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Intellectual Property Rights and International Free Trade: New Jurisprudence of International Exhaustion Doctrine under the Traditional Legal System

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Abstract. *The interaction between the exhaustion of intellectual property rights and the parallel importation has been being one of the most controversial issues under international intellectual property laws. Consequently, the main purposes of this article is to assure that intellectual property law—in particular, the exhaustion doctrine—is best fit to deal with the issue of the conflict between intellectual property rights and international free trade. Meanwhile, this article is also to determine that the international exhaustion doctrine is the optimal legal model for the harmonization goal through examining the theoretical arguments and observing legal experience in the global community.*

I. Introduction

The interaction between the exhaustion of intellectual property rights and the parallel importation has been one of the most controversial issues under international intellectual property laws. This issue arouses the strained conflicting positions in both the protection of intellectual property rights and the maintenance of international free trade. Since each country in the global community has faced discrepant political, economic and social backgrounds, the divergent exhaustion doctrine is preferred around the global community—basically, while the developing countries are dedicated to expanding the scope of the exhaustion doctrine, the developed countries tend to stick to more protection on intellectual property rights. The internationally undecided status in the adoption of the exhaustion doctrine also led to the fact that the WTO (World Trade Organization) and the WIPO(World Intellectual property Organization) gave up proposing the uniform exhaustion doctrine, leaving the member states absolute discretion in deciding the scope of the exhaustion doctrine.

Nonetheless, there are two main potential defects in the attitude held by the WTO and the WIPO. One is reflected in the worry about whether the national decision of the exhaustion doctrine is exactly based on reconciling the protection of intellectual property rights and the maintenance of international free trade, some other factors irrelevant to intellectual property laws being excluded in the decision of the exhaustion doctrine. If the exhaustion doctrine is used to achieve the policy goals outside of intellectual property laws, the protection of intellectual property rights would be excessively developed.

Another concern involves the possibility that some developed countries with strong bargaining power would force the developing countries to adopt the exhaustion doctrine favourable to the fulfilment of the specific economic policy of the developed countries through bilateral or multilateral trade negotiations. This potential result would break down the original balance mechanism established by the exhaustion doctrine between the two conflicting interests of intellectual property rights and international free trade, and distort international free trade.

In view of the potential defects in the international undecided attitude about the exhaustion doctrine and the consequential influence, in this author's view, it is necessary to establish a globally harmonized exhaustion doctrine in the WTO or WIPO to implicate the optimal interest balance between intellectual property rights and

international free trade. Consequently, the main purposes of this article is to assure that intellectual property law—in particular, the exhaustion doctrine—is the optimal legal approach to deal with the issue of the conflict between intellectual property rights and international free trade. Meanwhile, this article is also to determine that the international exhaustion doctrine is the optimal legal model for the harmonization goal by examining the theoretical arguments and observing legal experience in the global community.

This article is divided into five sections. The first section is the introduction for this article. The second mainly indicates the two conflicting interests between the protection of intellectual property rights and the maintenance of international free trade that are reflected in the cases of parallel importation. Another core content of section two (2) is to determine whether intellectual property laws (the exhaustion doctrine) are best fit to deal with the issue of parallel importation to balance the interest consideration under both intellectual property rights and international free trade.

Section 3 concentrates on the theoretical and academic debates over the application of the international exhaustion doctrine on the issue of parallel importation. There are two parts in the debates—while one is based on the policy consideration, the other is according to the economic analysis. Regarding the policy and economic arguments, this chapter bifurcates the positions into the two groups—one for the international exhaustion doctrine and the other against the doctrine. Section 4 contains the arguments supporting the international exhaustion doctrine in section three,. The dissertation indicates, in terms of laws and international trade practices, the weak theoretical basis and misconception about the gist of intellectual property laws on the arguments against the international exhaustion doctrine. In addition, from the angle of the observation of legal experience in the global community, it is found that the harmonized international exhaustion doctrine would not bring about the unbearable impact in the global community. Consequently, the international exhaustion doctrine is concluded as an optimal legal model. Moreover, this article also probes into the issues about the application of the international exhaustion doctrine to determine whether the international exhaustion doctrine should be indiscriminately applied to various intellectual property rights, re-importation, and different goods embodied with intellectual property rights. Section five develops the conclusion of this article.

2. Intellectual Property Rights and International Free Trade—The Interests Conflicting in Terms of Parallel Import and the Legal Approach for Resolution

2.1 The Exclusive Rights against Distribution of Goods under Intellectual Property Laws

The exclusive right under intellectual property rights against the distribution of goods is the focus of the cases of parallel imports. The distribution right, through legislation or legal interpretation, under patent law, trademark law, copyright law, is a potential threat to parallel imports.

2.1.1 Patent Law

The legislative purpose of patent law is mainly to provide inventors with a limited monopoly and sufficient incentives to engage in creating or inventing new technologies benefiting people around the country.[1] Generally speaking, the protection of patent law, in terms of an international comparative perspective, reaches out to infringement during manufacture and infringement after manufacture.[2] Infringement during manufacture is the

[1] Clause 8 of Section 8, Article I of the Constitution of the United States: "To promote the Progress of Science and useful arts, by securing for limited Times to Authors and Inventors the exclusive Right to their respective Writings and Discoveries;" ; *See also* Martin J. Adelman et al., Cases and Materials on Patent Law § 1.5[a][1] (3d ed. 2009) [hereinafter MARTIN J. ADELMAN ET AL., PATENT LAW]; F. SCOTT KIEFF ET AL., PRINCIPLE OF PATENT LAW-CASES AND MATERIALS 66-67 (4th ed. 2008) [hereinafter F. SCOTT KIEFF ET AL., PATENT LAW]; ROBERT P. MERGES ET AL., INTELLECTUAL PROPERTY IN THE NEW TECHNOLOGICAL AGE 23 (2d ed. 2000) [hereinafter MERGES ET AL., INTELLECTUAL PROPERTY]; W.R. CORNISH, INTELLECTUAL PROPERTY: PATENTS, COPYRIGHTS, TRADE MARKS AND ALLIED RIGHTS ¶¶ 3-38 to -48 (5th ed. 2003) [hereinafter CORNISH, INTELLECTUAL PROPERTY].
[2] *See* CORNISH, INTELLECTUAL PROPERTY ¶¶ 6-09 to -20.

illegal copy or imitation of the patented products or the patented invention process.[3] Infringement after manufacture occurs when patented products or products manufactured under a patented invention process, regardless of the illegal copies or authorized ones, are sold, offered to sell, or imported without patentee's consent.[4] From the angle of infringement after manufacture, patent law creates an exclusive right related to the marketing of the patented products or the products under patented process, that is, the patentee has an exclusive right to control the distribution of goods in the local market, even blocking goods from coming into the local market from the foreign countries.

2.1.2. Trademark Law

Traditionally, trademark law is used to protect the first user of trademark in commerce from likelihood of confusion of the two marks occurring when the subsequent users employ the same or similar trademark.[5] The protection reflects consideration of two interests—consumer's interest and trademark owner's interest.[6] On consumer's interest, the traditional protection of trademark serves a function of source indicator, assisting consumers in finding the accurate commercial commodities by the evaluation of trademark in mind under a low search cost.[7] The consideration of trademark owner's interest drives a guarantee of product quality because trademark law awards the trademark owner sufficient incentive to maintain or improve the qualities of the commodities.[8]

Lately, trademark protection has evolved to cover the economic value of a trademark being formed through the trademark owner's investment in developing commodities and creating goodwill.[9] As a result, the dilution of the reputed trademark becomes a kind of infringement under trademark law. [10]

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[3] *See* 35 U.S.C. § 271(a) (2003) ("Except as otherwise provided in this title, whoever without authority makes, uses... any patented invention, within the United States…during the term of the Patent therefor, infringes the patent."); *See also* Article 25 of Convention for the European Patent for the Common Market, 1976 Q.J. (L401) 1-28 [hereinafter the Proposed Community Patent Convention] (The convention is proposed for establishment of community patent and harmonization of patent law within the European Economic Community and amended in 1989, but never ratified by all Member States. *See Hanns Ullrich, Patent Protection in Europe: Integrating Europe into the Community or the Community into Europe?*, 8 EUR. L.J. 437-38 (2002).); Article 7 of Proposal for a Council Regulation on the Community Patent, Council document 7119/04, 8 March 2004[hereinafter Compact 2004]; Article 28 of Agreement on Trade-Related Aspects of Intellectual Property Rights, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization [hereinafter the WTO Agreement], Annex 1C, LEGAL INSTRUMENTS—RESULTS OF THE URUGUAY ROUND vol. 31, 33 I.L.M. 81 (1994) [hereinafter the TRIPS Agreement].

[4] *See* 35 U.S.C. § 271(a) (2003) ("Except as otherwise provided in this title, whoever without authority…offers to sell, or sells any patented invention, within the United States or imports into the United States any patented invention during the term of the patented therefore, infringes the patent."); *See also* Article25 of the Proposed Community Patent Convention; Article 28 of the TRIPS Agreement.

[5] *See* MERGES ET AL., INTELLECTUAL PROPERTY, *supra* note 1, at 559; Polaroid Corp. v. Polarad Elecs. Corp., 287 F.2d 492, 495 (2d Cir. 1961); AMF v. Sleekcraft Boats, 599 F.2d 341, 346 (9th Cir. 1979).

[6] *See* TIMOTHY H. HIEBERT, PARALLEL IMPORTATION IN U.S. TRADEMARK LAW 21-24 (1994) [hereinafter HIEBERT, PARALLEL IMPORTATION].

[7] *See* JEREMY PHILLIPS, TRADE MARK LAW ¶¶ 2.24 to .29 (2003); CORNISH, INTELLECTUAL PROPERTY, *supra* note 1, ¶ 15-24. *See also* WILLIAM M. LANDES & RICHARD A. POSNER, THE ECONOMIC STRUCTURE OF INTELLECTUAL PROPERTY LAW 166-68 (2003) [hereinafter LANDES & POSNER, INTELLECTUAL PROPERTY LAW] ("The benefits of trademarks in lowering consumer search costs presuppose legal protection….")

[8] *See* HIEBERT, PARALLEL IMPORTATION, *supra* note 6, at 3-6.

[9] The dilution theory of trademark is introduced to the United States by Professor Frank I. Schechter through his classic article "The Rational Basis of Trademark Protection". *See* Frank I. Schechter, *The Rational Basis of Trademark Protection*, 40 HARV. L. REV.813 (1927). Regarding the development of the dilution theory under trademark law, see TONY MARTINO, TRADEMARK DILUTION (1996).

[10] *See* 15 U.S.C. § 1125(c) (1999); Article 5(2) of First Council Directive 89/104/EEC of 21 December 1988 to approximate the laws of the Members States Relating to Trade Marks, 1989 Q.J. (L040) 1-7 [hereinafter E.C. Trademark Directive]; Moseley v. V Secret Catalogue, Inc., 537 U.S. 418 (2003); Nabisco, Inc. v. PF Brands, Inc., 191 F.3d 208 (2d Cir. 1999); Ringling Bros.-Barnum & Bailey Combined Shows, Inc. v. Utah Div. of Travel Dev., 170 F.3d 449 (4th Cir. 1999); Wagamama Ltd. v. City Cenre Restaurant, [1995] F.S.R. 713 (U.K. Case); Baywatch Prod. Co. Ltd. v. Home Video Channel, [1997] F.S.R. 22.

