶⁰), when the duties and other regulations of commerce imposed at the institution of any such union in respect of trade with contracting parties not parties to such union or agreement shall not on the whole be higher or more restrictive than the general incidence of the duties and regulations of commerce applicable in the constituent territories prior to the formation of such union [Article XXIV(5) GATT]. The Eurasian Economic Union may benefit from this provision as it aims to constitute a free trade area and to a certain extent a customs union. It should be noted, however, that even though regional exhaustion may benefit from the exception to MFN provided for in GATT Article XXIV, no possibility of exception seems possible with regard to the application of the MFN principle to differentiated international exhaustion rules based on geographic discrimination or on an investment protection principle.

The application of the conditions for the benefit of the GATT Article XXIV exception seems quite straightforward with regard to regional exhaustion. As it is explained by Grigoriadis,

“a transition from a regime of national exhaustion of trademark rights to a regime of regional exhaustion of those rights entails, indeed, preferential treatment for parallel imported goods originating in other Member States of the customs union or the free trade area, but it does not entail raising new obstacles to market access for parallel imported goods originating in third countries. In other words, such a transition does not make market access for goods imported in parallel more difficult but entails the legality of parallel imports that could previously be prohibited on the grounds that they concerned goods that had not been put on the domestic market by the holders of the trademarks borne by the goods or with their consent. Trademark proprietors retain the right to

¹⁶⁰ The concepts are defined in Article XXIV (8) GATT.

prevent parallel imports concerning goods originating in a third Contracting Party, as it is true by virtue of a regime of national exhaustion of trademark rights”¹⁶¹.

The opposite conclusion would be reached if on the contrary there was transition from a regime of international exhaustion to that of regional exhaustion, in which case Article XXIV would not apply and the restriction of parallel imports originating from non-members of the regional economic union would be found incompatible with the GATT. This would presumably be the case should the Eurasian Economic Commission choose a regime of regional exhaustion, in view of the fact that prior to signing the Eurasian Economic Union Agreement, Kazakhstan had an international exhaustion for all types of IP rights.

A more contentious issue would be the application of Article XXIV to justify a differentiated international exhaustion regime based on a geographic criterion. As long as such regime is not integrated in a regional economic union agreement, as this is defined in Article XXIV (8), it may not benefit from the exception of Article XXIV. Yet, if such regime forms part of a free trade area or a customs union, then it may benefit from the exception of Article XXIV.

Of particular significance would be here the consideration of the necessity of the system of differentiated international exhaustion for the constitution of the regional economic union. As the Appellate Body clarified in *Turkey – Textiles* “Article XXIV may, under certain conditions, justify the adoption of a measure which is inconsistent with certain other GATT provisions, and may be invoked as a possible ‘defence’ to a finding of inconsistency” but also noted that the chapeau of this provision “states that the provisions of the GATT 1994 ‘shall not prevent’ the formation of a customs Union”, which it read to mean “that the provisions of the GATT 1994 shall not make impossible the formation of a customs union”.¹⁶² Accordingly, the Appellate body held that “this wording indicates that Article XXIV can justify the adoption of a measure which is inconsistent with certain other GATT provisions only if the measure is introduced upon the formation of a customs union, and only to the extent that the formation of the customs union would be prevented if the introduction of the measure were not allowed”.¹⁶³ The Appellate Body thus acknowledged the link between the measure for which the exception of Article XXIV is required and the concept of customs union. This is linked to the need to ensure internal trade between the members of the union and vis-à-vis third parties the application of a common external trade regime and of substantially the same duties and other regulations of commerce.¹⁶⁴

¹⁶¹ GRIGORIADIS, n. 105, 119.

¹⁶² Appellate Body report, *Turkey – Restrictions on Imports of Textile and Clothing products*, WT/DS34/AB/R, adopted on October 22, 1999, para. 45.

¹⁶³ Appellate Body report, *Turkey – Restrictions on Imports of Textile and Clothing products*, WT/DS34/AB/R, adopted on October 22, 1999, para. 46.

¹⁶⁴ Appellate Body report, *Turkey – Restrictions on Imports of Textile and Clothing products*, WT/DS34/AB/R, adopted on October 22, 1999, para. 49.

The Appellate Body also held that text of the chapeau of Article XXIV: 5, states that the provisions of the GATT 1994 shall not prevent the formation of a customs union

“*Provided that*”, which indicates that Article XXIV can “only be invoked as a defence to a finding that a measure is inconsistent with certain GATT provisions to the extent that the measure is introduced upon the formation of a customs union which meets the requirement in sub-paragraph 5(a) of Article XXIV relating to the ‘duties and other regulations of commerce’ applied by the constituent members of the customs union to trade with third countries”.¹⁶⁵ In conclusion, the Appellate Body subjects the benefit of exception of Article XXIV to two cumulative conditions:

“First, the party claiming the benefit of this defence must demonstrate that the measure at issue is introduced upon the formation of a customs union that fully meets the requirements of sub-paragraphs 8(a) and 5(a) of Article XXIV. And, second, that party must demonstrate that the formation of that customs union would be prevented if it were not allowed to introduce the measure at issue”.¹⁶⁶

The assessment of these two conditions with regard to the Eurasian Economic Union goes beyond the task of this report. Yet, it is clear that the burden of proof here would be on the party alleging the benefit of the exception, the Eurasian Economic Union. It is also to be noted that although Article XXIV does not seem to require that the measure be introduced immediately when the customs union agreement is implemented, the Appellate Body requires that the measure at issue “is introduced *upon* the formation of a customs union” (emphasis added). The second condition will also require some separate analysis.

Looking more specifically to the requirement that the general incidence of quantitative restrictions should be on the whole less restrictive than the general incidence of regulations of commerce applicable in the constituent territories prior to the formation of the customs union, it is important to note that if there was a transition from a regime of domestic or regional exhaustion to that of differentiated international exhaustion based on geographic criteria, Article XXIV may apply, as such change may extend the number of jurisdictions benefiting from a regime of free market access, without restrictions on parallel imports. Transition from a regime of regional exhaustion to one of pure international exhaustion would not constitute a violation of the MFN clause and consequently it will not be necessary to justify it under Article XXIV.

¹⁶⁵ Appellate Body report, *Turkey – Restrictions on Imports of Textile and Clothing products*, WT/DS34/AB/R, adopted on October 22, 1999, para. 52.

¹⁶⁶ Appellate Body report, *Turkey – Restrictions on Imports of Textile and Clothing products*, WT/DS34/AB/R, adopted on October 22, 1999, para. 58.

However, transition from a regime of international exhaustion to a regime of differentiated international exhaustion would not benefit from the exception of Article XXIV GATT, as in this case the level of regulatory obligations imposed would be higher post constitution of the regional economic union than prior constitution of the union. For instance, although Kazakhstan benefitted from a regime of international exhaustion prior to the conclusion of the EEU treaty, a decision to turn towards a system of differentiated international exhaustion will mean that certain parallel imports that were able to enter without challenge the Kazakhstan market prior to the EEU agreement would not be able to do so after the decision to move to a differentiated international exhaustion regime.

The transition from a regime of regional exhaustion to one of differentiated international exhaustion based on an investment protection clause might also raise concerns, in view of the fact that after the Treaty on EEU (and its Annex 26) was signed by Kazakhstan, the regional exhaustion principle for trademarks became a law in Kazakhstan. In this case, the application of the exception to the principle of international exhaustion will depend on the characteristics of the specific trademark owner and in particular the fact that the trademark owner has made investments in the territory of the Eurasian Economic Union. It is possible in this case to make an argument based on the MFN principle that such regime leads to a de facto discrimination against the States whose companies do not satisfy in general the investment criterion. This may be indeed be the case of states that have not concluded bilateral investment protection treaties with the importing state or bilateral agreements promoting foreign direct investments in the importing state. Yet again, the possibility to justify such violation of the MFN principle will depend on the necessity of such measure to the regional economic union agreement and the level of regulatory obligations imposed now, in comparison to that prior the constitution of the regional economic union

D. Enforcement

It is not evident that WTO countries would themselves be motivated to initiate steps for WTO dispute resolution, particularly given that many other exhaustion regimes short of international exhaustion (and possibly even that) could be the subject of difficult scrutiny. Only states can bring a WTO action challenging the Eurasian proposal unless there are free trade agreements that could apply to the rights of IP owners in the EEC. Under most free trade agreements, injured private parties can sue the state directly and this could expedite direct challenges to any of the proposed solutions to exhaustion. They could also pursue investor-state arbitration in those cases where investment treaties are applicable. In addition, there is some risk of retaliation by aggrieved states which, in extreme cases, could lead to seizures of goods in transit for purposes of reparation. Far more likely, however, at least in the short term, is the possibility that aggrieved states would raise their complaints before the WTO's Council for TRIPS or equivalent bodies under the GATT. The effectiveness of such complaints is hard to

evaluate but they can certainly disrupt comity on which other relations may depend. Finally, as mentioned earlier, there is some risk that the moratorium on non-violatory acts of nullification under TRIPS may be lifted sooner than expected, and in any case remains viable under GATT.

A separate question arises concerning contracts between private parties that establish arrangements (such as restricting re-sale) regarding exhaustion that deviate from the legal rules imposed by the EEC. The enforceability of such agreements is a matter for the national courts or any judicial arm created by the EEC, with regard to, in particular, the possible application of competition law¹⁶⁷. These issues are beyond the scope of this report.

IV. THE UNCERTAIN STATUS AND UNRELIABILITY OF STATE PRACTICE

In evaluating the state practices set out below, two considerations must be borne in mind. First, none of the existing strategies adopted by different WTO Members with regard to exhaustion have been evaluated by WTO panels with respect to their compliance with either the TRIPS Agreement or the GATT (1994). Some or many of them could turn out to be characterized as de facto discriminatory, even if facially neutral. Second, even if some or all of these measures were to be deemed compliant with TRIPS or GATT, that in itself would tell us nothing about their continued compliance with either Agreement under a regime of differentiated exhaustion.

