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Parallel Imports and International Trade

1. Introduction

Parallel imports are one of the most iridescent and enigmatic phenomena of international trade. On the one hand, they strictly follow the laws of the market; yet on the other hand, the laws of the market are not the only ones that apply to this kind of activity. While industrial producers are pressing for general barriers in order to maintain price differences of goods among various countries, consumers find such differences puzzling in a world that is increasingly heading towards international trade and the removal of trade barriers. Easy resolution of the problem is not in sight.[1]

The term "parallel importation" refers to goods produced and sold legally, and subsequently exported. In that sense, there is nothing "grey" about them, as the English Patents Court in the *Deltamethrin* decision[2] correctly pointed out. Grey and mysterious may only be the distribution channels by which these goods find their way to the importing country. In the importing country, such goods may create havoc particularly for entrepreneurs who sell the same goods, obtained via different distribution channels and perhaps more expensively. In order to exclude such unwelcome competition, intellectual property rights have sometimes been of help. If products sold or imported by third parties fall within the scope of patents, trademarks or copyrights valid in this particular country, such sale or importation by third parties is generally deemed infringing. Owners of products covered by intellectual property rights have the exclusive right to put such products on the market. On the other hand, there is little doubt that once the owner of an intellectual property right has put such goods on the market either

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1 CORNISH, "Intellectual Property" 661 (3rd ed., London 1996).

2 Roussel Uclaf v. Hockley International, decision of 9 October 1995, [1996] R.P.C. 441.

himself or with his consent, there is little he can do about further acts of commercial exploitation, such as re-sale, etc., on the domestic market. Even if a car is covered by a number of patents, once the car maker has put that car on the market, there is a consensus that he cannot prevent that car from being re-sold, leased-out, etc. The reason for this has been answer differently in different jurisdictions.

The courts in two industrialised countries, Britain and Japan, have recently confirmed the lawfulness of parallel importation of patented products in the absence of any indication to the contrary. The *Deltamethrin* decision of the English Patents Court[3] confirms English case law, while the *BBS Wheels III* decision of the Japanese Supreme Court[4] came as a bit of a surprise.

2. *Parallel Imports and Recent Cases in England and Japan*

Under English common law,

> it is open to the patentee, by virtue of his statutory monopoly, to make a sale *sub modo*, or accompanied by restrictive conditions which would not apply in the case of ordinary chattels; ... the imposition of these conditions in the case of sale is not presumed, but, on the contrary, a sale having occurred, the presumption is that the full right of ownership was meant to be vested in the purchaser while ... the owner's rights in a patented chattel would be limited, if there is brought home to him the knowledge of conditions imposed, by the patentee or those representing the patentee, upon him at the time of sale.[5]

In other words, the patentee is allowed to impose limited conditions upon selling his goods, while an ordinary vendor of goods may not.

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3 *Id.*

4 Decision of 1 July 1997, 29 IIC 331 [1998].

5 *National Phonograph Company of Australia Ltd. v. Menck* , [1911] [28] R.P.C. 229, 248.

Apparently, this rule applies both to domestic sales and sales abroad. Parallel importation of goods produced abroad is permissible if these goods were produced with the consent of the domestic patent owner and subsequently sold without any clear notice of restriction. This rule applies regardless of the existence of any patent rights in the exporting country.[6] Given these clear precedents, there was little doubt about the outcome of the English case. And if the procedures are any indication, the plaintiffs were aware that their case would not stand up in court. Apparently, they had vainly tried to bully the defendant into putting an end to the parallel importation that they regarded a nuisance and an economic threat. It seems to be a consistent pattern in cases of parallel importation that the right owners – justifiably or not – try to use economic muscle to obtain the desired results. Unfortunately, very few jurisdictions allow a parallel importer acting legally to take action successfully against such arrogance of economic power.

The Japanese Supreme Court arrived at its result not because of any precedents in this respect, but rather by stressing the importance of unimpeded international trade. The right of the patentee over subsequent cross-border transactions only remains on condition that restrictions are clearly displayed on the patented products.