The use of trademark in commerce is an important factor to reserve rights in trademark.[11] For the same reason, infringement under trademark law is rested on the use of trademark in commerce. The use of trademark for infringement under trademark law, in terms of a global comparative perspective, consists of affixing trademark to the package of goods, trading goods under trademark, importing or exporting goods under trademark and advertising with trademark.[12] Among the use types of infringement, trading goods and the imports or exports of goods are related to the distribution of the goods. Consequently, the trademark owner has the exclusive right to block the distribution of the goods, provided that the junior's trademark use on trading, imports, or exports constitutes the likelihood of confusion or dilution of the senior's trademark.

2.1.3 Copyright Law

Unlike patent law and trademark law, under which an exclusive right against the distribution of the goods is created through interpreting the prohibition of sales or imports, the distribution right under copyright law, in terms of a global comparative perspective, directly gives the copyright owner the exclusive right to control the first public distribution of the copyrighted works.[13] The infringement of the distribution right can occur without illegally reproducing the copyrighted works.[14] From this, the copyright owner can use the distribution right to prevent the movement of goods in the market, if anyone put the copies of the copyrighted work into market for the first distribution without authorization.

2.2 The Globally Harmonized Free Trade Principle

The globally accepted free trade principle is driving the international free movement of goods and the global prosperous economy. It is also a focus in the cases of parallel imports if the free trade principle will be applied to parallel imports, and further protects parallel imports from the protection of the distribution right under intellectual property laws. It is important to affirm the free trade principle by observing the related provisions of the World Trade Organization, the European Union, and some free trade areas.

2.2.1 The World Trade Organization

The World Trade Organization (WTO) is an international organization with global common agreements binding the governments of Members to establish the environment of international free trade and solve transnational trade disputes. It is the successor of the General Agreement on Tariff and Trade (GATT). The establishment of WTO is the result of the Uruguay Round of Multilateral Negotiation of the GATT in 1994.[15] According to the Marrakesh Agreement Establishing the World Trade Organization (the WTO Agreement), the agreements binding Members consist of the GATT 1994 and all agreements annexed to the WTO Agreement.[16] Among the package of agreements, the GATT 1994, generally, incorporates the GATT 1947 and terminates the application of the GATT 1947.[17]

The GATT has been playing an important role in promoting international free trade by reducing the trade barriers since it was made. When the character of the international organization is transiting to the WTO, undoubtedly the WTO takes the responsibility to achieve the goal of international free trade. The free trade

[11] *See* 15 U.SC. §§ 1115(b)(2), 1127 (1999) (Abandonment of Trademark); E.C. Trademark Directive, *supra* note 10, Article 10-12 (Non-Use of Trademark).
[12] *See* 15 U.S.C. §§ 1114, 1124-25 (1999); E.C. Trademark Directive, *supra* note 10, Article 5.
[13] *See* 17 U.S.C. § 106(3) (2002); Article 4 of Directive 2001/29/EC of the European Parliament and of the Council of 22 May 2001 on the harmonization of certain aspects of copyright and related rights in the information society, 2001 Q.J. (L167) 10-19 [hereinafter E.C. Copyright Directive].
[14] *See* MARSHALL LEAFFER, UNDERSTANDING COPYRIGHT LAW § 8.13 (4th ed. 2005).
[15] *See* MITSUO MATSUSHITA ET AL., THE WORLD TRADE ORGANIZATION 5-6 (2003) [hereinafter MITSUO MATSUSHITA ET AL., THE WTO].
[16] *See id.* at 7-8.
[17] *Id.* at 9.

principle of the WTO is reflected in Article XI (1) (General Elimination of Quantitative Restrictions) of the GATT 1994,[18] and is also used to form the boundary of intellectual property protection under Agreement on Trade-Related Aspects of Intellectual Property Rights (the TRIPS Agreement) in view of the possible conflict between the safeguard of free trade and the protection of intellectual property rights.[19]

2.2.2 The European Union

The European Union is the most important customs union in the world.[20] The European Union originates from the European Coal and Steel Community (ECSC) in 1951. Then, in order to establish a customs union within the six founding countries of ECSC (Belgium, France, Germany, Italy, Luxembourg and Netherlands) through the Treaty Establishing the European Community (the Treaty of Rome) in 1957, the European Economic Community (EEC) was formed. In 1992, according to Treaty on European Union (the Masstricht Treaty), the EEC is renamed into the European Community (EC), and becomes part of the EU.

As a customs union, the paramount goal of the EU is to establish an internal common market within the territory of the EU. To achieve the goal, neither tariff nor other trade barriers between Member States are necessary. Compared with the free trade principle under the WTO to establish the international trade competitive environment, the free trade principle under the EU has more emphasis on the free movement of goods in the internal common market.[21] This is reflected in the requirement of elimination of custom duties and prohibition of quantitative restrictions between Member States according to the Treaty Establishing the European Community amended and renumbered by the Amsterdam Treaty of 1997, the Nice Treaty of 2001 and the Lisbon Treaty of 2007 [hereinafter the European Community Treaty].[22]

2.3 The Free Trade Areas

A free trade area is formed by free trade agreements of a group of countries. Within the free trade area, according to the free trade agreements, member states are bound to reduce or eliminate the trade barriers among themselves to create a region of free trade. However, different from the customs union, the purpose of a free trade area is not to establish a common market. The member states of a free trade area have the right to employ tariffs or impose custom duties against other states. Usually, the establishment of a free trade area might be the first step to form a customs union.

The free trade principle is driven throughout the trades within the free trade area because the environment of no custom duty and trade barrier expects to be built. This is reflected in the free trade agreements of the current free trade areas.[23]

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[18] Article XI (1) of General Agreement on Tariff and Trade (1994) [hereinafter the GATT 1994]:

> No prohibitions or restrictions other than duties, taxes or other charges, whether made effective through quotas, import or export license 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 of export of any product destined for the territory of any other contracting party.

[19] *See* the TRIPS Agreement, *supra* note 3, at preamble ("…Desiring to reduce distortions and impediments to international trade, and taking into account the need to promote effective and adequate protection of intellectual property rights, and to ensure that measures and procedures to enforce intellectual property rights do not themselves become barrier to legitimate trade…")

[20] Regarding the history of the European Union [hereinafter the EU], see RALPH H. FOLSOM, EUROPEAN UNION LAW 1-30 (3rd ed. 1999).

[21] *See* Frederick M. Abbott, *First Report (Final) to the Committee on International Trade Law of the International Law Association on the Subject of Parallel Importation*, 1 J. OF INT'L ECON. L. 607, 618 (1998) [hereinafter Abbott, *First Report*].

[22] *See* Article 25, 28, 29 of the Treaty Establishing the European Community (2001). See also Article 30, 34, 35 of Consolidated version of the Treaty on the Functioning of the European Union, OJ 2010/C 83/01, 30 March, 2010) [hereinafter the European Community Treaty].

[23] *See, e.g.*, Article 102(a), 301, 302, 309 of North America Free Trade Agreement [hereinafter the NAFTA] (The parties of the agreement are the United States, Canada and Mexico); Article 10, 11, 12 of Agreement on the European Economic Area [hereinafter the EEA Agreement] (Parties of the agreement include 3 members of the European Free Trade Association

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2.3 Parallel Imports and Ignition of the Interest Conflict

Parallel imports are a distinctive kind of trades. Traditionally, parallel imports are often connected with gray markets, and are rarely distinguished from gray markets. It is necessary to ascertain the definition and the scope of parallel import and the relation of parallel imports with gray markets before discussing the issue of parallel imports.

Although the parallel import is not different from the ordinary import in the international trade practice, its implication under law is complicated. It leads to a possible conflict between intellectual property rights and free trade. The measurement of the two conflicting interests will be a basis for selecting the legal approach to resolve the issue of parallel imports.

2.3. 1. Parallel Imports and Gray Markets

Both parallel imports and gray markets indicate the same phenomenon of international trade—unauthorized imports, though it seems that the two terms are different in terms of semantics.[24] Usually, for the efficient distribution of products, especially in the international marketing, the manufacturer may arrange the hierarchical distribution channels to market its products by establishing the distribution agents or cooperating with other distributors not affiliated with the manufacturer. The unauthorized imports occur when products are imported to the country of the manufacturer through the marketing channels other than the designated ones, or when the import of products is beyond the marketing schedule, that is, the import is not the manufacturer's intention. Most scholars, interpreting the parallel import or the gray market, tend to connect the unauthorized imports with intellectual property rights to emphasize the strained tension existing between international trade and intellectual property rights,[25] although, theoretically, there is some possibility that the authorized imports occur without any relation to intellectual property rights. The manufacturer as an owner of patent, trademark or copyright can control the movement of its products. Consequently, the problem of parallel imports or the gray markets will create an issue of whether the owner of intellectual property rights can block the unauthorized import under law. According to the comparative law perspective, judiciary cases and case law regarding parallel imports or gray

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[hereinafter the EFTA]—Iceland, Liechtenstein, and Norway, the European Community and 25 other European Countries; Articles 4 and 5 of Agreement on the Common Effective Preferential Tariff Scheme for the ASEAN Free Trade Area (Members of Association of Southeast Asia Nations (ASEAN) are Brunei Darussalam, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand and Vietnam); Protocol to Amend the Agreement on the Common Effective Preferential Tariff (CEPT) Scheme for the ASEAN free Trade Area (AFTA).

[24] *See* THOMAS HAYS, PARALLEL IMPORTATION UNDER EUROPEAN UNION LAW ¶ 1.01 (2004) [hereinafter HAYS, PARALLEL IMPORTATION]; Marshall Leaffer, *Parallel Importation and the Gray Market in the United States*, *in* INTELLECTUAL PROPERTY LAW & POLICY (Volume 1) 351 (Huge C. Hansen ed., 1996) [hereinafter Leaffer, *Gary Market*]. *See* also WARWICK A. ROTHNIE, PARALLEL IMPORTS 1 (1993) ("[T]he [parallel] imports may be described as being imported in 'parallel' to the authorised distribution network") (alteration in original) (note omitted).

[25] *See*, *e.g.*, Kerrin M. Vautier, *Economic Consideration on Parallel Imports*, in PARALLEL IMPORTS IN ASIA 1-11 (Christopher Heath ed., 2004) [hereinafter Vautier, *Economic Consideration*]; HAYS, PARALLEL IMPORTATION, *supra* note 24; W. R. Cornish, *The Free Movement of Goods I: Pharmaceutical, Patent and Parallel Trade*, *in* PHARMACEUTICAL MEDICINE, BIOTECHNOLOGY AND EUROPEAN LAW 11-24 (Richard Goldberg & Julian Lonbay eds., 2000) [hereinafter Cornish, *Parallel Trade*]; Nacy T. Gallini & Aidan Hollis, *A Contractual Approach to the Gray Market*, 19 INT'L REV. L. & ECON. 1 (1999); Herman Cohen Jehoram, *Prohibition of Parallel Imports through Intellectual Property*, 30 IIC 495 (1999) [hereinafter Jehoram, *Parallel Imports*]; Abbott, *First Reports*, *supra* note 21; Marshall Leaffer, *Gray Market*, *supra* note 24; HIEBERT, PARALLEL IMPORTATION, *supra* note 6; ROTHNIE, PARALLEL IMPORTS, *supra* note 24; SETH E. LIPNER, THE LEGAL AND ECONOMIC ASPECTS OF GARY MARKET GOODS (1990) [hereinafter LIPNER, GARY MARKET GOODS].

markets run the same track with the academic interpretation to resolve the entanglement between unauthorized imports and intellectual property rights.[26]

Generally speaking, there are three elements forming parallel imports or gray market. The first element is that products are imported from a foreign market to the native market of the manufacturer for competition. The second one rests on the authorization of the owner of intellectual property rights. In other words, the products (inventions, commodities affixed with trademark, or copyright works) are imported without consent of the manufacturer (patentee, trademark owner or copyright owner) because the non-designated distributors usually have no license for patented products, trademarked commodities and copyrighted works from the manufacturer. The source of parallel imports or gray markets may come from the licensed distributor by the licensee's breach of the licensing agreement to import the products into the market of the manufacturer. Additionally, it is possible for unlicensed distributors or the third parties to purchase the products from the licensee, and then import them into the native market.

