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Parallel Imports in a Global Market.
Should a Generalized International Exhaustion be the Next Step?

Abstract
"Exhaustion of intellectual property rights" means that right holders lose the right to control the resale of the protected goods. Without an exhaustion doctrine IPR holders would perpetually exercise control over the sale, transfer or use of the relevant goods, and would have a grip on commercial relations.
Article 6 TRIPs leaves WTO member countries free to adopt national, regional or international exhaustion regimes. After highlighting the benefits and costs stemming from the different types of exhaustion, the author argues that only international exhaustion is consistent with the spirit, provisions and targets of the WTO multilateral trading system and should therefore be imposed to all WTO countries.

1. *Rationale for Exhaustion*

The expression "exhaustion of intellectual property rights" means that right holders lose the right to control the resale of the protected goods. Once the relevant good is put on sale for the first time by the intellectual property right (IPR) owner (directly by him or with his consent), he cannot object to subsequent circulation of the product. Indeed his rights are "exhausted". This principle is known also as "first-sale doctrine" and determines the moment when the right owner loses the resale right on the protected goods.

Without an exhaustion doctrine IPR holders would perpetually exercise control over the sale, transfer or use of the relevant good, and would have a grip on commercial relations ([1]). The *rationale* for that doctrine is straightforward. From an economic perspective, right owners receive an amount of money at the first sale of the product, so that it would be inappropriate to receive further amounts (e.g. royalties) at any subsequent change of property of the same good. This holds true also from a legal perspective. Indeed patent or trademark registrations give their owner the exclusive right to exploit an intangible asset (e.g. an invention, a fancy trademark or a work of art), but not the physical goods incorporating that asset, which can therefore be freely re-sold ([2]).

Indeed, ownership of an IPR covering a certain product is different from the ownership of the product itself. An intellectual property asset is ubiquitous and is always incorporated and "present" in any physical goods covered by the relevant right. For example, a patented invention covering a new and original mobile telephone will be incorporated in any item produced and sold by the patentee, and such mobiles should freely circulate in the market, triggering further changes of ownership of the

([1]) UNCTAD/ICTSD, *TRIPS and Development Resource Book*, 2005, p. 92 (available at www.iprsonline.org, last accessed on 12 May 2010).
([2]) N. PIRES DE CARVALHO, *The TRIPS Regime of Patent Rights* (London, The Hague, New York, Kluwer Law International, 2002), p. 8. It has been noted that "*exclusive marketing rights need to exhaust at some point in order to bring about legal security in down-stream markets*": see T. COTTIER – I. MEITINGER, *The TRIPs Agreement without a Competition Agreement?*, Eni Enrico Mattei Working paper No 65-69 (1998), p. 12 (available on the Internet at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=200622; last accessed on 12 May 2010).

physical goods. It is therefore appropriate to prevent the patentee from enforcing his rights to prohibit the re-sale of the mobiles he has marketed. What the patent owner is entitled to do is prohibiting third parties not having his consent from producing and then selling similar mobiles (or from selling similar mobiles which have not been put in the market with patentee's consent), but not preventing said parties from further reselling original mobiles that they have acquired from legitimate sources([3]). In other words, the exhaustion doctrine is the response to the "ubiquity" of intellectual property assets ([4]).

The overall purpose of exhaustion regimes is therefore to strike and maintain a balance between a public interest (i.e. free movement of innovative goods) and the private interest of IPR owners (i.e. remuneration for their creative and artistic efforts)[5].

Exhaustion is internationally regulated by Article 6 TRIPs([6]). Before switching to this provision, it is worth spending a few words on the different types of exhaustion as well as on the impact of parallel trade in international markets.

2. *Exhaustion regimes and parallel trade.*

We have seen that the right to control further resale of IPR-protected goods is exhausted once the product is first put on the market by the right owner or with his consent.

What happens if for instance the IPR owner has patented the invention or registered the trademark in two countries (so that he has parallel rights) and sells the relevant products in both of them? Does the first sale in country "A" exhaust the right in country "B"? As is known amongst intellectual property practitioners, the answer depends on which exhaustion regime country "B" has chosen.

When country "B" adopts a national exhaustion regime, the sale of the product in country "A" has no impact on the former – i.e. the IPR owner does not lose his rights to resale the good in country "B" and is entitled to oppose its importation in said state.

([3]) In a very old UK case it was held that "*where a man has purchased an article he expects to have control of it, and there must be some clear and explicit agreement to the contrary to justify the vendor in saying that he has not given the purchaser his license to sell the article or to use it wherever he pleases as against himself*" (*Betts v Willmott*, 1871, 6 LR Ch App 239, 245).

([4]) T. COTTIER – M. STUCKI, *Parallel Imports in Patent, Copyright and Industrial Design Law – The Scope of European and International Public Law*, 1996, in F. ABBOTT – T. COTTIER – F. GURRY, *The International Intellectual Property System. Commentary and Materials* (The Hague, London, Boston, Kluwer Law International, 1999), pp. 605-608.

([5]) M. SLOTBOOM, *The Exhaustion of Intellectual Property Rights - Different Approaches in EC and WTO Law*, Vol. 6 Part 3 *Journal of World Intellectual Property* 2003, pp. 421-440, p. 422.