3. Parallel Imports and Continental Law

Continental law follows a different philosophy in order to determine the limits of intellectual property rights. Instead of theoretically allowing the owner of such right to impose contractual conditions upon the sale of protected products, continental law rather assumes absolute limits of intellectual property rights that can be described as the principle of "exhaustion". Unless otherwise stated in the law, the economic exploitation

[6] *Betts v. Willmott*, [1871] LR 6 Ch. App. 239.

of intellectual property rights is limited to the act of first sale. Further contractual conditions would thus be null and void. Exhaustion is thereby assumed even without any particular mention in the law itself.

With regard to patents, the German *Reichsgericht* held as early as 1902 that “if the patentee has marketed his products under the protection of a right that excludes others, he has enjoyed the benefits that a patent right confers on him and thereby consumed his right.”[7]

There has been very little question about the application of this principle within the boundaries of domestic trade. Perhaps, the implications on the free flow of domestic trade would be too severe to assume that a patentee can monopolise not only the marketing of patented products, but also subsequent sales.

In the context of international trade, however, the exhaustion doctrine is faced with problems that differ from the English theory of common law exhaustion. While under the latter doctrine, the sole condition is sufficient notice of the limits set by the patentee, under the exhaustion doctrine it is considered to what extent the first marketing of products abroad has the same effect as it has within the context of domestic trade. If the first marketing abroad had such effect, any objection by the patentee would be irrelevant. If, on the contrary, marketing abroad had no such result, the patentee could object to the importation even without proper notice to the public.

There are some twists in the argumentation, however. Under the exhaustion doctrine in the classical sense, it would of course be required that a foreign patent be exhausted upon the first sale. In other words, if products have been marketed abroad, the domestic patent right of the patentee can only be “exhausted” if the products were marketed abroad under an exclusive patent right, and if such patent right belonged to the domestic patentee. The – highly controversial – question is then to what extent marketing of

[7] 51 RGZ 139 – *Duotal.*

patented products abroad under the above conditions can indeed provide the patentee with those benefits the domestic patent right was intended to confer on him (first-sale doctrine).[8]

4. Exhaustion Doctrine Under European Law

As yet, there is no European patent system that would give a patentee one single patent right in all countries of the European Union. Accordingly, the European Court of Justice lacks jurisdiction in deciding on patent matters. However, since the exercise of intellectual property rights in general may interfere with the free movement of goods postulated under Sec. 30 of the Treaty of Rome, the ECJ did indeed render a couple of decisions that concern the prevention of parallel imports within the European Union. With regard to patents, the ECJ already held in 1974 that

> It cannot be reconciled with the principles of free movement of goods under the provisions of the Treaty of Rome if a patentee exercises his rights under the legal provisions of one Member State to prevent marketing of a patented product in said state when the patented product has been brought into circulation in another Member State by the patentee or with his consent.[9]

While the ECJ, in accordance with the exhaustion doctrine as mentioned above, also assumes that "the substance of a patent right should basically confer the exclusive right on the inventor to the first marketing of the patented product in order to permit a remuneration for the inventive activity",[10] the Court appears to attach more importance to marketing consent than monopolistic rights.

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8 Negative: German Federal Supreme Court, *Centrafarm and Dirk de Fluiter v. Eli Lilly & Co.*, 8 IIC 64 (1977) – *Tylosin*; REIMER, 1972 GRUR Int. 221; BEIER, 1996 GRUR Int. 1; BERNHARD & KRASSER, "Lehrbuch des Patentrechts" 582 (4th ed., 1986=. Positive: Tokyo High Court, 27 IIC 550 (1996) – *BBS Wheels II*; KOPPENSTEINER, 1971 AWD 357; HEATH, IP Asia, October 1995, 5.

9 *Centrafarm B.V. and Adriaan de Peijper v. Sterling Drug Inc.*, 6 IIC 102 (1975) – *Negram III.*

10 *Merck & Co. Inc. V. Stephar*, 13 IIC 70 (1982) – *Merck.*

In cases where products were marketed by the patentee or with his consent in countries of the European Union where no patent was or could have been obtained, the ECJ nevertheless assumed exhaustion.[11] This is of course slightly surprising when measured against the classical theory of exhaustion. If only the first marketing of goods under an exclusive, monopolistic right is sufficient to remunerate the patentee for inventive activities, then marketing in a country where everyone would be free to produce and market the invention could hardly be sufficient.