The final element for parallel imports or gray markets requires that the products imported from a foreign market must be genuine, [27]and be under the same invention, brand or copyright work as the original products in the native market. If the products are counterfeit or made through imitation, the manufacturer can prevent them from direct import according to intellectual property laws. This situation is called "black market". Nevertheless, the reason that "gray market" is "gray" is that the genuine products never violate intellectual property laws, but the unauthorized import sparks a dispute about whether the import infringes in the distribution right under intellectual property laws. As a result, this uncertainty is within the "gray" zone under law.

Further, a query is produced for the scope of parallel import: whether the re-importing of the products may be thought of or treated as the parallel import under law. Unlike the products of parallel import made in foreign countries, the products re-imported are manufactured in the market of the manufacturer, and exported into foreign markets according to the marketing scheme. However, as the products of parallel import, the re-imported products are imported into the native market. Although judiciary cases under law and case law, according to the comparative law perspective, seem not to put much emphasis on the issue,[28] the academic comments are divided into two different positions—one supporting no distinction between the two,[29] and the other expressing a different treatment for the two.[30] In this author's opinion, the core of parallel import or gray market focuses on the unauthorized import and the control of intellectual property rights over the import. The manufacture place of the genuine products is not a sufficient ground to make the re-import stay out of the scope of the parallel import and have different treatment under the law.

Finally, few academic comments and judicial cases mention the relation between parallel imports and gray markets.[31] Parallel imports and gray markets are often given the same meaning. In this author's opinion,

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[26] Regarding the U.S. cases, see generally Quality King Distribs., Inc. v. L'anza Research Int'l, Inc. 523 U.S. 135 (1998); K-Mart Corp. v. Cartier, Inc., 486 U.S. 281 (1988); Boesch v. Graff, 133 U.S. 697 (1890). As to the European Union [hereinafter the E.U.], see ECJ Case 355/96, Silhouette International Schimied GmbH & Co. KG v. Hartlauer Handelsgesellschaft mbH, [1998] E.C.R. I-4799, [1998] 2 C.M.L.R. 953 (1998) [hereinafter *Silhouette v. Hartlauer*]; ECJ Joint Cases 267/95 and 268/95, Merck & Co., Inc. v. Primecrown and Beecham Group plc v. Europharm of Worthington, Ltd., [1996] E.C.R. I-6285, [1997] 1 C.M.L.R. 83 (1996) [hereinafter *Merck v. Primescrown*]; Case 158/86, Warner Bros. Inc. and Metronome Video, aps v. Christiansen, [1998] E.C.R. 2605, [1990] 3 C.M.L.R. 684 (1988) [hereinafter *Warner Bros. v. Christiansen*].

[27] *See* Cornish, *Parallel Trade*, *supra* note 25, at 11; Jehoram, *Parallel Imports*, *supra* note 25, at 495; Hugh C. Hansen, *Protection of Intellectual Property Rights at the Border: Continuing Battle over "Parallel Imports"*, 536 PLI/Pat 39, 41 (1998); Leaffer, *Gray Market*, *supra* note 24, at 351.

[28] *See Quality King Distribs., Inc.*, *supra* note 26.

[29] *See* Christopher Heath, *Parallel Imports and International Trade*, 28 IIC 623, 628-29 (1997) [hereinafter Heath, *Parallel Imports*]; J.S. Chard & C.J. Mellor, *Intellectual Property and Parallel Imports*, 12 THE WORLD ECON. 69, 70 (1989).

[30] *See* Thomas Hays & Peter Hansen, *Silhouette is not the Proper Case upon Which to Decide the Parallel Importation Question*, E.I.P.R. 1998, 20(7), 278-79 [hereinafter Hays, *Silhouette*].

[31] Professor Leaffer has given a vivid description about the relation between parallel imports and the gray market: "In some instances, the U.S. trademark owner is an importer of the goods as well, in which case the gray market goods are known as 'parallel importation'". *See* Leaffer, *Gray Market*, *supra* note 24, at 351.

parallel imports mainly emphasize the unauthorized imports from foreign markets. The gray market is formed after the parallel imports, which focuses on the coexistence and competition of the genuine products imported and the products under the same brand, the same invention or the same copyright work originally circulating in the native market.

2.3.2 Parallel Import's Implication of Interest Conflict between Intellectual Property Rights and International Free Trade

Parallel imports, as unauthorized imports, encourage the intra-brand competition, unlike the inter-brand competition of ordinary imports under the arranged marketing channels, because usually they bring the same products manufactured in the foreign country into the market of the manufacturer to compete with the originally circulated products.[32] The threat of parallel imports to the manufacturer is the cheap price offered by the parallel importer as to the same product. Generally, the price of the imported products is below the price in the native market, even though the parallel importers bear the transportation cost.[33] With high competitive capability on price, theoretically and without the consideration of other factors, the imported products would supplant the same ones in the native market. Consequently, the sale revenue of the manufacturer would decrease due to the price advantage of the imported products.

The inducement of parallel imports mainly comes from the formation of the environment with the difference of price.[34] The difference of price leads to the room of arbitrage, that is, the parallel importer purchases the cheaper products in the foreign market, and then imports them into the native market with an advantageous price to invade the market share of the manufacturer.[35] The global environment with the difference of price as to the same product may be made by the change of the exchange rate between currencies or the price discrimination strategy of the manufacturer. When the currency in the import country appreciates and the product price is not adjusted according to the currency change, the environment with the difference of price automatically looms to attract the parallel importers to enter the native market.[36] On the occasion of the price discrimination, unlike the environment with difference of price formed by the change of the international economy, the different price is manipulated by the manufacturer.[37] In order to make an efficient marketing, the manufacturer usually sets up an individual price as to the same product in the different market according to the purchase capability and other factors in each market.[38] Therefore, the parallel importer may obtain the product sources in a cheap market and then deliver the products to the market with the advantageous price for sale.

The free-riding act is also a possible factor to aggravate the difference of price in the international markets.[39] On the import and marketing of the products, the parallel importer usually just enjoys the fruitful result of promotion of the products in the native market without contribution to efforts the manufacturer has made.

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[32] *See* Vautier, *Economic Consideration*, *supra* note 25, at 5-7; Hugh C. Hansen, *International Exhaustion: A Policy and Psychological Analysis of the Debate*, *in* INTELLECTUAL PROPERTY LAW & POLICY (Volume 6) 114-2 to -5 (Huge C. Hansen ed., 2001).

[33] *See* LIPNER, GARY MARKET GOODS, *supra* note 25, at 3; ROTHNIE, PARALLEL IMPORTS, *supra* note 24, at 1.

[34] *See* David A. Malueg & Marius Schwartz, *Parallel Imports, Demand Dispersion, and International Price Discrimination*, 37 J. INT'L ECON. 167, 169-170 (1994); Robert J. Staaf, *International Price Discrimination and the Gray Market*, 4 I.P.J. 301, 325 (1989) [hereinafter Staaf, *Price Discrimination*].

[35] *See* Vautier, *Economic Consideration*, *supra* note 25, at 4.

[36] *See* Leaffer, *Gray Market*, *supra* note 24, at 351; LIPNER, GARY MARKET GOODS, *supra* note 25, at 3-4.

[37] *Cf.* Staaf, *Price Discrimination*, *supra* note 34, at 327 ("Price discrimination resulting from trade restrictions is not caused by market, but rather government, power").

[38] *See* Vautier, *Economic Consideration*, *supra* note 25, at 3.

[39] *See* OECD, Joint Group on Trade and Competition, *Synthesis Report on Parallel Imports*, COM/DAFFE/COMP/TD (2002)18/FINAL, at 8-9 [hereinafter *the OECD Report*]. *But see* Robert J. Staaf, *The Law and Economics of the International Gary Market: Quality Assurance, Free-Riding and Passing Off*, 4 I.P.J. 191, 235 (1989) [hereinafter Staaf, *Free-Riding*] (The author thinks that the free-rider argument is weakened when the parallel importer charges a lower price and offers the same quality and services as the authorized sellers).

Moreover, the parallel importer rarely provides any warranty and service about the sale of products. The saving of the promotion cost and the warranty cost for the parallel importer imperceptibly fosters the difference of price between the importing country and the exporting country.[40]

The issue of parallel imports under law or economy has been complicated, even though the value of the parallel import just stands a small part of the total import value in the global trade.[41] In particular, when parallel imports involved the law aspect, they spark important disputes about whether parallel imports should be protected or prohibited under intellectual property rights, and how to achieve this policy goal.[42] Up to now, the dispute has not been settled in the global community.[43] Basically, the issue of parallel imports involves the collision of the free trade principle with the protection of intellectual property rights because the manufacturer in the native market is usually the owner of intellectual property rights. [44] Parallel imports are an importing act. Under the free trade principle, the parallel imports of products should not be restrained by any quantitative trade restriction of governments. Through the elimination of the trade barriers, the international market can ensure the free movement of goods and the sufficient competition of commodities so that the customers have a chance to enjoy the benefit under the competitive prices. However, it is not certain under legal interpretation whether allowing intellectual property rights to block parallel imports under law constitutes a quantitative trade restriction of a government, and whether unlimited protection of intellectual property rights indeed impedes the free trade of products.

From the angle of the protection of intellectual property rights, the distribution right under intellectual property laws gives the owner a right to control the movement of goods and further decide whether the products may be imported according to its interest assessment. If the free trade principle can exceed the consideration of intellectual property rights, that is, the parallel import is free from prevention, the incentive of the owner of intellectual property rights to invent, create or market new things will be weaken.[45] The owner of intellectual property rights will also consider quitting from the international market because the cheap products manufactured in the foreign markets are often used by the parallel importer to put its own original products in the native market and cut off the source of revenue that is necessary to maintain the basic incentive under intellectual property rights. [46]

The issue of parallel imports reveals that its resolution needs to consider the two conflicting interests - the interest of free trade with a reflecting benefit on customers and the interest of intellectual property rights. Consequently, it is important to balance the two interests while seeking a legal method to deal with the issue of parallel imports.