([6]) As is well known, TRIPs is one of the WTO agreements signed in 1994 at the end of the Uruguay Round and is one of the pillars of the multilateral trade system. It imposes on WTO Members the obligation to ensure a minimum level of protection of all types of IPR. For a thorough analysis of the TRIPs Agreement see M. BLAKENEY, *Trade Related Aspects of Intellectual Property Rights: A Concise Guide to the TRIPS Agreement* (London: Sweet and Maxwell, 1996); J. WATAL, *Intellectual Property Rights in the WTO and Developing Countries* (The Hague: Kluwer Law International); D. GERVAIS, *The TRIPS Agreement: Drafting History and Analysis*, 3rd ed. (London: Sweet & Maxwell 2008); C. CORREA, *Trade Related Aspects of Intellectual Property Rights* (New York: Oxford University Press 2007).

On the other hand, if country "B" adopts an international exhaustion regime, the sale of the IPR-protected good in any part of the world (including country "A") causes the exhaustion of rights also in country "B" ([7]). An essential requirement for international exhaustion to apply is the validity of the IPR not only in the country adopting such regime (country "B"), but also in the state where the relevant product is sold for the first time by the right holder (e.g. country "A"). If for example the right owner does not own patent rights in the country where it first has sold the product (e.g. for lack of filing, registration refusal, cancellation, ban on patenting, term expiration, etc.), international exhaustion does not apply.

An intermediate solution is regional exhaustion, which is usually adopted by countries part of a free trade or customs union agreement. In this case the sale of an IPR-protected product in one of these states exhausts the right to re-sell in the others. A well-known example is the exhaustion regime adopted in the European Economic Area (EEA). A Community-wide exhaustion has been affirmed by the European Court of Justice (ECJ) since the 1960s ([8]) and then codified in several IPR-related directives and regulations, e.g. Article 7 Directive 89/104 (now repealed by Article 7 Directive 2009/95) and Article 13 Regulation 40/94 (now repealed by Article 13 Regulation 207/2009).

The choice of whether to adopt an international or a national exhaustion regime does have a strong impact on international trade of goods([9]).

(i) On the one hand, if a country adopts an international exhaustion system it allows parallel imports in its territory. For example, a third party which legally purchases from the IPR owner a product in country "A", he can import and resell said product in country "B", if the latter has adopted an international exhaustion regime. In this case the IPR holder cannot prevent such parallel import, as his rights are exhausted with the first sale of the product in country "A". In other terms, the third party is allowed to compete with the right holder in the importing country. It must be noted that parallel trade does not regard fake goods but original products initially sold by the IPR owner on international markets and legally purchased and resold by third parties (*grey goods*) ([10]).

(ii) On the other hand, if a country adopts a national exhaustion regime, IPR holders are entitled to oppose parallel imports, which allows them to segregate international

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([7]) PIRES DE CARVALHO, *The TRIPS Regime of Patent Rights*, above fn. 2, p. 103.
([8]) As far as patents are concerned see *inter alia Centrafarm v Sterling Drug* (C-15/74). As regards trademarks see *inter alia Silhouette v. Hartlauer* (C-355/98); *Consten and Grundig v. Commission* (C-56-58/64). On EU and EEA wide exhaustion see also C. STOTHERS, *Parallel Trade in Europe, Intellectual Property, Competition and Regulatory Law* (Hart Publishing, Oxford, 2007); T. HAYS, *Parallel Importation under European Union Law* (Thomson, Sweet & Maxwell 2nd ed., 2010); D. SINDICO, *On Parallel Importation, TRIPs and European Court of Justice Decisions*, Vol. 5 Part 4 *The Journal of World Intellectual Property* 2002, pp. 505-516, pp. 508-513.
([9]) See also A. YUSUF – A. MONCAYO VON HASE, *Intellectual Property Protection and International Trade – Exhaustion of Rights Revisited*, 16 *World Competition* 1992, pp. 115-131, p. 116.
([10]) C. FINK, *Entering the Jungle of Intellectual Property Rights Exhaustion and Parallel Importation*, in C. FINK – K. E. MASKUS (edited by), *Intellectual Property and Development – Lessons from Recent Economic Research*, *World Bank – Oxford University Press*, 2005, pp. 173 et seq. (available on the website www.worldbank.org, last accessed on 12 May 2010).

markets. A regional exhaustion regime (e.g. EEA-wide exhaustion) allows parallel imports between the countries which are member of the regional agreement, but not the parallel trade coming from other states.

There exist two categories of parallel imports, i.e. *passive parallel imports* and *active parallel imports*. Passive parallel imports are more common and occur where third parties purchase IPR-protected goods in a country and then resell them in another state. Active parallel imports take place when a foreign distributor or licensee of the IPR holder sells the relevant goods in the right holder's country, or in another licensee or distributor's country, directly competing with them. In other terms, these products turn out to circulate outside the official distribution channels chosen by the right owner. It is clear that active parallel imports derive from a breach of contract committed by the licence or distributor of the IPR holder. Indeed, it is a common practice to insert in international licensing and distribution agreements *ad hoc* clauses which (i) segregate international markets and (ii) set a ban on "invasions" of the licensed products in other licensees' areas of competence. And parallel trade obviously breaks such contractual schemes.

What prompts parallel importers to purchase original products in the international market and export them to third countries?

First, the expectation of high profits.

It should be noted that IPR owners set different prices in different markets. This is due to a number of reasons, including the cost of production and distribution in different geographic areas. Such costs can vary depending on the specific country, particularly taking into account the cost of labor or raw materials as well as the presence of strict legislations on employment, environment, taxation and finance matters. Parallel importers therefore purchase from legitimate sources (i.e. from the IPR owner, or from his licensee or official distributor) the relevant products in low-price countries, and then resell them in countries where the right holder keeps the price higher.