The consequence of the ECJ's opinion is that for a patentee to receive remuneration under an exclusive right he must either obtain a patent in all Member States of the EU or else refrain from circulating the goods in these countries himself or with his consent. Since patenting in Europe is expensive, and the decision to apply for a patent must be taken long before the marketing potential of an invention is known, the ECJ's point of view is not very convincing in economic terms. In addition, the Court applies the principles of trade mark exhaustion (consent to market the products as the only criterion) to patents. While in the case of trade marks, for function as an indication of origin the trade mark owner's consent is indeed required (otherwise these goods could not be ascribed to the trade mark owner but rather to another source), the rationale for patents should be different.

For a patentee, the patent is the chance to cash in upon the first marketing of products under monopolistic conditions. When products are circulated in a country where patent protection has not been obtained, such monopolistic conditions are absent. On the other hand, if the patentee decides to cash in on his patent not by marketing patented products himself or with his consent, but rather by selling the patent to someone else who subsequently markets the products, then the patentee has obtained his reward and should

[11] *Id.*, for products that were imported from Italy, where they were produced with the consent of the patentee who had not obtained a patent there. *Merck v. Primecrown* [1997] 1 CMLR 83, in the case of voluntary marketing of patented products in Spain and Portugal, where at that time no patent rights could be obtained for pharmaceutical product inventions.

not be able to object to parallel importation of products that were marketed without his consent under a patent he previously owned and sold.

5. Parallel Imports and Principle of Territoriality

The implied licence doctrine under English law only attaches importance to proper notification of distribution limits to all subsequent users of the patented product. The classical exhaustion doctrine suggests, however, that limits to a patent right are inherent rather than dependent upon a patentee's clearly expressed intentions. Applying the principle of international exhaustion, as, *for example*, the Tokyo High Court and Supreme Court have done, has sometimes been objected to by invoking the principle of "territoriality of patents" as expressed in Art. 4^bis^ of the Paris Convention.[12] Domestic patent rights, so the argument runs, because of their territorial scope cannot be limited by acts committed outside such scope. In other words, a Japanese patent could not become exhausted because patented products were marketed in Germany, that is outside the scope of the Japanese patent right. Such an argumentation, however, misinterprets the intention of wording of Art. 4^bis^ of the Paris Convention.[13] Historically, some countries – particularly France – made the existence of a French patent right obtained under the priority of a foreign patent right dependent upon the existence of the latter.[14] Other countries refused to grand a subsequently filed patent a longer term of protection than that of the original one (Brazil, France, U.S.A., Belgium, Italy, and Spain). This principle of dependence of patents, also applied to trade marks under the Madrid Agreement, was found undesirable and indeed contravening the original spirit of the Paris Convention. For this reason, Art. 4^bis^ of the Paris Convention was inserted at the Brussels Conference in 1901, and subsequently clarified at the Washington Conference

12 This has been argued by the German Federal Supreme Court in the *Tylosin* decision, *supra* note 8, and explicitly rejected by the Japanese Supreme Court, *supra* note 4.

13 *See* BEIER, 1 IIC 48 (1970).

14 LADAS, "Patents, Trademarks and Related Rights" 505 *et seq*. (1975).

in 1911.[15] The present wording makes clear that the independence of patents concerns "grounds for invalidation and forfeiture and as regards their normal duration". However, there is nothing in the provision to suggest that developments abroad cannot influence patent rights at all. It is now standard practice that patents are only granted on condition of absolute novelty. Absolute novelty, however, requires taking into account the world-wide state of the art, not only the national one. In a similar fashion, national patent law may decree that foreign acts of marketing may have an effect on the exercise of the patent right with regard to particular goods marketed abroad. Article 4^{bis} of the Paris Convention is concerned with the existence of a domestic patent right, while the exhaustion doctrine concerns acts that "exhaust" further economic exploitation with regard to specific goods marketed under a patent. Under the exhaustion doctrine, the limits of economic exploitation are defined, and the Paris Convention in fact never dealt with this problem in the first place.