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[40] *See* Leaffer, *Gray Market*, *supra* note 24, at 352.
[41] The value of parallel imports per year in the U.S. is estimated at $10 billion. *See Id.* However, according to the statistics made by the World Trade Organization [hereinafter the WTO], the import value of the merchandise of the U.S. in 2007 is $2,020.4 billion. *See* The WTO, *International Trade Statistics 2007*, Table 1.8 Leading Exporters and Importers in world merchandise trade, 2007, at 12, *available at* http://www.wto.org/english/res_e/statis_e/its2008_e/its08_world_trade_dev_e.pdf (last visited Oct. 3, 2010) (on file with author). Additionally, the percentage of parallel import value in the total market value among six main countries of parallel imports in the EU is from 5% to 15%. *See* TIMOTHY J. ATKINSON, REUTERS BUSINESS INSIGHT, THE GLOBAL PARALLEL TRADE OUTLOOK 2001-2006: A COUNTRY-BY-COUNTRY ANALYSIS 96-97 (2001).
[42] *See* Abbott, *First Reports*, *supra* note 21, at 608. On interest conflicts of international trades between developed countries and developing ones, please see Robert L. Ostergard, Jr., *Economic Growth and Intellectual Property Rights Protection: A Reassessment of the Conventional Wisdom*, *in* INTELLECTUAL PROPERTY, TRADE AND DEVELOPMENT—STRATEGIES TO OPTIMIZE ECONOMIC DEVELOPMENT IN A TRIPS-PLUS ERA 155 (Daniel Gervais ed., 2007).
[43] *See* the TRIPS Agreement, *supra* note 3, Article 6 ("For the purpose of dispute settlement under this Agreement, subject to the provisions of Article 3 and 4 nothing in this Agreement shall be used to address the issue of the exhaustion of intellectual property rights.")
[44] *See* Abbott, *First Reports*, *supra* note 21, at 608.
[45] *See the OECD Report*, *supra* note 39, ¶ 52, at 16.
[46] *See* Malueg & Schwartz, *supra* note 34, at 190.

2. 4 Balancing Intellectual Property Rights and International Free Trade in Terms of Parallel Imports by Intellectual Property Laws

In order to resolve the issue of parallel imports and balance the conflicting interests between free trade and intellectual property rights, it is necessary to find an appropriate approach or a combination of approaches under the legal system. When the legal approach is chosen, then the next concern will be how to use it to resolve the disputed issues through incorporating a policy or economic consideration into legislation and legal interpretation.

Under intellectual property laws, the exhaustion doctrine, regardless of its theoretical basis from the Anglo-American law system or the continental law system, is used to deal with the issue of parallel imports. The exhaustion doctrine operates to release the control of the intellectual property owner over the disposal of the products by exhausting the related intellectual property right—the distribution right. It appears on the surface that the exhaustion doctrine favours the parallel importer. As a matter of fact, it is not the case. The doctrine is justified on the interest consideration of both intellectual property rights and the disposal of ownership. It gives the owner of intellectual property rights an exclusive right to market the products protected under intellectual property rights for the initial sales. When the first sale of the products is done, the reward is assumed, and intellectual property rights governing the distribution of goods are terminated, that is, under no circumstances can the owner of intellectual property rights control the second time of or later sales conducted by the successive buyers. Consequently, the doctrine, in the issue of parallel imports, is more effective to probe into the reward for intellectual property rights and the impact on the free trade of products. By drawing a definite boundary for the protection of intellectual property rights—the first sale—it reconciles the interest conflicts between free trade and intellectual property rights.

Nevertheless, the deficiency in the exhaustion doctrine is reflected in the lack of the international consensus on the territorial scope of the first sale of products protected under intellectual property rights. The exhaustion doctrine with the broadest territorial scope of the first sale is the international exhaustion. That is, the exhaustion of intellectual property rights occurs regardless of which market in any country in the world the first sale is put into. The region exhaustion usually allows intellectual property rights to be exhausted provided that the first sale is conducted in any market under a region of countries, like customs union. The narrowest territorial scope of the first sale is under the national exhaustion doctrine. In other words, the exhaustion of intellectual property rights is limited to the situation where the first sale is done in the domestic market in which the owner of intellectual property rights is protected under law.

Since intellectual property laws can explore the protection and the limitation of intellectual property rights, it is appropriate for intellectual property laws to serve as a primary approach. In spite of the lack of an international consensus in the marketing territory of the first sale of the products, the deficiency can be rectified through the TRIPS Agreement under the WTO.

2.5 Intellectual Property Laws—the Exhaustion Doctrine

The exhaustion doctrine has a collateral development under the Anglo-American law system and the continental law system. The exhaustion doctrine under the Anglo-American law system is formed by incorporating the theory of implied license, the theory of universality and the first sale doctrine. The continental exhaustion doctrine, compared with the Anglo-American one, is developed by a uniform and simple way.

2.5.1 The Anglo-American Law System

The Anglo-American exhaustion doctrine includes the theory of implied license, the theory of universality and the first sale doctrine. Accordingly, it will help explain the essence of the doctrine by observing the operating of the three important legal concepts.

A. Implied License

The theory of implied license may be used against the control of intellectual property rights over parallel imports, which can result in the exhaustion of intellectual property rights about parallel imports. In other words, as long as the implied license is affirmed under law, the owner of intellectual property rights will be deprived of the right to block parallel imports. When the owner of intellectual property rights sells its products protected by intellectual property rights without any reservation or restriction on the marketing territory, the buyer can freely make any disposal in the future, even including the parallel import.[47] Upon observing the legal system internationally, as a method to resolve the conflict between parallel imports and intellectual property rights, the application of the theory of implied license was rooted in the United Kingdom, and spreads its influence on the common law system, except U.S. law.[48] However, the theory of implied license is usually used to resolve the issue of parallel imports under patented products. According to the practice experience of the legal system, it seems that its application range is rarely stretching out the fields of trademark and copyright.

The application of the theory of implied license needs to be through courts' interpretation in each individual case. This undoubtedly produces some uncertainty about the development of parallel imports. Nevertheless, just owing to the characteristic of uncertainty, judges in the courts have broader room to consider the scope of implied license in specific objective circumstances to balance the interests between parallel imports and intellectual property rights.[49]

B. Universality

Unlike patents and copyrights, trademarks have a stronger relation with business activities. Naturally, the main purpose of business activities is to make profits. As a result, business activities under trademarks should be not obstructed by a nation's border because profits can be made and flow across the borders.[50] Based on this concept, the theory of universality is created. This theory reflects the enforcement of trademark law [51] and the resolution between trademarks and parallel imports under a common law system, including the United States.[52] Although the theory of universality seems to favour parallel imports by limiting trademark rights, "the confusion exception" exists to balance the interests between parallel imports and trademark rights, that is, when the imported goods could result in the confusion of customers to the same goods originally circulated in the native market, parallel imports would be prevented under trademark law.[53] Another exception comes from the independent goodwill of trademark owner in the native mark, playing the same function as the confusion exception to favour trademark rights by turning the theory of universality back to the territoriality concept.[54]

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[47] *See* Heath, *Parallel Imports*, *supra* note 29, at 624.

[48] *See* Abdulqawi A. Yusuf & Andrés Moncayo von Hase, *Intellectual Property Protection and International Trade—Exhaustion of Rights Revisited*, 1 WORLD COMPETITION 115, 117-119 (1992). Under U.S. law, the theory of implied license is usually used to determine whether the use of the patented product after purchasing constitutes an infringement under patent law. If the use is within the implied license through interpretation, the use is a legal act, for example, repairs of the product. On the contrary, if the use is beyond the reasonable expectation of an implied license, the use is infringing in the patent, for example, the reconstruction of the product. Regarding the distinction and the possible interplay between the theory of implied license and the first sale doctrine (the exhaustion doctrine) under U.S. law, see Amber Hatfield Rovner, *Practical Guide to Application of (or Defense Against) Product-Based Infringement Immunities under the Doctrines of Patent Exhaustion and Implied License*, 12 TEX. INTELL. PROP. L.J. 227 (2004); Mark D. Janis, *A Tale of the Apocryphal Axe: Repair, Reconstruction, and the Implied License in Intellectual Property Law*, 58 MD. L. REV. 423 (1999).

[49] *See* Alexander J. Stack, *TRIPS, Patent Exhaustion and Parallel Imports*, 1 J. WORLD INTELL. PROP. 657, 672 (1998).

[50] *See* HIEBERT, PARALLEL IMPORTATION, *supra* note 6, at 29-30; James E. Inman, *Gary Marketing of Imported Trademarked Goods: Tariffs and Trademark Issues*, 31 AM. BUS. L.J. 59, 85 (1993).

[51] The theory of universality applied on the enforcement of trademark leads to the extraterritorial effect of U.S. Trademark Law. The classic case under U.S. Trademark law is Steele v. Bulova Watch Co., 344 U.S. 280 (1952).

[52] Regarding the understanding of the background, see HIEBERT, PARALLEL IMPORTATION, *supra* note 6, at 32-36; ROTHNIE, PARALLEL IMPORTS, *supra* note 24, at 13-15.

[53] The confusion mainly comes from the different qualities of imported products. Case law has shown the impact of confusion on the application of the universality. *See, e.g.*, Lever Bros. Co. v. United States, 981 F.2d 1330 (1993) (the U.S. case); Colgate-Palmolive Ltd. v. Markwell Finance Ltd. [1989] RPC 497 (the U.K case).

[54] The exception protects the investment and goodwill an independent trademark owner has made in the local market. An independent trademark owner indicates that, on the commodities under trademark, the owner has no business relationship

There is another development to the status of universality. This occurs in the Anglo-Commonwealth countries. Under copyright law of these countries, the territoriality concept is strictly stuck.[55] Parallel imports could be an illegal act through the interpretation of the provisions regarding secondary infringement.[56] However, it is possible to save parallel imports out of secondary infringement by giving the elements of secondary infringement a more narrow interpretation.[57] Additionally, the legislations in Australia and New Zealand, which exempt parallel imports under specific situations from copyright infringement, are also a favourable way to parallel imports.[58] The two methods, as a matter of fact, serve as a propeller to drive the traditional territoriality concept toward the universality one.

C. The First Sale Doctrine

The first sale doctrine, among the countries under the common law system, appears only in the United States. It focuses on the marketing of products and distinguishes the two marketing stage—the first marketing and the future marketing after the first one. This doctrine is justified upon balancing between the movement of goods and intellectual property rights by giving the owner of intellectual property rights an exclusive right to put products into market for the first time and leaving the buyer the future disposal right on products after the first marketing. When the owner of intellectual property rights sold products protected by intellectual property rights in the market, the owner has no right to interfere in whom the buyer would like sell products to or what market the buyer would put products into later.[59]

On the issue of parallel imports, the first sale doctrine in the U.S. is applied in the fields of patent and copyright.[60] Whether the doctrine could exhaust intellectual property rights to favour parallel imports is rested upon interpretation for the territory of the first marketing, that is, whether the territory of the first marketing is limited to the U.S. market.[61] Certainly, the type of parallel imports is also considered.

In the U.S. experience about the first sale doctrine, on dealing with the issue of parallel imports, there are other external factors interfering with the application of the first doctrine. Under copyright law, the concept of territoriality - whether the manufacture is located within the U.S. - is sometimes considered a decisive factor to

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with the foreign firms as a type of parent-subsidiary or affiliation. If a trademark owner has this relationship, its business operation, under law, is considered to be connected with that of the foreign countries. From this, it is hard to block parallel imports from the foreign countries due to the concept of the international corporate group. However, case law has some preference for the goodwill protection of the independent trademark owner. In this situation, the trademark owner can prevent parallel imports of the same commodities from the foreign market. *See* Bourjois & Co. v. Katzel, 260 U.S. 689 (1923) (the U.S. case).

[55] *See* ROTHNIE, PARALLEL IMPORTS, *supra* note 24, at 194-199.

[56] Regarding the understanding of the background, see id. at 189-94.