3. Arguments in favor of international exhaustion.

Supporters of international exhaustion regimes stress that parallel imports strengthen the trade between countries, injecting competition into international markets and satisfying consumers' demand and interests. Indeed we have seen that parallel importers tend to compete with IPR owners by buying products in low-price areas and sell them in higher-price countries, which is no doubt beneficial to local consumers([11]).

Such trade practices can have a particularly positive impact in sensitive fields, such as the pharmaceutical and food industry, especially in developing and least developed

([11]) The opportunity of introducing regimes of international exhaustion (with particular reference to trademarked goods) is stressed by R. D. ANDERSON, *Intellectual Property Rights, Competition Policy and International Trade: Reflections on the Work of the WTO Working Group on the Interaction between Trade and Competition Policy* (1996-1999), in T. COTTIER – P. C. MAVROIDIS (Eds), *Intellectual Property – Trade, Competition and Sustainable Development* (University of Michigan Press, 2003), p. 252.

countries ([12]). Indeed, as shown above, parallel imports increase the distribution and availability of goods with a beneficial effect on prices. Moreover the practice of parallel importers to sell at prices lower than those of IPR holders can cause a positive "dumping" effect. In other terms, it is possible that right owners - threatened by the fierce competition of parallel traders - lower the prices of their own products. Indeed, sometimes just the threat to undergo parallel imports suffices to persuade right owners to lower prices. That is why it is believed that parallel trade might be a useful antidote against possible anti-competitive behaviors of IPR holders (13).

In particular parallel imports are said to have positive impact on those developing and least developed countries which have weak production capacity and heavily rely on export activities. It is believed that these trade practices could be the engine for their economic and commercial growth (14).

From a legal perspective, supporters of an international exhaustion regimes stress that the ban on parallel import amounts to a non-tariff barrier to trade between countries, which contravenes both the principles and the provisions of GATT/WTO.

What about GATT/WTO principles?

The WTO multilateral system is based on the theory of comparative advantages conceived by the English economist David Ricardo in his book "*On the Principles of Political Economy and Taxation*" (1817). This theory suggests that countries specialise and trade in goods and services in which they have a comparative advantage. A country has a comparative advantage in the production of a good or service that it produces at a lower opportunity cost than its trading partners. The theory in question argues that, put simply, it is better for a country that is inefficient at producing a good or service to specialise in the production of that good it is least inefficient at, compared with producing other goods.

Said that, it has been said that this theory is based on price mechanisms. Countries specialized in the efficient production of a certain product tend to export this product to areas where the good is more expensive. A restriction of parallel trade would therefore hinder the above and contravene David Ricardo's theory, as it would (i) block the free and physiological movement of goods from "cheaper" to "more profitable" areas and (ii) obstruct the efficient allocation of production resources on a global scale([15]).

([12]) N. GALLUS, *Parallel Policies on Pharmaceutical Parallel Trade*, 11(3) *International Trade Law & Regulation*, 2005, p. 77. In this regard, doubts have been expressed by J. WATAL, *Parallel Imports and IPR-based Dominant Positions: Where do India's Interests Lie*, in COTTIER – MAVROIDIS, *Intellectual Property*, above fn. 11, pp. 206-207.

(13) K. E. MASKUS, *Intellectual Property Rights in the Global Economy*, Institute for International Economics (Washington, 2000), p. 211. See also S. K. VERMA *Exhaustion of Intellectual Property Rights and Free Trade – Article 6 of the TRIPs Agreement*, 29(5) *ICC* 1998, pp. 534-567, p. 559.

(14) F. ABBOTT, *Discussion Paper for Conference on Exhaustion*, in ABBOTT – COTTIER – GURRY, *The International Intellectual Property System*, above fn. 4, pp. 1786, 1790 and 1796; C. FINK, *Entering the Jungle*, above fn. 10, p. 184. See also para. 15 of the *Declaration regarding the exhaustion of intellectual property rights and parallel trade*, adopted at the 69th Conference of the International Law Association, held in London, 25-29 July 2000.

([15]) In this regard, doubts have been expressed by M. BRONCKERS, *Where Should WTO Law Go on the Exhaustion of Intellectual Property Rights?*, in COTTIER – MAVROIDIS, *Intellectual Property*, above fn. 11, pp. 232-233.

What about GATT/WTO provisions?

It is believed that a ban on parallel trade would violate Article XI(1) GATT which expressly forbids "*quantitative restrictions*" of international trade as well as "*prohibitions or restrictions other than duties, taxes or other charges, whether made effective through quotas, import or export licences or other measures*". This is an all-embracing provision generally forbidding any non-tariff measure limiting the international flow of goods on a global scale (16). It should also be noted that non-tariff obstacles to international trade are considered as more detrimental than customs duties, as they can distort international markets to a much higher extent by surreptitiously altering the free movement of goods and heavily restricting business activities and consumers' choices.

Supporters of parallel imports also believe that a ban on these trade practices would go against the target of market liberalization pursued by WTO (17), and particularly by TRIPs. Indeed also TRIPs aims at reducing the obstacles to international trade of goods, namely those goods protected by IPRs.