6. TRIPs and Parallel Importation

While the Paris Convention may be silent on the issue of parallel importation, other international treaties may influence domestic law on this point. The most important one in the field of intellectual property is the Agreement on Trade-Related Aspects of Intellectual Property Rights concluded in 1994 as a package together with the GATT/WTO Agreement. Indeed, it would be expected from a treaty covering all aspects of intellectual property rights that the matter of parallel importation is also included. Not so. Although it was recognised that parallel importation would indeed fit nicely within the objective of international free trade advocated by GATT,[16] agreement could not be reached to allow generally for parallel importation. In order to overcome this stalemate situation, Art. 6 of the TRIPs Agreement now provides that "for the purposes of dispute settlement under this Agreement, ... nothing... shall be used to address the issue of

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15 Actes de la conference de Bruxelles 311 (1901); Actes de la Conference de Washington 22, 2249 (1911).

16 COTTIER, 28 CMLR 383, 401 (1991).

exhaustion of intellectual property rights." The dispute settlement mechanism in general allows every member to bring an action against another state if there is insufficient compliance with the principles of the GATT/WTO Agreement in general. Yet according to Art. 6, whatever national stance is taken on the matter of exhaustion, no complaint can be heard in this respect. While this certainly means that no country can be put in the dock for deciding for or against international exhaustion, it does not necessarily mean that the TRIPs Agreement as such would not favour either one or the other position.[17]

As this exception relates to procedural matters, it only means that members of the GATT/WTO Agreement cannot be made subject to sanctions, no matter how they decide on international exhaustion. Nevertheless, the agreement may favour explicitly or implicitly a certain solution to the issues of international exhaustion and parallel imports.

One aspect that has been particularly mentioned in this respect is the obligation of members to grant patentees a specific right of importation along with other exclusive rights such as for production and sale. However, to conclude that "[t]his means that substantive patent law under the TRIPs Agreement amounts to a barrier to international exhaustion",[18] is both rash and wrong. An importation right is certainly useful once it comes to preventing counterfeit products entering the country. Without an importation right, the patentee would have to wait until the counterfeit products are put on the market in order to obtain relief. This is certainly undesirable and inadequate. However, it is difficult to argue that the right of importation should follow different rules from the rights of production and sale. The importation right concerns an aspect of economic exploitation equal to that of production and sale. If, under the classical doctrine of exhaustion, further rights in commercial exploitation are exhausted upon the first sale of a patented article, and if such exhaustion is also assumed when such patented article is marketed abroad, then the exhaustion relates to all aspects of other commercial

[17] BRONCKERS, 31 CMLR 1267 (1994); STRAUS, in BEIER & SCHRICKER (eds.), "From GATT to TRIPs" 191 (1996).

[18] *Id.* at 192.

exploitation including importation. The correctness of this argument becomes particularly obvious in the case of re-imports. If a patented article is put on the market in, say, Japan, by the patentee or with his consent, then further acts of economic exploitation are “exhausted”. If the patentee therefore would not be able to prevent further acts of sale and distribution, then it is difficult to see how and why the patentee should be able to exert any influence over this article once it has been exported into another country and subsequently re-imported. If a patentee is granted a bundle of rights under his patent, such as production, sale and importation, then upon the act of first sale, the whole bundle becomes “exhausted” once and for all. Consequently, no importation right can be invoked later on for the very article that has been marketed previously, regardless where this took place.[19]

Concerning the doctrine of common law exhaustion as outlined by the above-mentioned English and Japanese decisions, there is nothing in the TRIPs Agreement to suggest that the importation right cannot be made subject to certain conditions such as giving proper notice to the public about any restrictions in this respect.

The above analysis would only merit a different evaluation once national patent rights were rendered worthless by permitting parallel importation. Such might be the case if the patentee could not object to the importation of products produced in third countries where no patent rights were obtained, since, in theory and practice, this would require a patentee to apply for patents in all possible countries in order to receive at least once proper compensation for putting the goods on the market. However, as yet, no country has permitted parallel imports under these circumstances.