[57] One element of secondary infringement under Anglo-Commonwealth law is that the manufacture of the imported article would have infringed copyright if it was made in the domestic market. This is "the hypothetical manufacturing requirement" for secondary infringement. The interpretation of "the manufacturer" becomes very important in the establishment of secondary infringement. If the manufacturer is limited to "the actual maker", imported products that are made by the copyright owner or its licensee shall not constitute secondary infringement because the parallel importer is not the actual maker. But the opposite result would happen while the interpretation of the manufacturer is "hypothetically" construed as the importer, even if the parallel importer gets its products made by the copyright owner or its licensee in the foreign country. *See id.* at 199-292.

[58] Regarding the understanding of the background, see Kerrin M. Vautier, *Exhaustion and Parallel Imports in New Zealand and Australia*, in PARALLEL IMPORTS IN ASIA 177-186 (Christopher Heath ed., 2004) [hereinafter Vautier, *New Zealand and Australia*]; Abraham Van Melle, *Parallel Importing in New Zealand : Historical Origins, Recent Developments, and Future Directions*, E.I.P.R. 1999, 21(2), 63-87.

[59] *See* NIMMER ON COPYRIGHT § 8.12 [A] (2010); LEAFFER, UNDERSTANDING COPYRIGHT LAW, *supra* note 14, §8.14 [A].

[60] *See, e.g.*, *Quality King Distribs., Inc.*, *supra* note 26 (Copyright); Jazz Photo Corp. v. International Trade Commission, 26 F.3d 1094 (Fed. Cir. 2001) (Patent).

[61] The issue is the core of this article, being related with the policy choice about the exhaustion doctrine. It will be discussed and evaluated later.

decide whether copyright is exhausted to favour parallel imports under the application of the first sale doctrine.[62] Moreover, under patent law, the interpretation of licensing also influences the application of the first sale doctrine.[63]

2.5.2 The Continental Law System

The exhaustion doctrine under the continental law system, similar to the first sale doctrine in the United States, is often applied to the issue of parallel imports.[64] Its justification basis, as with first sale doctrine, is to retain a right to make a first marketing of products for the owner of intellectual property rights as a reward.[65] After the first marketing, the buyer has a right to dispose of the products without any consent from the owner of intellectual property rights.[66] Certainly, like the first sale doctrine, the important factor influencing the resolution of the parallel import cases is the interpretation of the territory of the first marketing. To take the EU for example, if the first marketing is limited to the EU, the parallel import coming from other non-EU countries could be blocked from entering the EU market.

Compared with the Anglo-American law system, on treating the issue of parallel imports, the exhaustion doctrine of the continental law system seems plain and simple. The exhaustion doctrine may be applied in the fields of patent, trademark and copyright without any inconsistency or conflict.[67] Further, the doctrine must concern only the marketing acts. Consequently, the place of manufacture of products never takes part in deciding the exhaustion of intellectual property rights. Moreover, the interpretation of the license agreement between the owner of intellectual property rights and foreign distributors also has no influence on the application of the exhaustion doctrine, as long as the products have been put into the market with the owner's consent, or through its authorization.[68] Finally, there still is the territoriality concept driven to serve an exception of the exhaustion doctrine, similar to the exceptions of the universality theory under the Anglo-American law system.[69] However, the scope of the exception under the exhaustion doctrine seems narrower than that under the universality theory.[70]

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[62] *See* Parfums Givenchy, Inc. v. Drug Emporium, Inc., 38 F.3d 477 (9th Cir. 1994); Columbia Broadcasting System, Inc. v. Scorpio Music Distributors, Inc., 738 F.2d 424(3d Cir. 1984). In the case under Supreme Court favoring parallel imports by the first sale doctrine—Quality King Distribs., Inc. v. L'anza Research Int'l, Inc. 523 U.S. 135(1998)—the issue of the manufacture place is not mentioned because the products under the case are made in the U.S. From this, it is uncertain about if there would be a different treatment under Supreme Court while the products are made outside the U.S. Recently, the U.S. Supreme Court has decided to explore this issue again to make sue whether the copyrighted products made outside the U.S. would prevent the first sale doctrine from being applied. *See* Costco Wholesale Corp. v. Omega S.A., 541 F.3d 982 (Fed. Cir. 2008), aff'd, 131 S. Ct. 565 (2010).

[63] *See* Sanofi, S.A. v. Med-Tech Veterinarian Prod., Inc., 565 F. Supp. 931 (D. N.J. 1983) (the right of the U.S. exclusive licensee against the parallel import is not exhausted, even though the right of patentee has been exhausted because it made and marketed its products in the foreign market).

[64] *See* HAYS, PARALLEL IMPORTATION, *supra* note 24, ¶ 1.08.

[65] *See* Heath, *Parallel Imports*, *supra* note 29, at 625.

[66] *See* Yusuf & Hase, *supra* note 48, at 119-120.

[67] *See, e.g.*, *Merck v. Primecrown* (patent), *supra* note 26; *Silhouette v. Hartlauer* (trademark), *supra* note 26; *Warner Bros. v. Christiansen*, *supra* note 26 (copyright); Case C479/04 Laserdisken v. Kulturministeriet, [2007] 1 C.M.L.R. 6. (copyright).

[68] However, under E.U. law, the assignment of trademark may be a reason to block the parallel import coming from other Member State. *See* Case 9/93, IHT International Heiztechnik GmbH v. Ideal-Standard GmbH, [1994] E.C.R. I-2789, [1994] 3 C.M.L.R. 857 (1994).

[69] Article 7(2) of E.C. Trademark Directive:

> Paragraph 1 [The exhaustion of trade mark] 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.

[70] By literal interpretation, it seems that the confusion exception under the theory of universality can be covered in Article 7(2) of E.C. Trademark Directive. But it is worth further exploring if the exception of the independent goodwill is also within the provision.

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3. The International Arguments about the Scope of the Exhaustion Doctrine in Terms of Parallel Imports—Should Intellectual Property Rights Be Subordinated to the Global Free Movement of Goods?

3.1 Proponents of International Exhaustion in Terms of Parallel Imports

The international exhaustion of intellectual property rights represents a situation where international free trade gets beyond the protection of intellectual property rights, when the first reward of intellectual property rights has been assumed upon the first sale of products protected under the rights in any market in the world. In other words, the owner of intellectual property rights has lost the right to control the movement of products in the future, provided that it or its agents marketed the products first in any country. From this perspective, after the first sale, the products under intellectual property rights will flow freely beyond the country's borders according to any transaction. This has an important implication for international free trade. Usually, those who support the international exhaustion mainly focus on its function of promoting international free trade for goods.[71] Through international free trade, the goods can have fair and sufficient competition, and the utmost benefit of competition will be reflected in the consumption of the customers. Additionally, while Article 6 of the TRIPS Agreement adopts an approach to avoid a uniform norm about exhaustion, the proponents of international exhaustion are convinced that the international exhaustion of intellectual property rights is affirmed under the free trade principle under the WTO.[72]

There is a possible view attempting to interpret the phenomenon where the international exhaustion policy is pervasive among the developing countries. The main position rests upon the adoption of the international exhaustion policy in these countries, which reflects some resistance toward the protection of intellectual property rights,[73] just as the hostility of the developing countries for the TRIPS Agreement existed in the long period of struggle against the substantive minimum protection of intellectual property rights.[74] As a matter of fact, the position shows a lack of comprehensive consideration about the relation between international free trade and intellectual property rights, driven to an ideological conclusion. First, unlike the mandatory substantive rights under the TRIP Agreement, the scope of the distribution right deduced from the exhaustion doctrine seems vague and uncertain. Moreover, according to Article 6 of the TRIPS Agreement, the member states can decide the exhaustion doctrine fitting the national trade policy by its discretion. It is weak to assert that supporting international exhaustion is a reflection of opposition to the substantive minimum standard for the protection of intellectual property rights.

Second, it is still uncertain eventually to what extent the protection of intellectual property rights will enhance international free trade, or at least not set up the barriers of trade.[75] Let me make a hypothesis—the

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[71] *See* S.K. Verma, *Exhaustion of Intellectual Property Rights and Free Trade—Article 6 of the TRIPS Agreement*, 29 IIC 534, 552 (1998); Herman Cohen Jehoram, *International Exhaustion versus Importation Right: A Murky Area of Intellectual Property Law* at 13 (1996), *available at* http://www.ivir.nl/publications/cohen_jehoram/Cohen2.doc (last visited Oct. 4, 2010) (on file with author) [hereinafter Jehoram, *International Exhaustion*].

[72] *See* Verma, *supra* note 71, at 565-67.

[73] *See* Frederick M. Abbott, *Second Report (Final) to the Committee on International Trade Law of the International Law Association on the Subject of the Exhaustion of Intellectual Property Rights and Parallel Importation*, at 32 (2000) [hereinafter Abbott, *Second Report*] (Professor Hugh Hansen's presentation record); Jayashree Watal, *The TRIPS Agreement and Developing Countries Strong, Weak or Balance Protection?*, 1 J. WORLD INTELL. PROP. 281, 283 (1998) (" Some see this provision [of Article 6 of TRIPS] as a major policy option for developing countries to attenuate the ill effects of strong intellectual property protection, apart from unfair duplication of the rights of IPR holders.") (alteration in original) (note omitted).

[74] *See* Charles McManis, *Intellectual Property and International Mergers and Acquisitions*, 66 U. CIN. L. REV. 1283, 1290 (1998).

[75] *See* Carsten Fink & Carlos A. Primo Braga, *How Stronger Protection of Intellectual Property Rights Affects International Trade Flows at 13, available at*

higher level of protection of intellectual property rights produces freer international movement and competition of goods. Under this hypothesis, if the developing countries are still adopting the policy of international exhaustion to resolve the cases of parallel imports, it is rational to comment that the developing countries objects to the intellectual property rights because the international exhaustion is not only harmful to free trade, but also intellectual property rights. However, the international current status is not the case. Upon the lack of strong evidence showing that the protection of intellectual property rights would advance international free trade, it is probable that international exhaustion is made by the developing countries merely as a policy to improve the import trades, not as a tool to resist intellectual property rights under the TRIPS Agreement. This situation, especially, is observed from the fact that the imperative imports of pharmaceuticals in some developing countries[76] - these developing countries must rely on imports about products that they have no industrial capacity to develop themselves.[77]

Finally, the policy of international exhaustion is not exclusive for the developing countries. Some developed countries, for example, Australia, Japan and New Zealand, also use the policy to achieve the political or economic goal of the nation.[78] From this, it is inappropriate to say that the international exhaustion is one of the basic policies against the TRIPS Agreement in the developing counties.

3.2. Opponents of International Exhaustion

Generally speaking, those who oppose the international exhaustion are concerned about the scope of exhaustion of intellectual property rights, though the exhaustion doctrine is basically accepted. Some assert that the territory of the first sale of products under intellectual property rights should be limited, rather than expanded. There is also one view to think that the characteristics of products protected by intellectual property rights should be considered. Under this point, the products with specific characteristics should be given different treatment in the exhaustion, though other products are under the international exhaustion. Another view is to make a thorough inquiry into the attributes of each intellectual property right and decide what intellectual property should apply limited exhaustion.