Indeed, it should be noted again that parallel trade does not regard fake goods, but original products initially marketed by the IPR owner or with his consent, so that a ban on parallel imports would amount to a ban on circulation of original goods([18]). It has therefore been stressed that the ban on parallel trade is equal to an "*unfair duplication of the rights of IPR holder*", as IPR owners are entitled to exercise their exclusive rights on both fake products and original goods sold by themselves abroad, and imported by third parties(19).

4. *Arguments in favor of national exhaustion*

Of course, supporters of national exhaustion deem it necessary to ban or anyway restrict parallel trade.

With particular reference to high technology fields, they stress that the possibility for right owners to deter the aggressive competition of parallel importers and segregate

(16) Such broad interpretation was confirmed by both GATT and WTO Panels. See the GATT case *Japan – Semi-Conductors*, where it was held that the wording of Article XI "[…] *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*" (Panel Report in *Japan – Trade in Semi-Conductors*, Bisd 35S/116, 1989, para. 104). See also the WTO Panel Reports in both *India – Quantitative Restrictions on Imports of Agricultural, Textile and Industrial Products* (WT/DS90/R, 1999, para 5.128) and *India – Measures Affecting the Automotive Sector* (WT/DS146/R, WTDS175/R, 2001, para. 7.220). See also SLOTBOOM, *The Exhaustion of Intellectual Property Rights*, above fn. 5, p. 435.

(17) In the recitals of the Agreement establishing the WTO member states declare that they wish to expand "[…] *the production of and trade in goods and services*" (Recital 1) by means of "*arrangements directed to the substantial reduction of tariffs and other barriers to trade*" (Recital 3).

([18]) Such differentiation is also stressed in para. 5 of the *Declaration regarding the exhaustion of intellectual property rights and parallel trade*, above fn. 14.

(19) J. WATAL, *Intellectual Property Rights in the WTO and Developing countries*, above fn. 6, pp. 295-296. It has also been said that national exhaustion allows IPRs owners "*to multiply their benefits by helping them to restrict competition through division of world markets*". See VERMA *Exhaustion of Intellectual Property Rights*, above fn. 13, p. 559.

national markets allows IPR holders to recoup R&D-related investments and reinvest in further innovation, which would benefit consumers in the long run. On the other hand allowing parallel imports (i.e. aggressive trade practices carried out by competitors) would reduce profitability. This would damage particularly high-technology and knowledge-intensive industries (such as in the pharmaceutical, chemical and biotechnological field), which usually invest huge financial and human resources in both R&D and the subsequent manufacturing, testing and final distribution of products (20).

Here follows a number of more specific arguments brought by the opponents of parallel trade.

(i) We have seen that IPRs owners tend to set different prices depending on the specific market. It follows that prices in developing and least developed countries are lower than in rich countries. This practice is carried out by many companies owning parallel IPRs across the globe – and is known as *price discrimination*. In the poorest areas of the world it allows to increase the availability of products to consumers at reasonable costs([21]). Parallel trade would instead prompt right owners - who fear aggressive competition and speculative practices by importers([22]) - not to distinguish prices across national markets. On the contrary they would be prompted to uniform prices across countries (23) or even to decide not to supply those areas with higher risk of re-export (24), with the result that many consumers in developing and least developed countries could have no access to IPR-protected products and technologies. This would be particularly detrimental when it comes to sensitive goods such as drugs and foodstuff.

(20) Particularly in the pharmaceutical field allowing parallel imports of patented medicines would make it very hard for competent authorities (such as FDA or EMA) to carry out all the necessary checks before granting market authorization. This is due to the many differences between national legislations concerning safety of medicines (e.g. testing, packaging, labelling, etc.). Indeed importation of medicines from all over the world would complicate the work of these authorities which would have to check *inter alia* the conformity of drugs to different national requirements.
The reply to the above argument is the following. Safety of medicines and public health has nothing to do with whether a drug is patented or not, or whether the patent is exhausted. The authorities in question have the duty to prevent risks deriving from the use of any medicine, patented or not patented (ABBOTT, *Discussion Paper*, above fn. 14, p. 1794). Moreover if a WTO member state considers that public health is threatened by the importation of a given patented medicine, it could still ban such importation relying on Article XX(b) GATT which allows to adopt any restrictive measures "*necessary to protect human, animal or plant life or health*".
([21]) On the benefits stemming from price discrimination see R. D. ANDERSON, *Intellectual Property Rights, Competition Policy and International Trade: Reflections on the Work of the WTO Working Group on the Interaction between Trade and Competition Policy* (1996-1999), in COTTIER – MAVROIDIS, *Intellectual Property*, above fn. 11, pp. 251-252.
([22]) It has been noted, however, that the risk of speculative practices such as trade diversion of IPR-protected goods into richer markets is often overestimated. See CORREA, *Trade Related Aspects of Intellectual Property Rights*, above fn. 6, p. 89.
(23) C. FINK, *Entering the Jungle*, above fn. 10, p. 184.
(24) P. BRAGA – C. FINK – C. PAZ SEPULVEDA, *Intellectual Property Rights and Economic Development*, TechNet Working Paper, World Bank Group, 1998, in ABBOTT – COTTIER – GURRY, *The International Intellectual Property System*, above fn. 4, p. 1856; K. E. MASKUS – Y. CHEN, *Parallel Imports in a Model of Vertical Distribution: Theory, Evidence, and Policy*, in FINK – MASKUS (edited by), *Intellectual Property and Development*, above fn. 10, p. 192.