As to the general principles of the GATT/TRIPs Agreement, it should be borne in mind that, first, the GATT/WTO Agreement as such is concerned with removing rather than erecting trade barriers, and, second, that the TRIPs Agreement, far from giving one-

[19] This result seems to be common ground by now. See, e.g., BRONKERS, 32(5) Journal of World Trade, 137. The above example of a re-import product is only meant to highlight the fact that the importation right in general is part of the bundle of economic rights which may become exhausted upon first sale. So-to-speak, it does not lead a life of its own to become exhausted only upon first importation.

sided favours to intellectual property owners, is meant to promote “the mutual advantage of producers and users of technological knowledge in a manner conducive to social and economic welfare, and to a balance of rights and obligations” (Art. 7 TRIPs Agreement).

To read a prohibition of parallel imports into an agreement that is meant to “ensure that measures and procedures to enforce intellectual property rights do not themselves become barriers to legitimate trade”, requires a lot of imagination indeed.

7. Need for Harmonisation

Permitting the parallel importation of patented products under different circumstances in different jurisdictions is certainly not the best of all worlds. For this reason alone, harmonisation in this field looks desirable. However, the GATT/TRIPs negotiations have already exposed the wide differences in opinion on this aspect. The difficulties are both legal and economic.

(1) Adopting the European model of patent exhaustion as it stands at the moment would be impossible on a world-wide scale, as it would bring certain economic disaster to patentees. It would mean that products could be legally imported from wherever the respective products were produced by the patentee or with his consent, regardless of whether there was a patent or not. In order to obtain a reward upon first sale *under a monopolistic right*, the patentee would thereby be required to apply for patents in all countries with possible future production facilities or marketing plants. Given the fact that patents have to be applied for long before the market potential of patented products has become clear, such a solution does not look very attractive to patentees. Therefore, the European decision *Merck v. Primecrown*[20] is also unfortunate because it cannot serve as a world-wide model of exhaustion. The decision is consistent with the “Fortress

[20] *See supra* note 11.

Europe” idea entertained in some circles of the Commission, but it is certainly inconsistent with the Community’s true function to minimise barriers world-wide, not only within Europe (Art. 110 Treaty of Rome).

(2) Also, the solution adopted by the English and Japanese decisions can hardly be imagined as a world-wide model, otherwise the patentee would have to give proper notice to all re-salers involved and most certainly in all relevant languages – an impractical and most likely impossible undertaking.

(3) Banning parallel importation would of course be the patentee’s first choice. But not only would this contravene the spirit of free trade that has been advocated so vociferously in the last decade and manifested in a number of global and regional treaties, it would also have many undesirable economic side effects. It has often been argued that only by preventing parallel imports could patentees respond to price differences in different markets. But it should not be overlooked that patentees can also perpetuate such price differences by shutting off markets, which runs against the grain of a global economy. In addition, responding to price differences by setting different prices in different countries means nothing else than consumers in high-price countries subsidising consumers in low-price countries. This is questionable in times where subsidies in general are controversial, and it is particularly dubious in the case of subsidies that have no democratic legitimacy whatsoever. Market democracy rather than entrepreneural dictatorship should be the rule of the future. But entrepreneurs are responsible to their shareholders, and not to the general public. Thus, slapping surcharges on consumers in industrialised countries by enterprises that are accountable to their shareholders rather than the general public does not appear to be a very enticing solution. It is of course also questionable as to what extent higher prices in industrialised countries really benefit consumers in developing countries.

(4) This leaves a classical theory of exhaustion, whereby the patentee should be given one opportunity to release the patented goods under the monopolistic conditions of a patent right. This theory would exclude parallel imports from countries where the

patentee is operating, but has not obtained a patent right. It would also exclude parallel importation of products that have been put on the market under a compulsory licence or under schemes of price control. Put into practice, this would help to create free-market conditions in two ways. It might encourage governments to put an end to price-control schemes, on the one hand, and, on the other, it will help free-market forces to prevail over price differences that exist despite free-market conditions.