3.2.1 National Exhaustion

The supporters of national exhaustion tend to object strongly to the unlimited territory of the first sale of the products under intellectual property rights. In their view, the exhaustion of intellectual property rights only occurs when the products under intellectual property rights are initially marketed in the native country where the owner of intellectual property rights is protected under law. Consequently, any parallel import that is never marketed in the domestic market will be prevented from entering the domestic market by the owner of intellectual property rights, even though the owner has marketed these products in foreign countries. The main purpose of the policy of national exhaustion is to protect the interest and local goodwill of the local manufacturer.[79] After all, the same but cheaper products from parallel imports are not only a potential threat to the products domestically marketed by the manufacturer through the advantageous prices, but also create a likelihood of confusion of customers risking the local goodwill due to possible differences in the quality of products.

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http://wwwwds.worldbank.org/external/default/WDSContentServer/IW3P/IB/2000/02/24/000094946_99031911113671/Rendered/PDF/multi_page.pdf (last visited Oct. 3, 2010) (on file with author).

[76] For instance, AIDS is very rampant in Saharan African countries and South Africa, and parallel imports are playing an important role in accessing the medicine for treatment. *See* Debora Halbert, *Moralized Discourses: South Africa's Intellectual Property Fight for Access to Aid Drugs*, 1 SEATTLE J. FOR SOC. JUST. 257 (2002); Carlos M. Correa, *Public Health and Patent Legislation in Developing Countries*, 3 TUL. J. TECH. & INTELL. PROP. 1 (2001).

[77] *See* McManis, *supra* note 74, at 1291.

[78] *See, e.g.*, BBS Wheels III—Decision of the Supreme Court July 1, 1997—Case No. H6-(Ne)-3272, 29 IIC 331(1998) (Regarding BBS Kraftfahrzeugtechnik A.G. v. Racimex Japan Corp. and Japan Auto Products Co.); Louise Longdin, *Parallel Importing Post TRIPS: Convergence and Divergence in Australia and New Zealand*, 50 INT'L & COMP. L. Q. 54 (2001); AbrahamVan Melle, *Parallel Importing in New Zealand: Historical Origins, Recent Developments, and Future Directions*, E.I.P.R. 1999, 21(2), 63-87.

[79] *See* Yusuf & Hase, *supra* note 48, at 130.

3.2.2 Modified International Exhaustion

In spite of paying heed to the importance of international free trade in the national economy, some proponents of international exhaustion simultaneously consider other interests. These interests come from the promotion of specific industry, the maintenance of common market and the protection of some intellectual property rights. In order to balance the benefits of international exhaustion in stimulating free trade and above-mentioned special interests, the policy of modified international exhaustion of intellectual property rights is proposed.

a) International Exhaustion with the Exception of Products of High R&D Industries

High R&D (Research and Development) Industries, as implied by the name, usually sink a heavy investment in the research and development of products.[80] The manufacture and marketing of products completely rest upon whether the research and development could be successful. There is high uncertainty in products. In the pharmaceutical industries, the new drug needs the clinical experiment and the examination of the medical authority. In the end, only a low percentage of new drugs could pass all tests and enter the market.[81] Consequently, the pharmaceutical industries often cannot recover the high cost of R&D, provided that the new drug failed to have the approval of the medical authority.[82] Additionally, the life cycle of products under the high R&D industries is short, because the technological advance is going fast and the market competition is intense, that is, the high R&D industries must continuously engage in conducting inventions and improving the present products through the R&D expenditure to survive in the market. The short life cycle of products aggravates difficulties in recovering the high R&D cost.

In view of the importance of high R&D industries on the technological development and the healthy life of humans, it is proposed that the products of high R&D industries, at least the pharmaceutical ones, be exempted from the application of the international exhaustion doctrine.[83] Based on this thought, it could be predicted that the international exhaustion of intellectual property rights would make the R&D high industries lose the incentives for continuous invention and development because it seems that intellectual property rights cannot help them relieve the burden of the high R&D cost, especially in the case of parallel imports.

b) International Exhaustion with Limited Geographical Application—Regional Exhaustion

In terms of promoting the free movement and competition of goods in the market, the policy of regional exhaustion is just a new form of international exhaustion. Instead of setting the marketing scope of the first sale of products under intellectual property rights in any market in the world, the policy of regional exhaustion, by considering the special political or economic interest of the customs union or free trade areas, limits the marketing scope of the first sale to any market in the specific region.

The policy of regional exhaustion within the EU is a vivid example. The main purpose of the EU regional exhaustion is to maintain the economic development and integration of the EU common market.[84] Basically, the EU never denies the benefits of the policy of international exhaustion, and merely creates a position of reservation on its application, because the EU has misgivings about whether the application of international

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[80] Generally speaking, software industries, biotech industries and pharmaceutical industries are among the High R&D industries.

[81] *See* Claude E. Barfield & Mark A. Groombridge, *Parallel Trade in the Pharmaceutical Industry: Implications for Innovation, Consumer Welfare, and Health Policy*, 10 FORDHAM INTELL. PROP. MEDIA & ENT. L.J. 185, 208-10 (1999) ("[R]ecent studies have shown that about only one in 65,000 compounds synthesized by pharmaceutical laboratories are [sic] successful….").

[82] The estimated cost for developing a new drug in 1990 is $500 million. *See id.* at 209. *See also* Harvey E. Bale, Jr., *The Conflicts between Parallel Trade and Product Access and Innovation: The Case of Pharmaceutical*, 1 J. INT'L ECON. LAW 637, 642 (1998) ("Research-based companies must depend upon a few highly successful drugs (with sales of over, say, $750 million per year) to survive and continue investments in research and development.").

[83] *See* Barfield & Groombridge, *supra* note 81, at 259 & 262.

[84] *See* HAYS, PARALLEL IMPORTATION, *supra* note 24, ¶¶ 1.11 to .12.

exhaustion would hurt the firms of the EU around the world.[85] From this perspective, the EU thinks that the policy of international exhaustion is not suitable for the EU at the current stage.[86] However, the member states in the EU are allowed to adopt the policy of international exhaustion toward the third countries through the international bilateral or multilateral treaties, though regional exhaustion is mandatory among member states in the EU[87]

c) International Exhaustion subject to Specific Intellectual Property Right

One question involves whether patent, trademark and copyright should be applied by a coherent exhaustion policy in the cases of parallel imports. Some scholars think that the exhaustion policy should be differently treated according to the particular characteristics of each intellectual property right.[88] The patent system is established to encourage and promote the development of science and technology by giving the inventor some exclusive rights as a reward. Despite the strong exclusiveness of patent that would intervene in inventing or in the commercial activities of others, the patent system is still justified by the fact that patent just provides an incentive for inventor to develop technology, and the ultimate benefit is for society rather than the inventor. On the most important aspect, the patent is enjoyed in the limited period. This effectively assuages the monopoly of patent over the invention. As a consequence, even though the policy of national exhaustion is adopted in the field of patent, the negative impact on international free trade in the cases of parallel imports would be limited.[89]

On the aspect of copyright, similar to patent, the copyright system provides with some exclusive rights as an incentive to the creator for stimulating the creation of new artistic or scientific works to enhance the development of human culture and society. Copyright also has its limited period. In addition, the subject matter protected under copyright law is limited to the expression of works, not the ideas. After assessing the attributes of copyright, it seems to reach the same conclusion that there is a stronger reason to support the national exhaustion of copyright.[90]

Compared with patent and copyright, trademark is closer to commercial activities. The main purpose of the trademark system is to establish a fair commodity competition in the market. In other words, trademark law is enacted to avoid the confusion of customers about the original trademark by providing appropriate remedy for the trademark owner, when other people use identical or similar trademarks on the same or similar products. Although trademark law, undeniably, gives some exclusive rights for the protection of the trademark owner's incentive to develop and market new products and brands, the interest scope of the trademark owner under trademark law is not triggered by the investment that the trademark owner made in the products, but by other competitors' unfair market activities. Consequently, only when other competitors pass off the original trademark in the market to confuse consumers can the trademark owner assert the infringement of trademark for remedy. From this perspective, in the case of parallel imports, if the imported products are the same as ones marketed in the domestic market—there is no likelihood of customer confusion—it is not justified to block the imports according to the national exhaustion doctrine.[91] Additionally, the protection of trademark is without time limit, as long as the trademark is used incessantly in the market. This characteristic also fosters the application of international exhaustion for trademark in the case of parallel imports.

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[85] *See* NERA, *The Economic Consequences of the Choice of Regime of Exhaustion in the Area of Trademarks*, Final Report for DG XV of the European Commission, at 105-06 (1999) [hereinafter NERA, *the Choice of Regime* Report].
[86] Kimberly Reed, *Levi Strauss v. Tesco and E.U. Trademark Exhaustion: A Proposal for Change*, 23 NW. J. INT'L L. & BUS. 139, 178 (2002).
[87] *See* Willy Alexander, *Exhaustion of Trade Mark Rights in the European Economic Area*, E.L. REV. 1999, 24(1), 63 [hereinafter Alexander, *Exhaustion of Trade Mark Rights*].
[88] *See* Cornish, *Parallel Trade*, *supra* note 25, at 13-17; Abbott, *Second Report*, *supra* note 73, at 32-33 (Professor William Cornish's presentation record).
[89] *See* Cornish, *Parallel Trade*, *supra* note 25, at 13-15.
[90] See *id*. at 15.
[91] *Id.* at 15-16.

3.3 Policy Arguments for Divided Positions

The academic arguments about the exhaustion doctrine and the issue of parallel import may be carried out from both the policy aspect and the economic analysis. The policy arguments and the economic ones respectively represent discrepant meaning in the formation of a law policy. The policy arguments are concerned about the justification of the policy, while the economic ones pay much attention to the efficiency and welfare of the policy.

3.3.1. Policy Arguments for International Exhaustion in Terms of Parallel Imports

There are seven reasons for proponents of the international exhaustion policy to fight for their standpoint.

a) Strengthening Product and Price Free Competition

An important benefit from international exhaustion in the case of parallel imports is to enhance the free competition of products.[92] Even though the imported products are the same as ones circulating in the domestic market, the customers are still enjoying the product choice and the price comparison in making a final decision on buying products.[93] Especially, when the possibility of competition through inter-brand products is eliminated or reduced by the strong exclusive rights of intellectual property rights, it shows more desirability for international exhaustion applied in the case of parallel imports to protect the right of customers about the competitive price.

b) Preventing Market Monopoly

Although the exclusive power of intellectual property rights does not account for a kind of monopoly in the market, it helps form the market monopoly. Generally speaking, intellectual property rights, especially patent and copyright, have strong power to prevent the copying or imitating products. From this, the products copying or imitating the products protected under patent or copyright will be completely blocked from the market. If the intellectual property holder has some degree of market power and there are no substitutes for the products protected under intellectual property rights, the market for the products dominated by the holder is approaching the monopolization.[94] Under market monopoly, the arrangement for products and the establishment of product prices are exclusively decided by the owner of intellectual property rights. The adoption of the international exhaustion policy can lead some products with lower prices in the foreign countries to the domestic market. This importation would activate the competition of the market, even though the competition might be limited to an intra-brand competition. The lower prices of the imported products, at the very least, can destroy the price establishment under the market monopoly, further weakening the monopolized market barriers for possible substituted products. Certainly, the monopolization of market needs to be resorted to competition law to resolve thoroughly the abuse of market power.

c) Reducing Market Collusion

Market collusion often occurs when the authorized distributors of products in the same country reach an unvoiced pact among them to raise the unit price of a product. The price adjustment is out of the market scheme of the manufacturer. The manufacturer (the owner of intellectual property rights) always successfully monitors and corrects the situation according to the agreement or the internal discipline. Consequently, the international exhaustion policy in the case of parallel imports is expected to collapse the collusion. The lower price of products through parallel imports inhibits the market effects brought by colluding in the product price. Sometimes, parallel imports are considered a tool to resolve the collusion of authorized distributors by the manufacturer.[95]

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[92] *See* Bale, *supra* note 82, at 644; Verma, *supra* note 71, at 558.
[93] *See* Abbott, *First Reports*, *supra* note 21, at 612.
[94] *See* LIPNER, GARY MARKET GOODS, *supra* note 25, at 79-80.
[95] *See* John C. Hilke, *Free Trading or Free-Riding: An Examination of the Theories and Available Empirical Evidence on Gray Market Imports*, 32 WORLD COMPETITION 75, 80-81 (1988).

d) National Exhaustion as a Non-Tariff Barrier under WTO

Under the national exhaustion policy of intellectual property rights, the intellectual property holder can take advantage of the exclusive rights under law to prevent the same products from entering the domestic market in the case of parallel imports. In terms of the impact on free trade by the exercise of intellectual property rights, the national exhaustion policy obviously contradicts the fundamental aim of the WTO for promoting free trade. According to Article XI(1) of the GATT 1994, the national exhaustion policy can be interpreted as a kind of quantitative restriction against imports in the case of parallel imports.[96] From this perspective, the national exhaustion policy is intolerable among the WTO Members because the quantitative restriction against imports is prohibited under the WTO.