(ii) We have seen that passive parallel imports can increase availability of IPRs-protected goods at a low price in the importing country. However, we should also take into account the other side of the coin: such imports could also cause scarcity of said products in the exporting state, where the sale price might then be raised([25]).

(iii) Allowing parallel trade would have a chilling effect on the international transfer of technologies. For example patentees would be reluctant to license patented technologies in countries which adopt international exhaustion regimes, as these states would not give adequate guarantees that local licensees will not compete with right holders on international markets by re-exporting the products stemming from those technologies([26]).

As counter-argument it could be said that in order to avoid licensee's parallel imports it is not necessary to pass legislation generally banning parallel trade. It would suffice to insert into the licence agreements *ad hoc* clauses prohibiting licensees to invade other markets. However, even in case such contractual provisions are inserted, IPRs owners could still face difficulties in successfully enforcing them, especially in those countries devoid of legislations guaranteeing adequate contract enforcement. It is therefore believed that the ban on parallel import aims at supplementing contractual provisions([27]).

(iv) Parallel importers would unduly exploit the investments in marketing, promotional campaigns and pre and post sale services made by IPR holders for improving the efficiency of their international distribution network. As the above importers do not make analogous investments, they could not offer products having the same quality as the goods marketed by right owners, which would jeopardize consumers' interests([28]).

(v) Allowing parallel imports of goods subject to government price cap regulation (e.g. drugs) would amount to export subsidies. Such subsidies are prohibited under the WTO Agreement on Subsidies and Countervailing Measures, as they unduly distort international trade. Indeed parallel importers could take advantage of government-imposed price of IPR-protected goods in country "A", purchase them in said country and export them to country "B", where price control does not exist and the average price is much higher ([29]). This argument seems so convincing that also supporters of international exhaustion appear to accept a limitation of parallel trade under these circumstances. This holds true also in light of the aims pursued by government-imposed price caps, i.e. increasing availability of products amongst consumers living in the country adopting such measure, not amongst consumers living in other states([30]).

([25]) WATAL, *Intellectual Property Rights in the WTO and Developing countries*, above fn. 6, p. 301.
([26]) FINK, *Entering the Jungle*, above fn. 10, p. 180.
([27]) MASKUS – CHEN, *Parallel Imports*, above fn. 24, p. 192.
([28]) MASKUS, *Intellectual Property Rights in the Global Economy*, above fn. 13, p. 213; MASKUS – CHEN, *Parallel Imports*, above fn. 24, p. 89.
([29]) See also M. BRONCKERS, *The Exhaustion of Patent Rights Under WTO Law*, *32 Journal of World Trade*, 137, 1998, in ABBOTT – COTTIER – GURRY, *The International Intellectual Property System*, above fn. 4, p. 1817.
([30]) FINK, *Entering the Jungle*, above fn. 10, 179.

(vi) We have seen that IPR holders often divide international markets, e.g. they sell high-quality products in rich areas whereas lower quality goods are marketed in poorer countries. On the other hand parallel importers do not care about said market divisions and often import low-quality goods in a country where IPR holders sell instead high-quality products, which could deceive consumers or anyway jeopardize their confidence and interests. Yet supporters of parallel trade do believe that even imports of law quality goods do not harm consumers but might benefit them, as they increase consumers' possibilities to choose amongst products of different qualities and prices([31]).

(vii) Finally parallel trade would increase chances that fake goods enter the importing country together with original goods. It is therefore believed that such imports would favor the entry and sale of counterfeited products in the importing state: e.g. fake products seized by customs authorities are often coupled with original goods of the same type. This argument is not convincing. The parallel import of original products does not cause the same social alarm as in the case of pirated and counterfeited goods and should not be stopped just because some importers couple grey products with fake goods. The two activities should be treated in different ways([32]). Supporters of parallel trade also stress that these practices not only do not increase the sales of fake goods, but may have the effect of reducing them in the long run. Indeed if parallel trade is totally liberalized, many importers and companies will find such lucrative activity more attractive than trafficking in fake goods – and counterfeiters may abandon said unlawful activity and switch instead to parallel imports([33]).

5. *Article 6 TRIPs*

What does TRIPs provide with regard to exhaustion and parallel imports?

Article 6 states that "[…] *nothing in this Agreement shall be used to address the issue of the exhaustion of intellectual property rights*".

This is a "neutral" provision. It does not impose any exhaustion regime (national, international or regional), leaving countries free to adopt the system that best suits their needs. It also clarifies that, whatever regime is chosen, the immunity from legal actions before WTO courts is guaranteed. Article 6 basically amounts to an "*agreement to disagree*" (34).

Also Paragraph 5(d) Doha Declaration on the TRIPS Agreement and Public Health states that "*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 of exhaustion, without challenge* […]" (35).

([31]) *Ibid.*, p. 180.
([32]) *Ibid.*, p. 186 (note 24).
([33]) P. PICONE - A. LIGUSTRO, *Diritto dell' Organizzazione Mondiale di Commercio* (Cedam, Padova, 2002), p. 410.
(34) T. COTTIER, *The WTO System and Exhaustion of Rights - Committee on International Trade Law Conference on the Exhaustion of Intellectual Property Rights and Parallel Importation in World Trade*, Geneva, November 6-7, 1998, in ABBOTT – COTTIER – GURRY, *The International Intellectual Property System*, above fn. 4, p. 1797.
(35) The Doha Declaration on the TRIPS Agreement and Public health was adopted on 14 November 2001 by the WTO Ministerial Conference. It has been said that Paragraph 5 of the Declaration does not

Article 6 TRIPs is the result of a compromise between countries supporting a national exhaustion system (namely industrialized countries) and supporters of international exhaustion and parallel imports, e.g. many developing and least developed countries, but not only. Even certain rich countries such as New Zealand and Australia, which are net importers of IPR-protected goods, supported a system of international exhaustion during the Uruguay Round negotiations (36).