*A. The U.S. Approach to Exhaustion*¹⁶⁸

1. Patents and Exhaustion

The Patent Act confers upon the U.S. patent owner the rights to exclude others from making, using, or selling the patented invention in the United States--and, since U.S. accession to the WTO TRIPS Agreement the additional rights to exclude others from offering to sell the patented invention in the United States, and from importing the invention into the United States.¹⁶⁹ An exception to these rights is the “first sale” doctrine. Under this doctrine, once the U.S. patent owner sells (or authorizes another to sell) a product embodying the patented invention, the subsequent use or resale of that product by the purchaser and any subsequent

¹⁶⁷ It is an established policy in the European Union that agreements or unilateral practices limiting the opportunities of parallel trade constitute an infringement of Articles 101 and 102 TFEU: see, Joined Cases C-501/06P, C-515/06P and C-519/06P, *GlaxoSmithKline Services Unlimited, formerly Glaxo Wellcome plc v Commission and Commission, EAEPIC and Aseprofar v GlaxoSmithKline Services Unlimited, formerly Glaxo Wellcome plc* [2009] ECR I-9291; Joined Cases C468/06 to C478/06, *Sot. Lelos v GlaxoSmithKline* [2008] ECR I-7139.

¹⁶⁸ Courtesy of Professor Thomas F. Cotter, Notes on International Intellectual Property (2014).

¹⁶⁹ See 35 U.S.C. §§ 154(a)(1), 271(a).

possessors does not infringe.¹⁷⁰ In doctrinal terms, the patent owner's rights to exclude others from using and reselling that product are exhausted.

A question arises whether the first sale doctrine applies only upon the first lawful sale of the product in the United States, or upon the first lawful sale anywhere in the world (or whether some intermediate position is possible). In other words, if the first lawful sale of a product embodying the patented invention takes place outside the United States, does the subsequent importation, sale, or use of that product in the United States without the U.S. patent owner's permission infringe the U.S. patent owner's rights, i.e., national exhaustion? Or does the first sale doctrine prevent the U.S. patent owner from asserting those rights once the product has been the subject of a lawful first sale anywhere in the world, i.e., international exhaustion? Trying to determine which, if either, principle the United States follows can be difficult.

A small number of pre-1996 cases addressed the issue of whether a lawful first sale abroad exhausted the U.S. patent owner's rights to exclude others from using and selling the product in the United States. Assuming that these cases are still good law, they may provide some guidance on this issue, although only one case was decided at the U.S. Supreme Court level, and opinions may vary as to how broadly or narrowly this case should be interpreted.¹⁷¹ Consider a hypothetical example: A U.S. Patent owner manufactures her product in Italy and sells it to Buyer in Italy, without imposing any restrictions on Buyer's subsequent conduct. Buyer imports the product into the United States, or sells it to someone in Italy who subsequently imports it into the United States.

Several pre-1996 cases held that, under these circumstances, the U.S. patent owner could not prevent the subsequent use and resale of the product in the United States.¹⁷² A few cases, however, hold or state that the U.S. patent owner's exclusive U.S. licensee can enjoin the subsequent use and resale in the United States.¹⁷³ And a few cases held that if the U.S. patent

¹⁷⁰ See *Quanta Computer, Inc. v. LG Elecs., Inc.*, 553 U.S. 617 (2008); *United States v. Univis Lens Co.*, 316 U.S. 241, 249 (1942).

¹⁷¹ More recent case law from the United States Court of Appeals for the Federal Circuit, on the other hand, seems to indicate that the U.S. follows a national exhaustion regime. See, e.g., *Fuji Film Corp. v. Benun*, 605 F.3d 1366 (Fed. Cir. 2010); *Fuji Photo Film Corp. v. Jazz Photo Corp.*, 394 F.3d 1368 (Fed. Cir. 2005); *Jazz Photo Corp. v. ITC*, 264 F.3d 1094 (Fed. Cir. 2001). But it is unclear whether these cases consistent with the Supreme Court's recent copyright decision in *Kirtsaeng v. John Wiley & Sons*, 133 S. Ct. 1351 (2013), or whether they need to be consistent in this respect.

¹⁷² See *Curtiss Aeroplane & Motor Corp.*, 266 F. 71 (2d Cir. 1920) (distinguishing *Boesch* on the ground that, in that case, the U.S. patent owner had not participated "either as a party or as a privy, in the putting out of the article which is alleged to infringe"); *Kabushiki Kaisha Hattori Seiko v. Refac Tech. Dev. Corp.*, 690 F. Supp. 1339 (S.D.N.Y. 1988); *Sanofi, S.A. v. Med-Tech Veterinarian Prods., Inc.*, 565 F. Supp. 931 (D.N.J. 1983); *Holiday v. Mattheson*, 24 F. 185 (C.C.S.D.N.Y. 1885).

¹⁷³ See *Sanofi*, 565 F. Supp. at 938-39 (reasoning that, if the rule were otherwise, the foreign purchaser would acquire "rights greater than those possessed by the owner of the patent," in cases in which the latter has promised not to compete with his exclusive U.S. licensee); *accord* *PCI Parfums et Cosmetiques Int'l v. Perfumania*, 35 U.S.P.Q.2d 1159 (S.D.N.Y. 1995); *Sanofi, S.A. v. Med-Tech Veterinarian Prods., Inc.*, 222 U.S.P.Q.2d 143 (D. Kan. 1983).

owner sold the product abroad subject to the restriction that the product would not be imported into the United States, the subsequent use and resale in the United States was unlawful.¹⁷⁴ It is debatable, however, whether these cases remain good law in light of *Jazz Photo*¹⁷⁵ and *Kirtsaeng*.¹⁷⁶

Consider another hypothetical example in which the U.S. Patent owner manufactures a product embodying her patented invention in the United States, and then sells this product to an exporter in the United States. The latter exports the product to Italy; the importer buys the product in Italy and imports it back into the United States. Unless the new importation right adopted as a result of TRIPS was intended to create a radical departure from existing law, this importation should be lawful under U.S. law.

However, in a situation where the importer, located in Italy, makes and sells the U.S. Patent owner's product in Italy, without the U.S. Patent owner's permission, this does not violate U.S. law, because the U.S. patent laws do not have extraterritorial effect. (Whether it violates Italian law will depend on whether the invention is patented in Italy.) If the importer then imports the product into the United States, this should be a clear violation of the importation right. Pre-1996 case law held that the subsequent use or sale of the product in the United States under these circumstances was not protected by the first sale doctrine. For example, in *Boesch v. Graff*, 133 U.S. 697 (1890), the Supreme Court held that the subsequent use and sale of a patented product in the United States violated the U.S. patent owner's rights, even though a third party had lawfully manufactured the product in Germany and then sold it to the importer. According to the Court:

The right which Hecht [the German manufacturer] had to make and sell the burners in Germany was allowed him under the laws of that country, and purchasers from him could not be thereby authorized to sell the articles in the United States in defiance of the rights of patentees under a United States patent. . . . The sale of articles in the United States under a United States patent cannot be controlled by foreign laws.¹⁷⁷

Finally, it is worth noting that § 337 of the Customs Act of 1930 (19 U.S.C. § 1337) authorizes the United States International Trade Commission to remedy “[t]he importation into the United States, the sale for importation, or the sale within the United States after importation by the owner, importer, or consignee, of articles that . . . infringe a valid and enforceable patent.” *Id.* § 1337(a)(1)(B). This law also applies to articles that infringe registered copyrights and trademarks. *See id.* § 1337(a)(1)(B)(i),(C). The rule only applies, however, “if an industry in the United States relating the articles [in question] exists or is in the process of being established” as

¹⁷⁴ *See* *Dickerson v. Tinling*, 84 F. 192 (8th Cir. 1897); *Dickerson v. Matheson*, 57 F. 524 (2d Cir. 1893).

¹⁷⁵ *Jazz Photo Corp. v. ITC*, 264 F.3d 1094 (Fed. Cir. 2001).

¹⁷⁶ *Kirtsaeng v. John Wiley & Sons*, 133 S. Ct. 1351 (2013).

¹⁷⁷ *See also* *Daimler Mfg. Co. v. Conklin*, 170 F. 70 (2d Cir. 1909) (similar).

defined in the statute. *Id.* § 1337(d)(2). This may supply ample basis in support of the industry/investor driven justification for the Eurasian proposal.

2. Trademarks and Exhaustion

With respect to the exhaustion of trademarks, a different analysis is required. The parallel importation of goods bearing U.S. trademarks presents some difficult legal issues, because two different statutes--the Tariff Act of 1930 and the Lanham Act--are relevant, as are the Customs Service regulations promulgated under authority of these acts and the common law of trademarks. To prevail on a claim for trademark infringement the owner must prove a likelihood of confusion. In determining whether confusion exists, the trier of fact will consider a number of different factors, including the similarity of the marks; the similarity of the products or services; the relative sophistication of the purchasers of these products or services; the channels of trade in which the marks are used; the mark's inherent and acquired strength; whether the defendant adopted the mark in bad faith; and so on. Consistent with these principles is the proposition that, subject to certain exceptions, "one is not subject to liability [for trademark infringement] for using another's trademark . . . in marketing genuine goods or services the source, sponsorship, or certification of which is accurately identified by the mark."¹⁷⁸

U.S. trademark law, like patent and copyright law, recognizes a first-sale or exhaustion principle, which has been summarized as follows:

. . . the trademark owner cannot ordinarily prevent or control the sale of goods bearing the mark once the owner has permitted those goods to enter commerce. It can be said that the rights of the trademark owner are exhausted once the owner authorizes the initial sale of the product under the trademark or that the owner implicitly licenses others to further market the goods under the mark. Thus, no infringement occurs when the use of a mark properly identifies the source, sponsorship, or certification of the goods or services, even if the owner of the mark objects to the use.¹⁷⁹

As in patent and copyright law, however, the question arises whether this principle applies following the first lawful sale in the United States (national exhaustion) or the first lawful sale anywhere in the world (international exhaustion). The Supreme Court first addressed the issue of gray-market trademarked goods in *A. Bourjois & Co. v. Katzel*.¹⁸⁰ There, a French company owned the trademark in France and the United States for a brand of face powder; it then sold its U.S. business, including the registered U.S. trademark, to a U.S. company. The U.S. company imported the face powder from the French company and sold it in the U.S. under that mark. The defendant bought some of the face powder in France and imported it into the U.S. for sale here,

¹⁷⁸ Restatement (Third) of Unfair Competition Law; Restatement § 24.