Additionally, another argument against the national exhaustion policy is rested upon the fact that the exercise of national exhaustion in the parallel imports would constitute a discrimination against the imported products.[97] Under national exhaustion, any product manufactured in the foreign countries without any marketing acts in the domestic market would be blocked from imports, if without obtaining the permission of the intellectual property holder. Compared with the imported products, the same products circulating in the domestic market are protected thoroughly under the free trade principle and exempted from any intervention of the intellectual property holder, even without any consent. The discrimination existing between imported products and native ones violates Article III(4) of the GATT 1994—the national treatment provision.[98]

e) Access to Medicines on the Basis of Human Rights

The interaction of intellectual property rights and human rights has been the focus of much concern in the global community.[99] One important issue involves the right to access health facilities and medicine.[100] The concern comes from some serious epidemic and endemic diseases that are rampant in some developing countries, and most of these countries do not have enough industrial capacity to invent and develop new medicines to prevent, treat or control the diseases. When the new medicines are protected under intellectual property rights, it is doubtful that the patients in the developing countries can get enough medicines with a reasonable and affordable price.[101] The international exhaustion policy can be expected to solve the misgivings. It would bring, through parallel imports, the drugs with lower price into the developing countries that are faced with the invasion of serious diseases but have been not qualified for the application of compulsory licenses under the TRIPS Agreement.[102] From this perspective, the meaning of the international exhaustion policy is not only reflected in

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[96] *See* Abbott, *Second Report*, *supra* note 73, at 30-31 (Thomas Cottier's presentation record); Thomas Cottier, *The WTO System and Exhaustion of Rights*, *in* THE INTERNATIONAL INTELLECTUAL PROPERTY SYSTEM —COMMENTARY AND MATERIALS PART TWO 1798-1800 (Frederick Abbott et al. eds., 1999); Verma, *supra* note 71, at 554; Abbott, *First Reports*, *supra* note 21, at 632.

[97] *See* Verma, *supra* note 71, at 553-54; Abbott, *First Reports*, *supra* note 21, at 633-34.

[98] Article III(4) of the GATT 1994:

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

[99] Audrey R. Chapman, *The Human Rights Implications of Intellectual Property Protection*, 5 J. INT'L ECON. LAW 861, 866-70 (2002).

[100] *See id.* at 873-79.

[101] *See* Frederick M. Abbott, *The DOHA Declaration on the TRIPS Agreement and Public Health: Lighting a Dark Corner at the WTO*, 5 J. INT'L ECON. LAW 469, 472-73(2002) [hereinafter Abbott, *The Doha Declaration*].

[102] Some developing countries with a potential capability to develop the pharmaceutical industry, like India and Brazil, may solve the problem of medication supplies and prices through asserting the compulsory licenses under Article 31 of the TRIPS Agreement. But for other countries without this production capacity to apply for the compulsory licenses, like South Africa, parallel imports are better to solve the same problem. *See id.* at 494-97. *See also* CARLOS M. CORREA, TRADE RELATED ASPECTS OF INTELLECTUAL PROPERTY RIGHTS-A COMMENTARY ON THE TRIPS AGREEMENT 81 (2007). In order to make up the deficiency of Article 31 short of considering the production capacity of members, Article 31 *bis* was proposed to seek acceptance of members. On the amendment of the TRIPS Agreement, please see http://www.wto.org/english/tratop_e/trips_e/wtl641_e.htm (last visited Oct. 3, 2010).

the reconciliation of intellectual property rights and free trade, but also the deference of intellectual property rights to the global humanitarianism.

f) Promoting Export-oriented Economy in Developing Countries

In view of the global economic structure, the developing countries play a significant role in the global export economy.[103] Owing to the consideration of labour cost and other factors, the industries in developed countries often seek some developing countries as manufacturing bases to take advantage of favourable resources to manufacture products, and then export the final products through the global marketing network. The phenomenon represents the possibility of technology transfer to the developing countries. The technology transfer is with much meaning on balancing the global economy that the WTO is established to expect.[104] However, before the developing countries are capable of developing the manufacturing technology, apart from stimulating the job opportunities and increasing tax revenue, the indirect exports of the foreign industries merely contribute limited benefit to the export trade in the developing countries because many products for exports are entrusted to the local firms for assembling and manufacturing, and not under the brands of local firms.

The international exhaustion policy would work to enhance the export trade in the developing countries.[105] The local firms in the developing countries can purchase competitive products under the foreign industries, and then export them to other countries, including the domestic market of the manufacturer, without any fear that the manufacturer would use intellectual property rights to block exports from entering the domestic market.

g) Eliminating Intellectual Property Misuse

In the case of parallel imports, there is a situation occurring in which the owner of intellectual property rights attempts to take advantage of the labels or package protected under copyright to control the distribution of goods that the labels or packages are attached to. The situation reflects a kind of intellectual property misuse to some extent. The scope of copyright to control is limited to copyrightable labels or packages. It is incidental that the manufacturer attached the labels or packages to the goods. In other words, in the evaluation of copyright protection of the labels or packages, it is not necessary to consider the existence of goods. If the copyright owner can successfully make use of inseparability of the labels or packages and goods in the commercial acts to control the distribution of goods, the scope of the exclusive right under copyright law has obviously been manipulated to reach some non-copyrightable subject matters. This is an improper extension of copyright. In order to make the protection of labels or packages associated with goods, the manufacturer should assert the rights of trademark or trade dress.

To resolve the problem of the copyright misuse, under the national exhaustion system, using legislation or judicial cases to exclude the copyright misuse from the protection of copyright is essential so that the same products with the copyrightable labels or packages can enter the domestic market safely. However, the international exhaustion policy in the cases of parallel imports achieves the same goal with lower cost about the copyright misuse. Under the international exhaustion system, copyright has been exhausted when the copyrightable labels or packages associated with goods are sold in the foreign market. Consequently, in the case of parallel imports, there is no room for the manufacturer to abuse copyright when the goods enter the domestic

[103] The situation can be observed from the growth of foreign direct investment (FDI) in the developing countries recently. *See* United Nations Conference on Trade and Development (UNCTD), World Investment Report 2010, at 6, http://www.unctad.org/en/docs/wir2010_en.pdf (last visited Oct. 3, 2010) (on file with author).

[104] Agreement Establishing the World Trade Organization States:

> Recognizing further that there is need for positive efforts designed to ensure that developing countries, and especially the least developed among them, secure a share in the growth in international trade commensurate with the needs of their economic development,….

[105] *See* Yusuf & Hase, *supra* note 48, at 130 ("[T]erritorial exhaustion may undermine export-based economic development strategies of developing countries and countries undergoing transition to market economy.") (alteration in original).

market. The copyright misuse in the case of parallel imports is automatically cured by international exhaustion.[106]

3.3.2 Arguments against International Exhaustion in Terms of Parallel Imports

There are six reasons for opponents of the international exhaustion policy to support their stance.

a) Destructing Price Discrimination Scheme

The price discrimination scheme is a more efficient approach to conduct international marketing around the world than the price uniformity approach. The manufacturer may establish the discriminated prices in different countries according to the economic status of countries and the payment capability of people.[107] Usually, the price discrimination scheme is designed to charge higher prices in countries where the demand elasticity about the products is relatively low (developed countries), and set lower prices for the countries with high demand elasticity (developing countries).[108] This scheme takes advantage of high profits in the former countries to compensate for the possible loss in the latter countries to achieve a planned marketing goal.[109]

The international exhaustion of intellectual property rights would break the price discrimination scheme. In the cases of parallel imports, international exhaustion would make the products coming from the countries with high demand elasticity invade the countries with low elasticity by means of the advantageous low price. From this, the efficient market separation under the price discrimination scheme never survives the impact of parallel imports. In order to react to the situation caused by international exhaustion, the manufacturer (the owner of intellectual property rights) must adjust its marketing strategy toward the price uniformity scheme.[110] In other words, with the aim of avoiding the products with lower price entering into the countries with high prices, the manufacturer tends to fix a uniform price, being lower than the price in the developed countries under the price discrimination scheme and higher than the one in the developing countries. The result is that the customers in the developing countries, as a victim under international exhaustion, would bear greater financial burden for the products. To make matters worse, it is even possible that the customers in the developing countries would be faced with the predicament of no supplies of the products, especially medicines for serious disease, because the manufacturer could abandon the markets in the developing countries provided that the impact of international exhaustion is intolerable.[111]

b) Encouraging the Arbitrage of Products

Basically, parallel imports are a kind of arbitrage of products. They occur when the price difference of products exists between the source market where the parallel importer purchases products with a lower price and the target market where the parallel importer would like to import the products with a higher price. The price difference of products is usually caused by the price discrimination scheme of the manufacturer or the changes of the exchange rate between currencies. Parallel imports may disappear when the price difference has been mitigated, or the transportation cost adding up to the price of product in the source market has exceeded the price of product in the target market. This implicates the speculative characteristic of parallel imports. Although the international exhaustion policy could enhance the free movement of goods to some extent in the cases of parallel imports, it simultaneously could encourage the arbitrage of products. It is unwise to rely too much on parallel imports under the international exhaustion to activate free trade and price competition. Parallel imports are

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[106] *See Quality King Distribs., Inc.*, *supra* note 26. In this author's opinion, this case is a vivid example showing that the international exhaustion of copyright cures the copyright misuse, although it is still controversial about whether the case represents the adoption of the international exhaustion policy in U.S. copyright law.
[107] *See* Carsten Fink, *Entering the Jungle—The Exhaustion of Intellectual Property Rights and Parallel Imports*, *in* COMPETITIVE STRATEGIES FOR THE PROTECTION OF INTELLECTUAL PROPERTY 178 (Owen Lippert ed., 1999).
[108] *See* Chard & Mellor, *supra* note 29, at 76.
[109] *See* Fink, *supra* note 107, at 179.
[110] *See* Malueg & Schwartz, *supra* note 34, at 190.
[111] *See* Barfield & Groombridge, *supra* note 81, at 250-51.