What about the United States? Parallel trade started frightening this country around the mid-80s, when such trade was worth 2-3% of whole US imports([37]). United States finally approved the neutral wording of Article 6 which still allows them to put pressure on, and induce, other countries to adopt measures forbidding or limiting parallel imports. Said *TRIPS-plus* regime is permitted as TRIPs just sets minimum standards of protection and leaves countries free to determine the appropriate method of implementing such protection (Article 1(1)). This has prompted certain countries such as United States to conclude bilateral and regional agreements with other states with a view to obtaining stronger IPRs protection.

For example, the United States signed bilateral free trade agreements with Morocco (2004) and Australia (2004), such accords limiting parallel trade. In particular said accords prevent parallel importation of patented products, at least when the patentee has included a territorial limitation on the distribution of the good by contract or other means. Also the 2003 US-Singapore free trade agreement contains a provision limiting parallel trade of pharmaceutical products, by giving drug companies a cause of action against parallel traders purchasing drugs from someone whom they know has been contractually prevented from selling to them.

These agreements formally comply with Article 1(1) TRIPs, which leaves WTO members free to introduce stronger IPRs protection. However it has been said that negotiating and concluding *TRIPs-plus* agreements containing the above provisions is not consistent with the multilateral spirit of the Doha Declaration, which leaves countries free to choose an exhaustion regime that best suits their own needs (without any pressure from other countries)([38]). More generally, said bilateral approach adopted by countries that accepted to be part of a multilateral context (the WTO) has been considered a violation of international law obligations([39]).

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give a general interpretation of Article 6, and that its application is limited to the public health sector. This argument appears convincing as the provision in question is contained in a declaration dealing exclusively with the protection of public health. See PIRES DE CARVALHO, *The TRIPS Regime of Patent Rights* above fn. 2, pp. 95-96.

(36) MASKUS – CHEN, *Parallel Imports*, above fn. 24, p. 190. Also Japan favors an international exhaustion regime.

([37]) FINK, *Entering the Jungle*, above fn. 10, p. 182.

([38]) UNCTAD/ICTSD, *TRIPS and Development Resource Book*, above fn. 1, pp. 115-116.

([39]) M. RICOLFI, *Interface between Intellectual Property and International Trade: Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS Agreement)*, in *International Conference on Intellectual Property Education and Training (New Delhi, July 11 to 13, 2001) – Collection of Papers compiled by the WIPO Worldwide Academy*, 2001, p. 71 (note 15). See also para. 6 of the *Declaration regarding the exhaustion of intellectual property rights and parallel trade* (above fn. 14), which encourages "*WTO Members to refrain from threatening or taking actions with respect to Member government policies which permit trade into their territories in so far as such policies are consistent with the terms of the TRIPs Agreement*".

On the other hand, most developing and least developed countries consider parallel trade not only as a tool to promote competition on foreign markets and prevent possible anti-competitive behaviours of IPR owners, but also as a good opportunity for economic growth([40]). Some of these countries have therefore adopted international exhaustion systems.

6. *Conclusions. Only international exhaustion regimes are consistent with WTO principles and provisions and should therefore be imposed on WTO countries*

The fact that TRIPs gives states the right to choose an international exhaustion regime allowing parallel imports is to be praised. The author believes however that it is now time to go further and impose upon all WTO members a generalized and compulsory system of international exhaustion without any possibility to rely on national or regional regimes. This solution would get rid of detrimental and artificial barriers to the flows of goods between countries, and further boost the WTO-driven process of commercial and economic integration.

The author shares the arguments brought by the supporters of international exhaustion. An evolved multilateral trading system which aims at eliminating obstacles to trade cannot allow countries to adopt national exhaustion systems and build artificial barriers, such obstacles preventing the trade in original goods initially sold by IPRs owners.

It appears evident that national exhaustion regimes contravene the spirit, rules and targets of the GATT/WTO system([41]), and are not justified by the hypothetical advantages brought by said regimes (42).

Also TRIPs dislikes an excessive protection of IPRs if such protection is capable of creating barriers to international trade of goods. Recital 1 TRIPs stresses that WTO member states wish "*to reduce distortions and impediments to international trade, and taking into account the need to promote effective and adequate protection of intellectual property rights, **to ensure that measures and procedures to enforce intellectual property rights do not themselves become barriers to legitimate trade***" (emphasis added). The underlying principle is that also an overprotection of intellectual property assets could be detrimental to international flow of goods across countries.

This recital and generally the TRIPs Agreement impose to make a comparative assessment between the benefits brought by international exhaustion systems on the one hand and the advantages deriving from a system prohibiting parallel imports on the other hand. In view of what highlighted at paras 2 and 3 above, it seems that the benefits in the former case, especially in developing countries, are higher and outweigh the possible costs linked to the adoption of a generalized international exhaustion regime.

([40]) See also VERMA *Exhaustion of Intellectual Property Rights*, above fn. 13, p. 565.