¹⁷⁹ Restatement, *id.*, comment b.

¹⁸⁰ 260 U.S. 689 (1928).

in competition with the U.S. company. The U.S. company sued the importer. The Supreme Court held that the defendant infringed the U.S. trademark owner's rights, even though the product was the genuine product of the French company:

After the sale the French manufacturers could not have come to the United States and have used their old marks in competition with the plaintiff. . . . It is said that the trademark here is that of the French house and truly indicates the origin of the goods. But that is not accurate. It is the trademark of the plaintiff only in the United States and indicates in law . . . that the goods come from the plaintiff although not made by it.¹⁸¹

As noted in the Restatement, the Court in *Katzel* rejected the 'universality' principle in favor of a 'territoriality' principle that recognizes a separate legal existence for a trademark in each country whose laws afford protection of the mark. Under this view, the trademark does not necessarily identify to purchasers in a particular country the original manufacturer of the goods, but may instead identify the company that owns the exclusive trademark rights within that country.¹⁸²

Unfortunately, trademark law is not the only body of law that is relevant in understanding the US approach to exhaustion; customs law also has a role to play. While the *Katzel* case was pending before the Supreme Court, Congress enacted the Tariff Act of 1922--a protectionist measure designed to shield U.S. firms from the effects of foreign competition. The act was later amended by the Tariff Act of 1930. Notwithstanding the move towards global free trade beginning with the establishment of GATT and now embodied in the WTO, some portions of this Act, including one affecting parallel importation, remain good law in the U.S. A related provision is found in § 42 of the Lanham Act.

First, under § 526 of the Tariff Act (19 U.S.C. § 1526(a)), it is unlawful:

to import into the United States any merchandise of foreign manufacture if such merchandise . . . bears a trademark owned by a citizen of, or by a corporation or association created or organized within, the United States, and registered in the Patent and Trademark Office by a person domiciled in the United States . . . unless written consent of the owner of such trademark is produced at the time of making entry.

¹⁸¹ *Id.* at 691-92. The Restatement, however, goes on to note some ambiguities and suggests that the proper test remains likelihood of confusion. Under the Restatement approach, a trademark owner has an infringement claim against the importer of genuine, identical goods only if U.S. consumers are likely to be confused into erroneously thinking that the source or sponsor of the imported goods is the U.S. trademark owner. As with any likelihood of confusion claim, the trademark owner may have a cause of action under § 32 of the Lanham Act if the mark is registered; under § 43 if the mark is not registered; and under state common law.

¹⁸² Restatement (Third) of Unfair Competition Law, above n.164, §24, comment f.

Second, § 42 of the Lanham Act states that:

Except as provided [elsewhere], no article of imported merchandise which shall copy or simulate the name of any domestic manufacture, or manufacturer, or trader, or of any manufacturer or trader located in any foreign country which, by treaty, convention, or law affords similar privileges to citizens of the United States, or which shall copy or simulate a trademark registered in accordance with the provisions of this chapter or shall bear a name or mark calculated to induce the public to believe that the article is manufactured in United States, or that it is manufactured in any foreign country or locality other than the country or locality in which it is in fact manufactured, shall be admitted to entry at any customhouse of the United States.

Note the differences between the two provisions. Under § 526, the importation of an article of foreign manufacture is unlawful if the article bears a registered U.S. trademark owned by a U.S. citizen or U.S. corporation. Under § 42, the importation is unlawful if the article (1) copies or simulates (a) a trade name or (b) a registered U.S. trademark, or (2) bears a name or mark calculated to deceive the U.S. public about its place of manufacture. Thus, it is possible to violate § 42 (but not § 526) by copying a trade name, or by copying a registered U.S. trademark owned by a non-U.S. citizen or non-U.S. corporation.

Although these two statutes may seem, at first blush, to create an absolute bar to the importation of gray goods, the regulations the Customs Service has promulgated to implement these rules purport to create some exceptions.¹⁸³ For present purposes, the most relevant provision of the regulations is 19 C.F.R. § 133.23. The principal difference between this regulation and its predecessors (which were at issue in the *K-Mart* case discussed below) is the addition of rules governing the importation of goods that are physically and materially different from their U.S. counterparts.

First, § 133.23 defines “restricted gray market articles” as “foreign-made articles bearing a genuine trademark or trade name identical with or substantially indistinguishable from one owned and recorded by a citizen of the United States or a corporation or association created or

¹⁸³As Professor McCarthy notes, the *K-Mart* decision discussed in the text above addressed the validity of Customs Service regulations interpreting the Tariff Act, not . . . the Tariff Act itself. However, it is equally true that when the Supreme Court holds that a federal agency has reasonably interpreted a statute, that view of the statute will necessarily have a very weighty impact on courts interpreting the statute in suits under the Tariff Act brought by private companies seeking to bar gray market imports. . . .

While Customs’ regulations do not define the full scope of § 526, some courts have interpreted Tariff Act § 526 to have the same scope as the Customs’ Service regulations upheld by the Supreme Court in *K-Mart*

5 J. Thomas McCarthy, *McCarthy on Trademarks and Unfair Competition* § 29:49 (4th ed. 2014) (citations omitted).

organized within the United States and imported without the authorization of the U.S. owner.” 19 C.F.R. § 133.23(a).

Second, the regulation provides that, subject to an exception noted below, “[a]ll restricted entry gray market goods imported into the U.S. shall be denied entry and subject to detention” *Id.* § 133.23(c).

Goods that are subject to these provisions “shall be detained for 30 days from the date on which the goods are presented for Customs examination, to permit the importer to establish that any of the following exceptions” apply:

- a. “The trademark or trade name was applied under the authority of a foreign trademark . . . owner who is the same as the U.S. owner, a parent or a subsidiary of the U.S. owner, or a party otherwise subject to common ownership or control with the U.S. owner” *Id.* § 133.23(d)(1) (the “common ownership or control” exception); and/or
- b. “For goods bearing a genuine mark applied under the authority of the U.S. owner, a parent or subsidiary of the U.S. owner, or a party otherwise subject to common ownership or control with the U.S. owner, that the merchandise as imported is not physically and materially different . . . from articles authorized by the U.S. owner for importation or sale in the United States.” *Id.* § 133.23(d)(2); or
- c. “Where goods are detained . . . as physically and materially different from the articles authorized by the U.S. trademark owner for importation or sale in the U.S., a label in compliance with Sec. 133.23(b) *Id.* § 133.23(d)(3).¹⁸⁴

The effect of § 526, § 42, and the regulations is to create a general rule and an

¹⁸⁴ “Goods determined by the Customs Service to be physically and materially different under the procedures of this part, bearing a genuine mark applied under the authority of the U.S. owner, a parent or subsidiary of the U.S. owner, or a party otherwise subject to common ownership or control with the U.S. owner (see §§ 133.2(d) and 133.12(d) of this part), shall not be detained under the provisions of paragraph (c) of this section where the merchandise or its packaging bears a conspicuous and legible label designed to remain on the product until the first point of sale to a retail consumer in the United States stating that: “This product is not a product authorized by the United States trademark owner for importation and is physically and materially different from the authorized product.” The label must be in close proximity to the trademark as it appears in its most prominent location on the article itself or the retail package or container. Other information designed to dispel consumer confusion may also be added.” *Id.* § 133.23(b). Where the goods are detained for being physically and materially different, the importer has 30 days to add such a label. *See id.* § 133.23(d)(3).

exception. The general rule is that the U.S. trademark owner can prevent a foreign firm from importing goods bearing the U.S. trademark owner's registered trademark into the United States, even if the goods lawfully bear that mark abroad and (arguably) even if there is no likelihood of confusion under general trademark principles.

The exception to the rule is that the U.S. trademark owner cannot prevent the importation if:

the US and foreign firms are subject to common control, and either

- (1) the imported goods are physically and materially identical to the domestic goods, or
- (2) the goods are properly labeled as being physically and materially different from the authorized domestic goods.

Following the Supreme Court's discussion in *K-Mart Corp. v. Cartier, Inc.*, 486 U.S. 281 (1988), we can create a taxonomy of the various ways in which gray market goods may make their way into the United States, and then determine whether their importation is lawful or unlawful.

Case 1: Domestic firm purchases from an independent foreign firm the rights to register and use the latter's trademark as a U.S. trademark, and to sell its foreign-manufactured products here.

- If foreign manufacturer imports and distributes goods here, domestic firm is harmed.
- Similarly, if a third party lawfully purchases the goods abroad and imports them into the US, the domestic firm is harmed.
- Section 526 renders parallel importation under these circumstances illegal. *See K-Mart*, 486 U.S. at 287. This is the same result the Court arrived at in *Katzel*.

Case 2: Domestic firm registers U.S. trademark for goods manufactured abroad by an affiliated manufacturer.

- Case 2a: Foreign firm incorporates subsidiary here; subsidiary registers here a U.S. trademark identical to parent's foreign trademark;

third party lawfully buys goods abroad from the foreign firm and imports them into U.S.

- Case 2b: American-based firm establishes abroad a mfg. subsidiary to produce U.S.-trademarked goods, and then imports them for domestic distribution; third party lawfully purchases some of the merchandise abroad and imports it into the U.S. to compete against the American-based firm.
- Case 2c: American-based firm establishes abroad an unincorporated manufacturing division to produce U.S.-trademarked goods, and then imports them for domestic distribution; third party lawfully purchases some of the merchandise abroad and imports it into the U.S. to compete against the American-based firm.
- The Customs regulation discussed above, and earlier versions of the same regulation, permits the importation in all three variations of Case 2 (at least when the goods are not physically and materially different, or are properly labeled).¹⁸⁵
- Case 3: Domestic holder of U.S. trademark authorizes an independent foreign manufacturer to use the mark, typically on condition that foreign manufacturer will not export goods under that mark into U.S. Third party lawfully purchases goods abroad and then imports them into U.S. At one time, a customs regulation purported to permit this importation as well.
- In *K-Mart*, however, a majority of the Court held that this regulation was invalid. Section 526 could not be reasonably construed to permit the importation under these circumstances. *See K-Mart*, 486 U.S. at 293-94.