([41]) *Ibid.*, pp. 552-555. It has been stressed that "*both national and regional exhaustion amount, from the angle of trade regulation, to a quantitative restriction and a non-tariff barrier that is contrary to Art. XI GATT*". See. T. COTTIER, *The Exhaustion of Intellectual Property Rights – A Fresh Look*, 39(7) *IIC* 2008, pp. 755-757.

(42) The only exception (to a generalized international exhaustion regime) which would be worth admitting is the one mentioned at point v) of para. 4.

Also EU law principles support the above arguments. As is known, the EU pursues targets of commercial integration and since the 1960s has adopted a regional exhaustion system which aims at boosting the movement of goods across its member states. Such exhaustion shares the same structure as the international one, as it allows parallel imports within the EU borders. In other words, EU-wide exhaustion is an international exhaustion "on a small scale".

In light of all the above, the authors believes it is time now for WTO – which pursues targets similar to EU's ones (e.g. elimination of barriers to trade between their member states) – to impose countries a generalized international exhaustion regime([43]).

The similarities and contact points between EU and WTO systems are even more evident if we look closely at both EU legislation regarding free movement of goods (and the relevant interpretation given by the European Court of Justice (ECJ)) as well as Article XI(1) GATT.

Take for example the ECJ ruling in *Centrafarm v Sterling Drug* (C-15/74), the leading case on exhaustion of patent rights.

The facts of the case are well known. The US company *Sterling Drug* owned parallel patents in the Netherlands and Britain covering the medicine Negram useful against urinary infections. *Centrafarm* purchased stocks of Negram in UK (where the price had been lowered by the government) and imported it in the Netherlands (where the average price was higher). *Sterling Drug* sued *Centrafarm* before the Dutch courts, claiming patent infringement and asking to enjoin the import of Negram in the Netherlands. The case was finally referred to the ECJ, which was asked whether the principle of free circulation of goods enshrined in the EC Treaty allowed the holders of parallel patents in various member states to stop parallel imports.

The ECJ clarified that the exercise of patent rights aiming at stopping parallel imports within Community borders amounted to a segregation of European market and therefore violated the principle of free circulation of goods enshrined in Article 30 EC Treaty (now Article 34 Treaty on the Functioning of European Union, TFEU), which states that "*quantitative restrictions on imports and all measures having equivalent effect shall be prohibited between Member States*". Similar arguments were used by the ECJ in *inter alia Deutsche Grammophon v Metro* when it came to ruling on copyright exhaustion (C-78/70).

Said that, Article 30 EC Treaty (now Article 34 TFEU) shares the spirit and wording of Article XI(1) GATT which, as we have seen, strictly forbids "*quantitative restrictions*" of international trade as well as "*prohibitions or restrictions other than duties, taxes or other charges, whether made effective through quotas, import or export licences or other measures*". With the result that ECJ's legal reasoning in the above cases could be transposed (and would fit) into WTO legal system.

([43]) International exhaustion is also backed, at least as far as trademark rights are concerned, by paras. 7 and 8 of the *Declaration regarding the exhaustion of intellectual property rights and parallel trade* (above fn. 14).

However it might be counter-argued that WTO member states could legally forbid parallel trade, relying on the general exception enshrined in Article XX(d) GATT, which permits states to limit imports by adopting measures "*necessary to secure compliance with laws or regulations which are not inconsistent with the provisions of this Agreement, including* […] *the protection of patents, trade marks and copyrights, and the prevention of deceptive practices*" (emphasis added).

Yet such argument would be ungrounded.

The ban on parallel imports could not be included amongst the measures allowed by Article XX(d) for the following reasons. First, as highlighted above, the author believes that adopting national exhaustion regimes and accordingly permitting a ban on parallel trade is inconsistent with the provisions of GATT and therefore does not satisfy the requirement laid in Article XX(d) (see above the added emphasis). Secondly, a ban on parallel trade does not even comply with the *chapeau* of Article XX GATT, which generally forbids states to adopt measures "*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 author believes that a ban on parallel imports amounts to "*a disguised restriction on international trade*" for the following reasons([44]).

We should first look at how Article XX(d) has been interpreted under GATT jurisprudence. The case to look at is *United States – Imports of Certain Automotive Spring Assemblies* (decision of 26 May 1983). In such a case the GATT Panel scrutinized the lawfulness of a US measure aimed at hindering the import from Canada of car components infringing US patent rights. The Panel concluded that the US measure complied with Article XX(d) GATT, stressing that the measure in question did not block the import to the US of original goods produced and sold by a patent holder's licensee. That is why, according to the Panel, such measure could not be considered a disguised restriction on international trade (para. 56 of the decision). The author believes that if this case had concerned original goods (or, as the Panel put it, goods produced and sold by a foreign licensee of the patentee), the decision would have been the opposite, i.e. a ban on imports of original goods would amount to a disguised restriction on trade.

It appears clear that a ban on parallel trade amounts to a disguised restriction on trade (45). Indeed such measure would block the international trade of original products thanks to an (over)protection of intellectual property rights. But this protection is actually unnecessary, because, as we have seen, a protection is already given to right holders, i.e. the right to prohibit third parties from marketing goods (e.g. bearing an identical trademark or incorporating the same invention) which have been initially sold without his consent. The author does agree with J. Watal when stressing that a ban on parallel trade is equal to an "*unfair duplication of the rights of IPR holder*"([46]).