B. The EU Approach to Exhaustion

1. A Free Circulation Right and/or “Exhaustion” as Regards Sales within the EU

Following the constitution of the “common market”, and in the absence of EU-wide intellectual property rights, it was realised that IP rights in different Member States could divide

¹⁸⁵ A majority of the Supreme Court upheld this regulation in *K-Mart*, though for different reasons. *See id.* at 292-93 (opinion of Kennedy and White, J.); *id.* at 295-312 (opinion of Brennan, Marshall, and Stevens, J.).

what should be a common market. Companies tried to use IP rights to keep old national markets distinct – maintaining higher prices in some countries than others. Traders naturally tried to parallel import products from low to high price countries.

The European Court of Justice put an end to this by a series of cases involving trademarks, patents and copyright. There was no express provision about exhaustion of IP rights in the Treaty on the European Economic Communities (hereinafter EEC Treaty), but the Court interpreted the Rome Treaty to achieve it for goods or services put on the common market. Art. 30 EEC Treaty, as it then was numbered (now Article 34 TFEU), prohibited “quantitative restrictions on importation and all measures with equivalent effect” on trade between Member States. An exception to this was permitted by Art. 36 EC Treaty (now Article 30 TFEU) in the case of, inter alia, “the protection of industrial or commercial property”. However, the exception cannot apply if there is an “arbitrary discrimination or a disguised restriction on trade between member States.”

The first issue to be brought in front of the Court was the legality of parallel imports and the relation between the national IP rights and the material scope of the Treaty of Rome, in particular its competition law rules. In *Consten & Grundig* the Court examined the legality of a European Commission decision that had found that an agreement on the registration and the exclusive use of a trademark in a Member State concluded between an exclusive distributor and a supply that prevented trademarked goods from being imported in parallel infringed Article 85 EC (now Article 101 TFEU), prohibiting collusion with the object or effect to restrict competition in the Common Market. The applicants argued that Articles 36 EEC and 222 EEC¹⁸⁶ (now Articles 30 and 345 TFEU) excluded industrial property from the scope of the EU treaty and thus it was not possible to prevent a trademark right to be used even if this would lead to a situation of absolute territorial protection, thus reinstating through private means barriers to trade between Member States. The Court rejected this argument, noting that Article 36 EEC cannot limit the scope of Article 101 TFEU and that Article 222 EEC (now Article 345 TFEU), “does not affect the granting of (trademark rights) but only limits their exercise to the extent necessary to give effect to the prohibition under Article 85(1) of the EEC Treaty [now Article 101(1) TFEU]”¹⁸⁷.

Until the early 1970s, competition rules were the main provisions of the Treaty applied with regard to restrictions to parallel imports. This case law relating to the interaction between competition law rules and IP rights, the Court of Justice of the EU examined in subsequent case law the legality of parallel imports of trademarked goods in the light of the free movement of

¹⁸⁶ According to this provision, “This Treaty shall in no way prejudice the rules in Member States governing the system of property ownership.”

¹⁸⁷ Joined cases C-56/64 and 58/64, *Consten and Grundig v Commission of the EEC*, ECLI:EU:C:1966:41

goods rules of the Treaty. The Court of Justice found that the free movement rules of the Treaty applied to industrial property rights in the following way:

“As a result of the provisions of the Treaty relating to the free movement of goods, and in particular Article 30 [of the EEC Treaty, now Article 34 of the TFEU], quantitative restrictions on imports and all measures having equivalent effect are prohibited between Member States. Under Article 36 [of the EEC Treaty, now Article 36 of the TFEU] those provisions nevertheless do not preclude prohibitions or restrictions on imports justified on grounds of the protection of industrial and commercial property. However, it is clear from that same Article, in particular its second sentence, as well as from the context, that whilst the Treaty does not affect the existence of rights recognized by the laws of a Member State in matters of industrial and commercial property the exercise of those rights may nevertheless, depending on the circumstances, be restricted by the prohibitions contained in the Treaty. Inasmuch as it creates an exemption to one of the fundamental principles of the common market, Article in fact admits of exceptions to the rules on the free movement of goods only to the extent to which such exemptions are justified for the purpose of safeguarding the rights which constitute the specific subject-matter of that property”¹⁸⁸.

In essence, with this case law the Court found that the strict territorial nature of the exclusive protection of national industrial property rights constitutes a quantitative restriction to trade, which although incompatible with Article 30 EEC (now Article 34 TFEU) could be justified under Article 36 EEC (now Article 30 TFEU). In order to assess how the prohibition of parallel imports of trademarked products could fall within the scope of the prohibition of Article 34 TFEU, the Court made use of the following operational doctrines in order to balance the conflicting interests of protecting industrial property rights but also ensuring market integration and the constitution of a common market: the existence/exercise of the right distinction, the doctrine of the specific subject matter of the right and that of the essential function of the right, the doctrine of common origin of the right, and most importantly for our purposes the doctrine of the Community exhaustion of the rights.

The Court’s bold rulings were to the following effect:

¹⁸⁸ Case C-192/73, *Van Zuylen fre`res v. Hag AG*, [1974] ECR 731, paras 8 and 9; Case C-15/74, *Centrafarm BV and Adriaan de Peijper v. Sterling Drug Inc.*, [1974] ECR 1147, paras 7 and 8; Case C-16/74, *Centrafarm BV and Adriaan de Peijper v. Winthrop BV*, [1974] ECR 1183, paras 6 and 7; Case C-119/75, *Terrapin (Overseas) Ltd. v. Terranova Industrie CA Kapferer & Co.*, [1976] ECR 1039, para. 5; Case C-102/77, *Hoffmann-La Roche & Co. AG v. Centrafarm Vertriebsgesellschaft Pharmazeutischer Erzeugnisse mbH*, [1978] ECR 1139, para. 6; Case C-3/78, *Centrafarm BV v. American Home Products Corporation*, [1978] ECR 1823, paras 7–10; Case C-1/81, *Pfizer Inc. v. Eurim-Pharm GmbH*, [1981] ECR 2913, para. 6. For an extensive analysis, see GRIGORIADIS, above n. 105, Chapter 7; C. Stothers (2007), *Parallel trade in Europe: intellectual property, Competition and Regulatory Law*, (Hart, Oxford), Chapter 2.

- (1) An IP right was a measure with equivalent effect to a quantitative restriction on importation;
- (2) There is a distinction between the existence of an IP right and its exercise¹⁸⁹, the exercise being subject to regulation by EU law.
- (3) The distinction between existence and exercise of the right being not clear, as one may expect for tangible property rights for instance, the Court of Justice was forced to develop operational criteria by turning to the doctrines of the “specific subject matter of the right” and that of “the essential function of the right”, the latter doctrine being essentially indistinguishable to the first one, or at least an important part of the first doctrine. The CJEU employed the doctrine of the “specific subject matter of the right” for trade-marks in the 1970s and defined the “specific subject matter” of trade-marks as following: “the specific subject-matter of the industrial property is the guarantee that the owner of the trade mark has the exclusive right to use that trade mark, for the purpose of putting products protected by the trade mark into circulation for the first time, and is therefore intended to protect him against competitors wishing to take advantage of the status and reputation of the trade mark by selling products illegally bearing that trade mark”¹⁹⁰. The specific subject matter was interpreted as including the right to affix the trademark to a good, to put into circulation the good under the trademark for the first time, to re-affix the trademark to the good, if this was put on the market without the trade-mark owner’s consent, which relate to the “origin function” of the trademark, the need to ensure, for the benefit of the trade-mark owner but also consumers, that the trade-mark provides information on the origin of the good (and its status or reputation), as well as, to a more limited extent, of the advertising function of trade-marks, that is the possibility of the trade-mark owner to be protected against the possibility that the reputation of the trademark is unfairly exploited by a parallel importer, in particular for luxury products¹⁹¹.
- (4) If it is permissible for the owner of an IP right in a Member State to prevent imports of products embodying his right that had been put on the market in another Third State, this is not the case for products that had been put on the market in another Member State of the EEC (now EU) by the owner of the IP right or his consent, as this would be incompatible with the EEC Treaty. The rationale of this rule may be that it operates as a limit set in order to avoid the multiple reward of the IP holder and thus restricts the possibility of the trademark owner to increase the economic value of the trademark by

¹⁸⁹ Case C-78/70, *Deutsche Grammophon Gesellschaft mbH v. Metro-SB Großmärkte GmbH & Co. KG*, [1971] ECR 487

¹⁹⁰ Case C-16/74, *Centrafarm BV and Adriaan de Peijper v. Winthrop BV*, [1974] ECR 1183, para. 8.

¹⁹¹ Case C-324/09, *L’Oreal SA and Others v. eBay International AG and Others*, [2011] ECR I-6011.

opposing to the price arbitrage of parallel importers. Yet, it may also be related more prosaically to the need to ensure the free movement of goods between Member States of the EU and to increase the opportunities of intra-EU trade. As the Court noted in *IHT Internationale Heiztechnik v. Ideal-Standard*, “Articles 30 and 36 [EEC, now Articles 34 and 30 TFEU] debar the application of national laws which allow recourse to trade-mark rights in order to prevent the free movement of a product bearing a trade mark whose use is under unitary control.”¹⁹²

The effect of this case law was summarised in *Merck v Stephar*,¹⁹³ re-affirmed in *Merck v Primecrown* (which although cases concerning patents provide interesting insights on the rationale of the rule).¹⁹⁴ In the latter the Court held:

“Articles 30 and 36 of the EC Treaty preclude application of national legislation which grants the holder of a patent for a pharmaceutical product the right to oppose importation by a third party of that product from another Member State in circumstances where the holder first put the product on the market in that State after its accession to the European Community but before the product could be protected by a patent in that State, unless the holder of the patent can prove that he is under a genuine, existing legal obligation to market the product in that Member State”.

This policy decision (which applies equally to other IP rights, including trademarks) actually goes beyond IP exhaustion. For in both cases the IP owner had sold his goods in countries (Italy in the first case, Spain in the second) in which he did not have (and by reason of the laws in force at the time, could not have had) any patent. He had no “right” to exhaust but nonetheless he could not prevent the circulation of the products into other member states where he did have patent rights. So within the EU the rule is one of free circulation, hence broader than just “Community exhaustion.”

In contrast, for products put on the market in a Third State, the prevention of parallel imports is not considered as constituting a measure having equivalent effect and prohibited under Article 34 TFEU. In *EMI Records v. CBS United Kingdom*, the Court held that “the exercise of a trade-mark right in order to prevent the marketing of products coming from a third country under an identical mark, even if this constitutes a measure having an effect equivalent to a quantitative restriction, does not affect the free movement of goods between Member States and thus does not come under the prohibitions set out in Article 30 et. seq. of the Treaty” as “in such circumstances

¹⁹² Case C-9/93, *IHT Internationale Heiztechnik GmbH and Uwe Danzinger v. Ideal-Standard GmbH and Wabco Standard GmbH*, [1994] ECR I-2789.

¹⁹³ Case C-187/80, *Merck & Co. Inc. v. Stephar BV and Petrus Stephanus Exler*, [1981] ECR 2063

¹⁹⁴ Joined Cases C-267/95 and C-268/95, *Merck & Co. Inc., Merck Sharp & Dohme Ltd and Merck Sharp & Dohme International Services BV v. Primecrown Ltd, Ketan Himatlal Mehta, Bharat Himatlal Mehta and Necessity Supplies Ltd and Beecham Group plc v. Europharm of Worthing Ltd*, [1996] ECR I-6285.

the exercise of a trade-mark right does not in fact jeopardize the unity of the Common Market which Article 30 et seq. of the Treaty are intended to ensure”.¹⁹⁵ The same principle applies if the products were put on the market of the Third State without the consent of the trade-mark owner. The possibility for the trade-mark owner to oppose parallel imports originating in third (non EU) countries distinguishes the EU exhaustion regime from that of international exhaustion and was re-affirmed following the implementation of the trademark directive by the CJEU in *Silhouette International Schmied v. Hartlauer Handelsgesellschaft*.¹⁹⁶

One should, however, also keep in mind the possibility for the EU to have concluded association agreements with some other countries. Most often, these agreements include provisions equivalent to Articles 34 and 36 TFEU and establish a free trade area. In this case, the legality of preventing parallel imports originating from the state with which the EU has signed an association or free trade agreement will depend on the interpretation of the provisions of that agreement and of its purpose, which might be different from that of the EU treaties.¹⁹⁷ It will also depend on reciprocity. As it was indicated in the Commission’s Explanatory Memorandum to the Amended Proposal for a Council Regulation on the Community trade mark,

“(o)n the question of international exhaustion of the rights conferred by a Community trade mark, the Commission has formed the opinion that the Community legislator should refrain from introducing this principle and make do with the rule of Community-wide exhaustion. The Community must, however, be empowered to conclude, at some future time with important trading partners, bilateral or multilateral agreements whereby international exhaustion is introduced by the contracting parties. The restriction to Community-wide exhaustion, however, does not prevent national courts from extending this principle in cases of a special nature, in particular where, even in the absence of a formal agreement, reciprocity is guaranteed.”¹⁹⁸

Hence, there remains at least an argument that the EU may allow international exhaustion where there is a guarantee of reciprocity on exhaustion.¹⁹⁹

¹⁹⁵ Case C-51/75, *EMI Records Limited v. CBS United Kingdom Limited*, [1976] ECR 811, paras 10-11.

¹⁹⁶ Case C-355/96, *Silhouette International Schmied GmbH & Co. KG v. Hartlauer Handelsgesellschaft mbH*, [1998] ECR I-4799.

¹⁹⁷ See the position adopted by the CJEU in Case C-270/80, *Polydor Limited and RSO Records Inc. v. Harlequin Records Shops Limited and Simons Records Limited*, [1982] ECR 329, with regard to copyright and the refusal to extend the application of the Community exhaustion principle to products originating in the Third country in view of the fact that the agreement in question (with Portugal when this was not a Member of the EU) although making provision for the abolition of restrictions of trade, did not “seek to create a single market reproducing as closely as possible the conditions of a domestic market”. The implementation of the Trademark Directive and the fact that this does not provide in its Article 7(1) for parallel imports originating in jurisdictions with which the EU has concluded association or free trade agreements indicate that trademark owners may prevent parallel imports in this case. For a similar conclusion, see GRIGORIADIS, above n. 105, 185.

¹⁹⁸ Com (84) 470 final, 31 July 1984, vi–vii.

¹⁹⁹ C-4/98 *Calvin Klein v. Cowboyland* (case withdrawn and never decided).

2. Specific EU Legislation in the Case of IP Rights Which Are Either Pan-EU Rights or Parallel National Rights Granted Pursuant to National Laws Which Have Been Harmonised

After the free circulation rule was established by the Court, a number of EU Directives²⁰⁰ and Regulations²⁰¹ concerned with IP were passed, namely with regard to trademarks the Trade Marks Directive in 1989²⁰² and the Community Trade Mark Regulation in 1994²⁰³. Each of these contains a provision headed “exhaustion of rights” as follows:

Trade Marks Directive

Article 7 Exhaustion of the rights conferred by a trade mark

1. The trade mark shall not entitle the proprietor to prohibit its use in relation to goods which have been put on the market in the Community under that trade mark by the proprietor or with his consent.
2. Paragraph 1 shall not apply where there exist legitimate reasons for the proprietor to oppose further commercialization of the goods, especially where the condition of the goods is changed or impaired after they have been put on the market.

Trade Marks Regulation

13. Exhaustion of the rights conferred by a Community trade mark

1. A Community trade mark shall not entitle the proprietor to prohibit its use in relation to goods which have been put on the market in the Community under that trade mark by the proprietor or with his consent.
2. Paragraph 1 shall not apply where there exist legitimate reasons for the proprietor to oppose further commercialisation of the goods, especially where the condition of the goods is changed or impaired after they have been put on the market.

As it was earlier noted, although these are described as “exhaustion” rules they are really rules about first marketing within the European Union. And in essence they are codifications of the pre-existing case law. Note that in the case of trademarks there is a

²⁰⁰ Requirements upon member states to align their respective national laws.

²⁰¹ Measures which take effect as law throughout the EU without further enactment.

²⁰² First Council Directive 89/104/EEC of 21 December 1988 to approximate the laws of the Member States relating to trade marks, [1989] OJ L 40/1; Directive 89/104/EC Directive 2008/95/EC repealed and replaced Directive 89/104/EEC: Directive 2008/95/EC of the European Parliament and of the Council of 22 October 2008 to approximate the laws of the Member States relating to trade marks [1999] OJ L 299/25.

²⁰³ Council Regulation (EC) No 40/94 of 20 December 1993 on the Community trade mark, [1994] OJ L 11/1. Originally 40/94 now replaced by Council Regulation (EC) No 207/2009 on the Community trade mark [2009] L 78/1.

limited exception – where there are “legitimate reasons” – for instance selling trade-marked goods as new when they are second-hand or out of date.

Article 7 of the Trade Mark Directive was interpreted by the CJEU as denying any competence to the Member States to choose the option of international exhaustion. Assessing an Austrian rule enabling international exhaustion of the trade-mark, the Court held in *Silhouette International Schmied v. Hartlauer Handelsgesellschaft* that

“National rules providing for exhaustion of trade-mark rights in respect of products put on the market outside the EEA under that mark by the proprietor or with its consent are contrary to Article 7(1) of First Council Directive 89/104/EEC of 21 December 1988 to approximate the laws of the Member States relating to trade marks, as amended by the Agreement on the European Economic Area of 2 May 1992”²⁰⁴.

In arriving to this conclusion, the CJEU relied on the wording, overall scheme and purpose of Article 7 (1) of Directive 89/104/EEC (now Article 7 (1) of Directive 2008/95/EC), which was found to provide for a complete harmonization of the rules relating to the rights conferred by a trade mark. Trademark owners can therefore prohibit parallel imports of trade-marked goods that have not been put on the market in the EEA by them or with their consent.²⁰⁵

3. Importations into the EU and Exhaustion – Trade Marks

The position for trade-marks is settled. An owner of a registered trade-mark can rely upon his EU trade-mark rights (whether registered as a national trade mark or as a Community Trade Mark) to prevent importation into the EU. Only if he has clearly and unambiguously consented to the importation under challenge will there be a defence.

The leading case is *Davidoff v A & G Imports*.²⁰⁶ It is sufficient to quote the Court’s final ruling:

1. On a proper construction of Article 7(1) of First Council Directive 89/104/EEC of 21 December 1988 to approximate the laws of the Member States relating to trade marks, as amended by the Agreement on the European Economic Area of 2 May 1992, the consent of a trade mark proprietor to the

²⁰⁴ Case C-355/96, *Silhouette International Schmied GmbH & Co. KG v Hartlauer Handelsgesellschaft mbH*, [1998] ECR I-4799, para. 31.

²⁰⁵ See also Case C-173/98, *Sebago Inc. and Ancienne Maison Dubois & Fils SA v G-B Unic SA*, [1999] ECR I-4103; Joined Cases C-414/99 to C-416/99, *Zino Davidoff SA v A & G Imports Ltd and Levi Strauss & Co. and Others v Tesco Stores Ltd and Others*, [2001] ECR I-8691, confirming this interpretation of Article 7(1) of the Trade-mark Directive.

²⁰⁶ Joined Cases C-414/99 to C-416/99, *Zino Davidoff SA v A & G Imports Ltd and Levi Strauss & Co. and Others v Tesco Stores Ltd and Others* [2001] ECR I-8691.

marketing within the European Economic Area of products bearing that mark which have previously been placed on the market outside the European Economic Area by that proprietor or with his consent may be implied, where it follows from facts and circumstances prior to, simultaneous with or subsequent to the placing of the goods on the market outside the European Economic Area which, in the view of the national court, unequivocally demonstrate that the proprietor has renounced his right to oppose placing of the goods on the market within the European Economic Area.

2. Implied consent cannot be inferred:

— from the fact that the proprietor of the trade mark has not communicated to all subsequent purchasers of the goods placed on the market outside the European Economic Area his opposition to marketing within the European Economic Area;

— from the fact that the goods carry no warning of a prohibition of their being placed on the market within the European Economic Area;

— from the fact that the trade mark proprietor has transferred the ownership of the products bearing the trade mark without imposing any contractual reservations and that, according to the law governing the contract, the property right transferred includes, in the absence of such reservations, an unlimited right of resale or, at the very least, a right to market the goods subsequently within the European Economic Area.