([44]) See also YUSUF – MONCAYO VON HASE, above fn 9, p. 125.
(45) For a contrary opinion see COTTIER, *The WTO System and Exhaustion of Rights*, above fn. 34, pp. 1799-1800.
([46]) See above fn. 19.

The above leads to the conclusion that Article XX(d) GATT should be interpreted as allowing WTO member states to take measures banning exclusively the trade in counterfeited goods (which is the quintessential of IPR protection), not the trade in original products marketed by right owners in the international market.

Again EU law strengthens this argument.

After forbidding quantitative restrictions to trade (i.e. former Article 30 EC Treaty, now Article 34 TFEU), EU legislation contains a provision (former Article 36 EC Treaty, now Article 36 TFEU) very similar to Article XX(d) GATT (47), i.e. it specifies that the ban on restriction to trade between member states "*shall not preclude prohibitions or restrictions on imports, exports or goods in transit justified on grounds of* […] *protection of industrial and commercial property*". Moreover such provision goes on clarifying that "*such prohibitions or restrictions shall not, however, constitute a means of arbitrary discrimination or a disguised restriction on trade between Member States*" (this is very similar to the *chapeau* of Article XX GATT).

Said that, the ECJ decision in *Centrafarm v. Sterling Drug* – in which the above provisions were interpreted - seems to strengthen the argument brought by the author. The *ratio decidendi* of the ruling is as follows. It is first held that national exhaustion regimes and the ban on parallel imports amount to obstacles to the free circulation of goods (paragraph 10). Such obstacle cannot be justified under former Article 36 EC Treaty (now Article 36 TFEU), as the product whose importation was blocked had been "*put onto the market in a legal manner, by the patentee himself or with his consent, in the member state from which it has been imported*". On the other hand, the patentee should be allowed to stop such imports when the "*protection is invoked against a product* […] [which] *has been manufactured by third parties without the consent of the patentee*", i.e. an infringing good (paragraph 11).

The ECJ clarified that if a patentee is allowed to block parallel imports, he might "*be able to partition off national markets and thereby restrict trade between member states, in a situation where no such restriction was necessary to guarantee the essence of the exclusive rights flowing from the parallel patents*" (paragraph 12). Thus in such a case the departure from the principle of free movement of goods cannot be justified on grounds of patent protection. The ECJ added that what can justify restrictions to intra-Community trade is "*the exclusive right to use an invention with a view to manufacturing industrial products and putting them into circulation for the first time, either directly or by the grant of licences to third parties, as well as the right to oppose infringements*" (paragraph 9).

The above arguments have been used by the ECJ in other several cases regarding IPRs exhaustion([48]).

Said that, the author believes that the arguments brought by the ECJ in its exhaustion-related decisions could and should be transposed from EU to WTO([49]). Indeed, as

(47) The GATT Agreement and the EC Treaty were signed respectively in 1947 and in 1957, i.e. in relatively close periods.

([48]) See e.g. *Deutsche Grammophon Gesellschaft mbH v Metro-SB-Großmärkte GmbH & Co. KG* (C-78-70); *Centrafarm BV and Adriaan de Peijper v Winthrop BV* (C-16/74); *Merck & Co. Inc. v Stephar BV and Petrus Stephanus Exler* (C-187/80).

already shown, EU and WTO share analogous general principles and in perspective similar targets (e.g. elimination of barriers to trade).

Yet it has been argued that there are so many differences between WTO and EU that it would be impossible and inappropriate to extend the principles and rules of the latter (e.g. parallel trade freedom) to the former. In particular, it has been noted that WTO has not given rise to a single market similar to EU, and that there are still too many obstacles to world trade, such as tariffs, customs duties and *anti-dumping* duties, defence clauses, etc. (50).

While it is true that WTO has not yet given rise to an EU-style single market, on the other hand the long-term target of such a system is no doubt to gradually remove obstacles to the international exchange of goods, especially non-tariff obstacles. Certainly WTO should not aim at consolidating said barriers. Whether to adopt a generalized system of international exhaustion should not depend on the present degree of integration reached by WTO, but by its long-term and dynamic targets. Rather the very fact that the WTO commercial integration process has still room for further trade opening and liberalization should lead to choose an international exhaustion regime, which is one of the tools useful to meet the above targets and fill those gaps.

Moreover, the claim that EU and WTO would be so different (as the former would be more committed to free trade than the latter), and therefore that it would be impossible to extend the principles and rules of the former (e.g. parallel trade freedom) to the latter, is rather weak. Indeed, WTO law is sometimes even keener in defending free trade principles than EU: e.g. rules on fiscal discrimination, the notion of subsidies and trade restrictions for public health reasons ([51]). Further, the EC started to accept parallel trade freedom in the mid 1960s, when legislation on market harmonization did not yet exist. Indeed at that time no commercial integration process had occurred in the EC and there were still many differences in relation to trade conditions ([52]).

([49]) A similar parallel between EC/EU law and international trade law has already been stressed. See e.g. YUSUF – MONCAYO VON HASE, *Intellectual Property Protection*, above fn. 9, p. 128; VERMA *Exhaustion of Intellectual Property Rights*, above fn. 13, p. 555.

(50) BRONCKERS, *The Exhaustion of Patent Rights*, above fn. 29, p. 1814; SLOTBOOM, *The Exhaustion of Intellectual Property Rights*, above fn. 5, pp. 421-422.

([51]) SLOTBOOM, *The Exhaustion of Intellectual Property Rights*, above fn. 5, p. 440.

([52]) *Ibid.*, p. 430.