3. With regard to exhaustion of the trade mark proprietor's exclusive right, it is not relevant:

— that the importer of goods bearing the trade mark is not aware that the proprietor objects to their being placed on the market in the European Economic Area or sold there by traders other than authorised retailers, or own purchasers contractual reservations setting out such opposition, even though they have been informed of it by the trade mark proprietor.

The result is what has been called “fortress Europe” for trade-marks.

4. The Essence of the EU Regime – The Choice of the Trade-mark Proprietor

The application of Article 7(1) of Directive 2008/95/EC and Article 13(1) of Regulation 9EC) 207/2009 stipulating a regime of Community exhaustion requires that the trade mark proprietor has put on the market in the EU under that trade mark an item of product or has consented to putting this product on the market. It remains important therefore to determine what is meant by “putting on the market” and “consent”.

In *Peak Holding* the CJEU noted that the need for a uniform protection of trade-mark owners across the EU requires the term “putting on the market” to be determined by EU law, and not by national law²⁰⁷. This may be of particular importance in the context of an exhaustion regime integrated in a regional trade agreement, such as that of the Eurasian Economic Union. The CJEU noted that the Directive is intended in particular to ensure that the proprietor has the exclusive right to use the trade mark for the purpose of putting the goods bearing it on the market for the first time and consequently “(a) sale which allows the proprietor to realise the economic value of his trade mark exhausts the exclusive rights conferred by the Directive, more particularly the right to prohibit the acquiring third party from reselling the goods.”²⁰⁸ The CJEU made a distinction between putting the products on the market, defined as allowing the realization of the economic value of the trade-mark, and the preparatory actions of importing the products with a view to selling them in the EEA or offering them for sale in the EEA, which are not considered as equivalent of putting them on the market within the meaning of Article 7(1) of the Directive. Indeed, “(s)uch acts do not transfer to third parties the right to dispose of the goods bearing the trade mark” and, in particular, “they do not allow the proprietor to realise the economic value of the trade mark”, as “(e)ven after such acts, the proprietor retains his interest in maintaining complete control over the goods bearing his trade mark, in order in particular to ensure their quality.”²⁰⁹

Some authors interpret this case law as requiring that the economic value of the trade-mark be realized with respect to the product, for instance, “through the shifting of the profit or loss, namely the economic risk, of any onward sale of a trademarked good from the trademark proprietor to a third party [...] who, [...] may have assumed a contractual obligation to resell the good”²¹⁰. This may not only include the sale of the trade-marked products based on the free will of the trade-marked proprietor, but also a forced sale by court order, or the donation of the trade-marked good, as long as this does not aim to promote the sale of other products²¹¹. In contrast, in addition to the preparatory acts referred to above, do not constitute a “putting on the market” within the meaning of Article 7(1) of Directive 2008/95/EC, “the transfer of ownership of a trademarked good by way of security, when the assignor remains in possession of the good in question”, “the sale of a trademarked good to an undertaking that has its own legal personality but belongs to the same group as the trademark proprietor”, “the internal transit of a trademarked good”, the offer for sale or the sale of a trademarked good after the good in question has entered physically but not legally the territory of the EU” (for instance the non-EU good entered in the EU and was placed under the external transit procedure or a customs warehousing procedure, “the distribution, free of charge, of trademarked items intended to promote the sale of other

²⁰⁷ Case C-16/03, *Peak Holding AB v Axolin-Elinor AB* [2004] ECR II-11313.

²⁰⁸ Case C-16/03, *Peak Holding AB v Axolin-Elinor AB* [2004] ECR II-11313, para. 40.

²⁰⁹ Case C-16/03, *Peak Holding AB v Axolin-Elinor AB* [2004] ECR II-11313, para.42.

²¹⁰ GRIGORIADIS, above n. 105, 219.

²¹¹ GRIGORIADIS, above n. 105, 221.

goods because such items are not distributed in any way with the aim of them penetrating the market”²¹². In these circumstances the trade-mark proprietor may oppose the offer for sale or sale of the trademarked products, on the basis of Article 5(3) of Directive 2008/95/EC.

It also follows from this case law that the trade-mark proprietor will be deemed to have put the product on the market even if she sells the product to an undertaking based in the EU, which has undertaken a contractual obligation to resell the goods outside the European Economic Area, thus pushing the trade mark owners to sell directly to the distributors established outside the EU in order to avoid the Community exhaustion of their rights²¹³. As the Court held in *Peak Holding*, “(a)ny stipulation, in the act of sale effecting the first putting on the market in the EEA, of territorial restrictions on the right to resell the goods concerns only the relations between the parties to that act” and “cannot preclude the exhaustion provided for by the Directive”²¹⁴. The same would apply even in case the trademark owner entrusted a commercial agent to sell the goods in the EU, given that the commercial agent acts in the name of and for the account of the principal, in this case the trade-mark owner²¹⁵.

The concept of “consent” is also considered an EU law concept, and is not interpreted according to national law, basically for the same reasons than led to an EU law definition of the concept of “putting on the market”. Otherwise, it would have been possible to easily deviate from a regime of regional exhaustion to a regime of international exhaustion, simply by adopting a wide definition of “consent” in the respective national law²¹⁶. Consent may be established through an express statement. In its leading case law *Zino Davidoff SA and Levi Strauss* the CJEU noted that the consent of the trade-mark owner to the good bearing his trademark to be put on the market, within the meaning of Article 7(1) of the Trade-mark Directive may also be inferred implicitly from some facts or circumstances “prior to, simultaneous with or subsequent to the placing of the goods on the market outside the EEA which, in the view of the national court, unequivocally demonstrate that the proprietor has renounced his rights”²¹⁷. However, consent cannot be inferred from the mere silence of the trade-mark owner. According to the CJEU, “(a) rule of national law which proceeded upon the mere silence of the trade mark proprietor would not recognise implied consent but rather deemed consent” and “(t)his would not meet the need for consent positively expressed required by Community law”²¹⁸. Furthermore,

²¹² GRIGORIADIS, above n. 105, 221-224.

²¹³ Case C-16/03, *Peak Holding AB v Axolin-Elinor AB* [2004] ECR II-11313, para. 56.

²¹⁴ Case C-16/03, *Peak Holding AB v Axolin-Elinor AB* [2004] ECR II-11313, paras 54-55.

²¹⁵ GRIGORIADIS, above n. 105, 282.

²¹⁶ Joined Cases C-414/99 to C-416/99, *Zino Davidoff SA v A & G Imports Ltd and Levi Strauss & Co. & Others v Tesco Stores Ltd and Others*, [2001] ECR I-8691.

²¹⁷ Joined Cases C-414/99 to C-416/99, *Zino Davidoff SA v A & G Imports Ltd and Levi Strauss & Co. & Others v Tesco Stores Ltd and Others*, [2001] ECR I-8691, para. 46.

²¹⁸ Joined Cases C-414/99 to C-416/99, *Zino Davidoff SA v A & G Imports Ltd and Levi Strauss & Co. & Others v Tesco Stores Ltd and Others*, [2001] ECR I-8691, para. 58.

“[...] implied consent cannot be inferred from the fact that a trade mark proprietor has not communicated his opposition to marketing within the EEA or from the fact that the goods do not carry any warning that it is prohibited to place them on the market within the EEA.

Finally, such consent cannot be inferred from the fact that the trade mark proprietor transferred ownership of the goods bearing the mark without imposing contractual reservations or from the fact that, according to the law governing the contract, the property right transferred includes, in the absence of such reservations, an unlimited right of resale or, at the very least, a right to market the goods subsequently within the EEA”²¹⁹.

It is important to note that “the rights conferred by the trade mark are exhausted only in respect of the individual items of the product which have been put on the market with the proprietor's consent in the territory there defined. The proprietor may continue to prohibit the use of the mark in pursuance of the right conferred on him by the Directive in regard to individual items of that product which have been put on the market in that territory without his consent”²²⁰. Hence, the exhaustion of the right does not extend to the whole of the production line of a product²²¹.

It seems, therefore, that the EU exhaustion rule leaves a margin of discretion to the trade-mark owner who may avoid the Community exhaustion of her rights, by avoiding putting the product in the EU market, in the various ways contemplated by the case law interpreting Article 7(1) of the Trade-mark Directive, or by taking care not to provide her consent to such market penetration in the EU. The case law provides guidance as to the criteria for identifying consent, in particular by establishing presumptions of consent in certain circumstances. Although it is not the purpose of this Section to provide an exhaustive analysis of this jurisprudence, it seems that the marketing of a trademarked good by an undertaking of the same group than the trade-mark owner is assumed to have gained the consent of the trade-mark owner. A similar presumptions applies for the marketing of a trade-marked product by a trade-mark licensee, or by an authorized (exclusive or selective) distributor or the forced sale of the trade-marked product in the European Economic Area following a court order²²². According to Article 8(2) of the Trade-mark Directive, the proprietor of a trade mark may invoke the rights conferred by that trade mark against a licensee who contravenes any provision in his licensing contract, among other things, the quality of the goods manufactured or of the services provided by the licensee. Although this provision concerns the relations between the trademark proprietor and the licensee, an *erga*

²¹⁹ Joined Cases C-414/99 to C-416/99, *Zino Davidoff SA v A & G Imports Ltd and Levi Strauss & Co. & Others v Tesco Stores Ltd and Others*, [2001] ECR I-8691, paras 56-57.

²²⁰ Case C-173/98, *Sebago Inc. and Ancienne Maison Dubois & Fils SA v G-B Unic SA*, [1999] ECR I-4103, para. 19.

²²¹ GRIGORIADIS, above n. 105, , 291.

²²² GRIGORIADIS, above n.105, 293-296.

omnes effect and thus the possibility to object to parallel trade may be possible, on the basis of that provision of the Directive, if the licensor made the decision to control the licensee by including provisions in the agreement requiring the licensee to comply with his instructions and giving the licensor the possibility to verify such compliance. Yet, “(w)here the proprietor of the mark refrains from controlling distribution or does not avail himself of contractual means of exercising such control, there is no reason to grant him trade mark rights in respect of third parties.”²²³ Similarly, where the licensor “tolerates the manufacture of poor quality products, even though he has contractual means of preventing it, he must bear responsibility for it”²²⁴. Although the Directive stays silent as to the burden of proof of these different factual allegations, the issue depending on the evidence law of the Member States, the CJEU recognized in *Zino Davidoff and Levi Strauss* that the consent must be proved by the trader alleging it²²⁵. The national evidence rules should not render the task of the parallel importer exceedingly difficult, as it was also recognized by the CJEU in *Van Doren*.²²⁶

In practice, the typical case will take the following form:

“The trademark proprietor bears the initial burden of proving the general elements of infringement, i.e. that the parallel importation of goods bearing the trademark infringes his right.

– In reply to the claim of the trademark proprietor on trademark infringement, the independent trader (parallel importer—independent reseller) will have to either:

- a) prove the existence of a positively expressed consent of the trademark proprietor for putting the goods on the market in the EEA where the trademark proprietor challenges only the existence of such consent, or
- b) where the trademark proprietor challenges in general the exhaustion of his right:
 - (i) prove that the goods were initially put on the market in the EEA by the trademark proprietor or with his consent, if so required by the applicable national procedural rules; or

²²³ Opinion of AG Kokott in Case C-59/08, *Copad SA v Christian Dior couture SA, Vincent Gladel and Société industrielle lingerie (SIL)*, [2009] ECR I-3421, para. 51.

²²⁴ Opinion of AG Kokott in Case C-59/08, *Copad SA v Christian Dior couture SA, Vincent Gladel and Société industrielle lingerie (SIL)*, [2009] ECR I-3421, para. 50. Interpretation supported by the judgment of the CJEU in Case C-59/08, *Copad SA v Christian Dior couture SA, Vincent Gladel and Société industrielle lingerie (SIL)*, [2009] ECR I-3421, para. 47.

²²⁵ Joined Cases C-414/99 to C-416/99, *Zino Davidoff SA v A & G Imports Ltd and Levi Strauss & Co. & Others v Tesco Stores Ltd and Others*, [2001] ECR I-8691, paras 53-54.

²²⁶ Case C-244/00, *Van Doren + Q. GmbH v. Lifestyle sports + sportswear Handelgesellschaft mbH and Michael Orth*, [2003] ECR I-3051.

- (ii) allege a risk of market partitioning between Member States as a consequence of the fact that he bears the burden of proving that the right flowing from the trademark borne by the goods he sells has been exhausted. [...] a real risk of partitioning of national markets will exist in the following cases:

- aa) where it is impossible or excessively difficult for the independent trader to prove exhaustion of the trademark right. [...]

- bb) where the trademark proprietor puts products on the market within the EEA through an exclusive distribution system, so there is the possibility of the trademark proprietor acting on the facts revealed by the independent trader in meeting the burden to eliminate the source of supply.

In both the above cases, the independent trader must establish all the following facts and circumstances:

- aa) that he purchased the goods he sells within the EEA, so there is a presumption that Article 7 (1) of Directive 2008/95/EC or Article 13 (1) of Regulation (EC) 207/2009 applies;

- bb) that price differences exist for the goods bearing the trademark of the trademark proprietor between the EU Member States, regardless of whether those differences can be justified (e.g., on the basis of a difference of costs of production between Member States), so there is a presumption that the trademark proprietor tries, by prohibiting the parallel importation, to maintain those differences;

- cc) that there is no clear difference between the goods bearing the trademark of the trademark proprietor sold within and outside of the market of the EEA if the trademark proprietor argues that the independent trader ought to have known, based on the nature or the particular marking of the goods he sells, that the goods he sells were not intended to be marketed in the EEA.”²²⁷

One should also not forget the possibility offered by Article 7(2) of the Trade-mark Directive to the proprietor of the trade-mark to oppose the commercialization of the products bearing the mark where there exist “legitimate reasons,” “especially where the condition of the goods is changed or impaired after they have been put on the market.” This provision has also

²²⁷ GRIGORIADIS, above n. 105, 322-323.

led to an extensive jurisprudence of the EU courts in order to define the terms employed by the Directive.²²⁸

C. Approaches to Exhaustion in Other Jurisdictions

There is a great diversity in the exhaustion regimes chosen by various jurisdictions in the area of trade-marks. A major distinction concerns between importing and exporting countries,²²⁹ the latter usually adopting the international exhaustion regime, as this is more favorable to parallel trade.²³⁰ It is also frequent that the exhaustion regime may change over time, or that the choice of policy remains undetermined by national legislation, thus leaving it up to national courts to determine what exhaustion rules to apply in specific cases. For instance, in the absence of any provision in the Chinese legislation, Chinese courts have generally avoided addressing the question directly.²³¹

In contrast, Indian law adopts international exhaustion for trade-marks, although it provides the trade-mark owner with the possibility of opposing parallel imports of trademarked products under limited circumstances, such that the conditions of the goods have been changed or impaired after they were put on the market.²³² The South African Trademarks Act adopts a similar position, stating in § 34 (2) (d) of the Trade Marks Act that a trade mark registration is not infringed by ‘*the importation into, or distribution, sale or offering for sale in the Republic, of goods to which the trade mark has been applied by or with the consent of the proprietor.*’²³³

²²⁸ For an extensive analysis, see GRIGORIADIS, above n. 105, Chapter 10, 338 *seq.*

²²⁹ “Exporting country” is the country out of the market of which a good is exported in parallel and “Importing country” is that where a good is imported in parallel.

²³⁰ GRIGORIADIS, above n. 105, 60.

²³¹ See, for instance, the discussion of Chinese law in D. Chow (2011), *Exhaustion of Trademarks and Parallel Imports in China*, SANTA CLARA LAW REVIEW, 51(4): 1283-1309.

²³² High Court of Delhi, *Kapil Wadhwa & Ors. vs Samsung Electronics Co. Ltd* [decided on October 3, 2012], FAO(OS) 93/2012, where the High Court interpreted Section 30 (3) of the Indian Trade Marks Act 1999 to cover international exhaustion. Section 30(4) of the Indian Trademarks Act empowers a brand owner to have parallel imported goods declared infringing on the basis of any ‘legitimate reason’. The High Court recognized the wide scope of this exception enabling the trade-mark proprietor to oppose parallel imports by noting the following: (para. 68) “[...] it would be relevant to note that further dealing in the goods placed in the market under a trademark can be opposed where legitimate reasons exist to oppose further dealing and, in particular, where the condition of the goods has been changed or impaired. With respect to physical condition being changed or impaired, even in the absence of a statutory provision, the registered proprietor of a trademark would have the right to oppose further dealing in those goods inasmuch as they would be the same goods improperly so called, or to put it differently, if a physical condition of goods is changed, it would no longer be the same goods. But, sub-Section 4 of Section 30 is not restricted to only when the conditions of the goods has been changed or impaired after they have been put on the market. The section embraces all legitimate reasons to oppose further dealings in the goods. Thus, changing condition or impairment is only a specie of the genus of legitimate reasons, which genus embraces other species as well.”

²³³ However, under the Consumer Protection Act, the parallel importer ‘a person who markets any goods that bear a trade mark, but have been imported without the approval or licence of the registered owner of that trade mark, must apply a conspicuous notice to those goods in the prescribed manner and form.’ See South African Consumer Protection Act, No 68 of 2008 (s. 25 (2)).

Canada recognizes international exhaustion with respect to trademarks. In *Consumers Distributing Co. v. Seiko Time Canada Ltd.*,²³⁴ a manufacturer of watches tried to prevent unauthorized sales of its products in Canada. The plaintiff alleged trade-mark infringement but the court held for the defendant, stating that “the distribution of a trade-marked product lawfully acquired is not, by itself, prohibited under the *Trade-marks Act* of Canada, or indeed at common law.”²³⁵ This approach was subsequently adopted by the Federal Court of Appeal in other cases.²³⁶ Brazil adopts the principle of domestic exhaustion.²³⁷ Of particular interest is Australia, which introduced amendments to its Copyright Act in 1991²³⁸ limiting restrictions on Australian publishers and distributors to import a book which is an overseas work in order to supply verifiable orders from individuals for a single copy of a book for their own use, or to supply multiple copies to libraries. Similar exceptions also apply with regard to the importation of a non-infringing copy of a work (literary dramatic or musical) that may be included in sound recording. In two reports published in 1999 and 2001 the Australian Competition and Consumer Commission (ACCC) noted that allowing competition from parallel imports should lead to more competitive pricing and better choice of product and service for consumers and retailers²³⁹. This led in 2003 to abolish the possibility of IP holders to prevent parallel imports on computer software, and the electronic form of books, periodicals and sheet music, thus adopting an international exhaustion regime for these products.²⁴⁰ Similar calls to lift the remaining parallel importation restrictions in the 1968 Copyright Act have been made for “genuine books” in 2009²⁴¹ and IT products in 2013²⁴². Australia has an international exhaustion regime for trade-

²³⁴ [1984] 1 S.C.R. 583, 1984 Carswell Ont 869.

²³⁵ Above at para. 18.

²³⁶ See, e.g., *Coca-Cola Ltd. v. Pardhan*, [1999] F.C.J. No. 484(F.C.A.) and *Smith & Nephew Inc. v. Glen Oak Inc.* (1996), 68 C.P.R. (3d) 153(F.C.A.).

²³⁷ Article 132 of the Industrial Property law (No. 9.279 of May 14, 1996) holding that once the trade-mark proprietor has put products on the Brazilian market he may not “prevent the free circulation of products placed in the internal market by himself or by another with his consent.” In a recent case the Superior Court of Justice (Diageo) held that “(u)nder Brazilian law, therefore, exhaustion of the use of the mark occurs through the legitimate introduction, with the consent of the mark owner, into the national market, because [...] it is presumed that the owner, when placing the product on the domestic market, is automatically remunerated and will not be able to prevent said product from circulating indiscriminately [...] Therefore, the owner of an international mark has, in principle, the right to demand that its consent be obtained for parallel importation into the national market”. Yet, in this case the consent of the trade-mark owner was assumed from the absence of complaint or opposition to parallel imports of her products for at least 15 years. The Court noted: “[...] the parallel importation which has been carried out by [...] GAC cannot be held to be unlawful in view of the [...] appellants’ failure to oppose it for such a long time, thereby conferring consent [...] It had the right to purchase the goods, in view of this long acquiescence”. For a discussion of this case, see <http://www.glpi.com.br/fotos/galeria/2014/05/21/2013-04-29-superiorcourtofa.pdf>.

²³⁸ Copyright Amendment Act 1991 (Cth) ss 5, 8, inserting ss 44A, 112A into the Copyright Act.

²³⁹ ACCC, *Potential Consumer Benefits of Repealing the Importation Provisions of the Copyright Act 1968 as They Apply to Books and Computer Software* (March 1999); ACCC, *Summary of the Commission’s March 1999 Report on the Potential Consumer Benefits of Repealing the Importation Provisions of the Copyright Act 1968 as They Apply to Books and Computer Software — Including Price Updates for Books, Computer Software and Sound Recordings* (April 2001).

²⁴⁰ *Copyright Amendment (Parallel Importation) Act 2003* (Cth).

²⁴¹ Productivity Commission, *Restrictions on the Parallel Importation of Books* (Research Report, June 2009) xxv (recommendation 1).

marks and for patents, although for patents this principle may be contractually restricted by the patent holder²⁴³.

V. CONCLUSIONS

In principle, any credible exhaustion regime, however artfully devised, cannot violate the outer boundaries of TRIPS Article 6 which are the national treatment and MFN rules as well as National Treatment. Put simply, a differentiated exhaustion regime (domestic exhaustion, regional exhaustion, differentiated international exhaustion) that distinguishes between countries, whether de jure or de facto, would likely constitute both a GATT and a TRIPS violation²⁴⁴. The exceptions recognized in the TRIPS MFN rule stated in Article 4 appear to be inapplicable to the Eurasian proposal and context. In our view, the foregoing suggests:

1. A regime of pure international exhaustion, without any differentiation, is the most WTO compatible exhaustion regime. Such regime will not impose state trade barriers and would thus be in conformity with the trade liberalization objective of the GATT. In view of Article 6 TRIPS, it will also be compatible with the approach followed by the TRIPS agreement to protect intellectual property rights, while ensuring the principle of free trade. Possible private restrictions that may be imposed by the trade-mark proprietors or by the trade-marked proprietor's official distributors, such as prohibitions to export agreements, collective boycotts, collusive pricing practices or unilateral price or non-price related practices affecting parallel imports may be subject to the competition law rules, should these apply to practices involving intellectual property rights. It is particularly important to give reflection on the possible use of competition law provisions in order to guarantee that the move to a system of pure international exhaustion will not be jeopardized by commercial strategies adopted by the trade-mark proprietors. These may take different forms that may go from an export ban to temporary price reductions or rebates to authorized agents, thus leading to price discrimination or promotional allowance and support to

²⁴² House of Representatives Standing Committee on Infrastructure and Communications, Parliament of Australia, *At What Cost? IT Pricing and the Australia Tax* (2013) (the so called "*IT Pricing Report*") xii–xiii (recommendation 4). For a discussion of these initiatives see, Arlen Duke, *The Empire will Strike Back: The Overlooked Dimension to the Parallel Import Debate*, 37 MELBOURNE UNIVERSITY L REV 585 (2014).

²⁴³ In fact, as it is noted by Arlen Duke, *The Empire will Strike Back: The Overlooked Dimension to the Parallel Import Debate*, 37 MELBOURNE UNIVERSITY L REV 585, 586 (2014): "courts have accepted that contracts involving the sale of patented goods contain an implied licence that gives the purchaser the absolute right to deal with the goods as she thinks fit, including the right to sell the good in any country", although it is possible with an explicit clause in the contract to restrict the purchaser's right to resupply the goods.

²⁴⁴ We define as "differentiated exhaustion" a regime that distinguishes between countries, on the basis of criteria of differentiation, such as geographic origin or investment. Hence domestic, regional and forms of differentiated international exhaustion based on geographic criteria or an investment protection clause, constitute forms of differentiated exhaustion. These should be opposed to pure international exhaustion, which does not provide for differentiated treatment on the basis of origin (directly or indirectly, such as with investment protection clauses).

the advertising campaigns of authorized distributors, extended warranties and interest free terms offered only to the authorized distributors etc²⁴⁵. The competition law dimension of the issue should not be overlooked. Further possibilities offered to trade-mark owners to oppose parallel imports include the use of legal strategies, such as bringing suits for the tort of passing off in order to prevent the misappropriation of a trader's reputation and goodwill, for violation of prohibitions of misleading or deceptive conduct, breach of contract, among others, depending on the possibilities offered by the domestic legal system²⁴⁶. It is also possible to develop practices that create disincentives for parallel imports that may not fall under the prohibition of the competition rules, such as uniform pricing throughout the vertical chain, product differentiation (for instance through specific product packaging) and volume discounts. Hence, despite the move towards a regime of international exhaustion, trade-mark proprietors dispose of possibilities to restrict parallel imports.

2. Differentiated exhaustion among sectors and IPRs is well established, and among industrial sectors may be plausible if backed by justifications that would satisfy relevant GATT principles. The principal justifications that may be put forward rely on Articles XX(d) and XXIV GATT and are subject to specific conditions, as explained above. Yet, the application of Article XXIV may run into problems, as it was also explained above, in view of the fact that Kazakhstan was obliged to adopt in order to join the Eurasian Economic Union a regime of regional exhaustion for trademarks, following the implementation of Annex 26 of the EEU Treaty, while before the agreement, it had an international exhaustion regime. This transition from an international exhaustion regime to a regional one may not be justified under Article XXIV GATT, only if the regional economic union or customs treaty does not create new obstacles to market access for parallel imported goods originating in third countries. This does not seem to be the case here, as parallel imports originating from third countries were subject to international exhaustion, before Kazakhstan joined the EEU, while they are not subject now to exhaustion, unless the products were put on a market covered by the EEA agreement by the trade-mark proprietor or with his consent. A similar argument may be made in case Armenia joins the EEU, as it has now an international exhaustion regime. Yet, one may remark that a similar problem may arise with regard to the situation in the EU, as since the *Silhouette International Schmied v. Hartlauer Handelslgesellschaft* judgment of the CJEU, Member States of the EU that had previously an international exhaustion regime are obliged to adopt a regional

²⁴⁵ For an indicative list of potential business practices to limit parallel imports, even in a regime of international exhaustion, see S T Cavusgil and Ed Sikora, *How Multinationals Can Counter Grey Market Imports* 23(4) COLUMBIA JOURNAL OF WORLD BUSINESS 75 (1988); Rachel Yang, Reza H Ahmadi and Kent B Monroe, *Pricing in Separable Channels: The Case of Parallel Imports* 7 JOURNAL OF PRODUCT & BRAND MANAGEMENT 433 (1998).

²⁴⁶ For an interesting discussion with regard to Australia, see Arlen Duke, *The Empire will Strike Back: The Overlooked Dimension to the Parallel Import Debate*, 37 MELBOURNE UNIVERSITY L REV 585 (2014).

exhaustion one. So far, the compatibility of the EU rule to the WTO has not been challenged.

3. A differentiated exhaustion regime among IPR categories is arguably permissible and established in state practice. Nonetheless, there must still be considerable attention given to how particular IP categories (trademarks versus patent) or specific rights are selected for national versus international exhaustion under the Eurasian proposal. Customs arrangements or legal schemes that appear to discriminate in favor of specific countries (even if there are a few outliers) are likely to run afoul of the nascent WTO TRIPS jurisprudence on national treatment and MFN or of Articles XI(1), III(4) and (I1) GATT.

4. Differentiated exhaustion between sectors and IPRs requires at least justification in terms of objective justification and proportionality to make the case sound; Likewise, for a regime of differentiated international exhaustion based on an investment protection criterion that follows a protectionist purpose. Although there is a possibility of justification under Article XX(d) GATT, this article requires that the measure does not constitute a means of unjustifiable and arbitrary discrimination and that it is not applied in a manner that constitutes a disguised restriction on international trade. As it was shown in part III.C.1. it would be riskier for a Contracting party to the WTO to justify a regime of domestic exhaustion or a regime of differentiated international exhaustion based on an investment protection clause that is motivated by protectionist considerations in favour of domestic undertakings/industry than it would be for regimes based on regional exhaustion or differentiated international exhaustion based on geographic criteria. As we have previously explained, the additional possibility of justification provided by Article XXIV GATT may not be open in this case, in view of the transition in Kazakhstan from a regime of international exhaustion to a regime of regional exhaustion, or even a regime of differentiated international exhaustion, both options being less trade-friendly than a system of pure international exhaustion. That said, the practice of domestic, regional or some forms of differentiated international exhaustion distinguishing between types of IP rights, or certain type of products (e.g. books) is well established in a number of jurisdictions.
5. Given that a regime of international differentiated exhaustion is fairly new and raises new questions of justified exceptions under GATT, a customs procedure that is time-limited and justified in terms of investment might serve to avoid immediate challenges. Should this option be chosen, instead of pure international exhaustion, we recommend that this is not based on investment protection criteria that may be deemed to have a protectionist purpose.
6. In view of the recent *Argentina – Measures Affecting the Importation of Goods* WTO panel report, “unwritten measures” may be challenged in WTO dispute settlement²⁴⁷. Hence, if the EEU adopts a regime of justified regional or international exhaustion but in practice the customs authorities implement a regime that constitutes a differentiated exhaustion that may be found incompatible with the WTO rules, it is possible that this enforcement practice may be challenged in the WTO, even if the State measure in question is not contained in any law, regulation, administrative act or official publication. The complainants need “to clearly establish, through

²⁴⁷ Report of the Panel, *Argentina – Measures Affecting the Importation of Goods*, adopted on August 22, 2014, WT/DS438/R, WT/DS444/R, WT/DS445/R.

arguments and supporting evidence, at least: (a) that the measure is attributable to the responding Member; and (b) its precise content". Furthermore, "if a complainant requests a finding about a measure "as such", it also needs to establish that the measure has general and prospective application"²⁴⁸.

²⁴⁸ Report of the Panel, *Argentina – Measures Affecting the Importation of Goods*, adopted on August 22, 2014, WT/DS438/R, WT/DS444/R, WT/DS445/R, para. 6.42.