highly speculative and selective. Even if the price discrimination scheme could lead to market monopoly and unfair competition, parallel imports under international exhaustion do not always work well on this problem because it all depends upon the interest measurement of the parallel importer if parallel imports would enter the market, instead of other consideration of public interests. Consequently, in order to avoid the market monopoly and unfair competition that the price discrimination scheme could result in, it is more appropriate to appeal to competition law or other laws to examine the scheme, rather than have much expectation on parallel imports under international exhaustion.

c) Free Riding and Passing Off— Improper Appropriation of Manufacturer Goodwill and Consumer Confusion

One important reason for opposing international exhaustion of intellectual property rights is that the parallel importer often appropriates goodwill or reputation that the manufacturer has established in the domestic market through long-term investment in the innovation and improvement of products, or enjoys the results of the product promotion and advertisement without any contribution.[112] In other words, the parallel importer can save or ignore any cost about product administration and advertisement and then take advantage of the favourable product price to compete with the manufacturer or its authorized licensees. The parallel importer's concern is limited to the price by which it purchases the products in the source market, and the transportation cost by which the products in the source market can be delivered to the target market. Since the goodwill about the products has been established and the advertisement expenditure has been disbursed by the manufacturer in the domestic market, the same products through parallel imports can enjoy the benefit of cost saving and reflect the benefit in pricing. This is the so-called free riding problem. The free riding of parallel imports distorts the market pricing and creates unfair competition. Consequently, the international exhaustion policy has some extent of instigating the free riding acts, given the policy is promoting parallel imports. As an economic comment remarks, the benefit of the international exhaustion policy would be weakened, as long as some free riding acts involve in the parallel imports.[113]

Another problem existing in parallel imports under international exhaustion is passing off.[114] Since parallel imports are price-oriented—the parallel importer puts nearly all focuses on the measurement of product costs to decide whether parallel imports would proceed—the control of product quality is not always regarded thoroughly. When the same products with inferior quality through parallel imports are brought into the domestic market to compete with the products originally circulated, there would be some negative impact on the customers and the manufacturer in the domestic market, even some jeopardy running toward the trademark system. On the one hand, the product difference triggers the confusion of customers about their constant reliance on the manufacturer or the trademark of the manufacturer to obtain products with a specific level of quality. The customer confusion can decay the function of the trademark system and makes customers bear extra search costs to seek the desired products that might otherwise be obtained according to the reliance on trademark. In addition, the products with inferior quality may imperil the customers in the issues of health and security.[115] On the other hand, customer confusion is also reflected in the fact that some customers tend to give up the products of the manufacturer and divert to seek other alternative products in the market to avoid the high search cost. In this situation, the manufacturer (the trademark owner) would lose some sale revenue due to the parallel imports with inferior quality. Moreover, the products with inferior quality are fatal to the reputation or goodwill of the manufacturer. To sum up, parallel imports under international exhaustion would lead to a potential risk for the customers and the manufacturer in the domestic market. The cost seems difficult to compensate by the benefit resulting from the promotion of international exhaustion about free trade.

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[112] *See the OECD Report*, *supra* note 39, at 8-9; Staaf, *Free-Riding*, *supra* note 39, at 207-211; Hilke, *supra* note 95, at 77-78. *See also* Chard & Mellor, *supra* note 29, at 73 (including also the after-sales of products—warranty service and repair service— in the targets of the free-riding acts). Dr. Rothnie shares the same view. *See* ROTHNIE, PARALLEL IMPORTS, *supra* note 24, at 565.

[113] *See the OECD Report*, *supra* note 39, ¶ 25, at 9.

[114] *See the OECD Report*, *supra* note 39, ¶¶ 41-42, at 13; ROTHNIE, PARALLEL IMPORTS, *supra* note 24, at 563-64; Chard & Mellor, *supra* note 29, at 73; Staaf, *Free-Riding*, *supra* note 39, at 228-233; Hilke, *supra* note 95, at 80.

[115] *See* Barfield & Groombridge, *supra* note 81, at 254-55.

d) Uncertainty about Product Services after Sales

Generally speaking, the parallel importer rarely provides the buyer with sale warranties or product services after sale.[116] Usually, the products through parallel imports are manufactured in foreign counties, and the manufacturer and its local authorized licensees do not take the place of foreign agents to provide the buyer with any service. Consequently, the customers would assume the risk of the product defects after sale by themselves. Compared with the ordinary sale, parallel imports seem to deprive the customer of the consumer benefits that are available under the ordinary sale. From this perspective, parallel imports are apparently unfavourable for the public because they take the core of the transaction security—the protection of consumers—out of the sale. Because the international exhaustion policy is helpful for parallel imports, it indirectly brings the consumers into the predicament where there is uncertainty about the protection of the transaction security.

e) Discouraging Incentives for the Intellectual Property Owner about the Invention, Creation and Marketing of New Products

The essence of the exhaustion doctrine is on balancing the conflicting interests between free trade and intellectual property rights by giving the right for first marketing of products to the owner of intellectual property rights, leaving the later unspecified buyers the future privilege for resale. When the intellectual property holder has conducted the first sale of the products under intellectual property rights, the reward for intellectual property rights about marketing is assumed, and the holder never has any chance to control the flow of products by means of intellectual property rights. The exhaustion doctrine seems a reasonable interest division theoretically. However, in practice, especially under international exhaustion, the reasonable interest division of the exhaustion doctrine would be distorted because the assumption of reward about the first sale could be dysfunctional in some situations. For example, the intellectual property holder marketed its products first in foreign countries where no intellectual property rights are available for this kind of products,[117] the compulsory license is applied to this kind of product,[118] or the government enforces the price control measures on this kind of product.[119] Under anyone among the three above-mentioned situations, it is difficult for the owner of intellectual property rights to use intellectual property rights to exploit the reward in the first sale because no intellectual property right exists in the countries, or the pricing function of intellectual property rights is broken by the government's interference. From this perspective, not only could the incentives of the intellectual property holder for further development in the products be frustrated, but the spirit of the exhaustion doctrine—the interest division—would also crumble, supposing that the international exhaustion policy is adopted in the above-mentioned situations to allow unlimited parallel imports to enter the domestic market.

f) Supporting Indirectly the Black Market

The international exhaustion policy opens the passageway for parallel imports. This means that the parallel imports are not only free from the control of intellectual property laws, but also can be exempted from the examining and tracing of the Customs in the domestic market. Under this situation, in order to pursue the maximum profits, it is possible for the unworthy importers to mix some illegal copies that violate intellectual property law with the genuine products that are subject to a parallel importation plan through a legal parallel import.[120] In other words, the legal parallel import indirectly paves a channel to cover the smuggling of the illicit copies. Given the fake products by illegal reproduction have a lower price and a higher uncertainty about product security and quality than the genuine products through parallel imports, their entering the domestic market would threaten seriously the interests of consumers and intellectual property holders. Perhaps, it is controversial to beat the gray market through parallel imports by intellectual property laws. Nonetheless, it is no doubt that the black market replete with illegal copies is the primary target of intellectual property laws. The

[116] *See* Chard & Mellor, *supra* note 29, at 73.
[117] *See Merck v. Primecrown*, *supra* note 26; ECJ Case 187/80, Merck & Co. v. Stephar BV and Merck & Co. v. Exler, [1981] E.C.R. 2063, [1981] 3 C.M.L.R. 463 (1981) [hereafter *Merck v. Stephar*].
[118] *See* ECJ Case 19/84, Pharmon BV v. Hoechst AG, [1985] E.C.R. 2281, [1985] 3 C.M.L.R. 775 (1985) [hereinafter *Pharmon v. Hoechst*]
[119] ROTHNIE, PARALLEL IMPORTS, *supra* note 24, at 487-94; Chard & Mellor, *supra* note 29, at 77.
[120] *See the OECD Report*, *supra* note 39, ¶ 40, at 13; Chard & Mellor, *supra* note 29, at 75.

international exhaustion policy, besides enhancing free trade, also brings heavy social costs and law enforcement costs into the domestic market because it indirectly supports the black market.

3.3.3 Responses to Arguments

a) Responses to Arguments for International Exhaustion

In respect of arguments supporting the international exhaustion policy, the opponents would possibly rebut the position with the following counterarguments. First, the proponents of international exhaustion think that international exhaustion can strength the international competition of products so that the customers in the target market can obtain a reasonable price about the products through parallel imports. However, the competition through parallel imports under international exhaustion comes under the intra-brand competition, rather than inter-brand competition.[121] The intra-brand competition would break down the scheme of price discrimination of the intellectual property owner. Consequently, it may be anticipated that the owner of intellectual property rights is compelled to lift the product price in the source market for parallel imports (some developing countries) for fear that the lower products will flow into the domestic market (target market). In the long run, the customers in the source market suffer from the increase of product price while the customers in the target market enjoy the competitive price. It is doubtful if the customers eventually can benefit from parallel imports under international exhaustion.[122]

Next, it seems arbitrary to conclude that parallel imports under international exhaustion can prevent the market monopoly of the intellectual property owner and reduce the market collusion of authorized distributors (licensees). Under intellectual property laws, intellectual property rights have some extent of exclusive monopoly effects that are mainly designed to encourage people to contribute to society by inventing and creating new things. However, the monopoly power of intellectual property rights does not always represent the monopoly power in the market. Even though there is some obscure implication of market monopoly when the owner of intellectual property rights takes advantage of the price discrimination scheme to market products, no strong evidence directly supports that the scheme leads to market monopoly.[123] As a result, it is inappropriate to use international exhaustion policy to prevent a market monopoly that is inevitable in the exercise of intellectual property rights. Moreover, the problem of collusion of the authorized distributors (licensees) against the pricing plan, as a matter of fact, is a violation of fiduciary duties. It is better to solve the problem through the market monitoring mechanism and the contact than the intellectual property policy.

Third, the conclusion that the national exhaustion of intellectual property rights constitutes a non-tariff barrier under the WTO is based on an incorrect knowledge of the basic spirit of the WTO. According to this view, the promotion of international free trade under the WTO triumphs any other interest. When parallel imports spark the conflict between international free trade and intellectual property rights, it becomes the corollary that the international exhaustion policy backing up free trade always surpasses the national exhaustion policy protecting intellectual property rights. Based on this opinion, the national exhaustion policy seems to be interpreted as a non-tariff barrier under the WTO. In fact, both international free trade and intellectual property rights share equal positions for interest consideration under the WTO.[124] This concept may be observed from the TRIPS Agreement enacting to balance the interest of free trade and the protection of intellectual property rights.[125] From this perspective, Article 6 of the TRIPS Agreement—an agreement to disagree—should be respected. Any interpretation attempted to preclude the national exhaustion from the WTO is tantamount to emptying the TRIPS Agreement.[126]

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[121] Hansen, *supra* note 32, at 114-2 to -5.
[122] *See* Malueg & Schwartz, *supra* note 34, at 170.
[123] *See* Staaf, *Price Discrimination*, *supra* note 34, at 303 (enumerating three elements necessary for effective price discrimination—prevention of resale, difference of demand elasticity and market power).
[124] *See* Abbott, *Second Report*, *supra* note 73, at 23-24, 30 (the presentation records of Adrian Otten and Macro Bronckers).
[125] *See* Macro Bronckers, *The Exhaustion of Patent Rights under WTO Law*, 32 J. WORLD TRADE 137, 144 (1998).
[126] *See id.* at 157-58.

Fourth, while parallel imports under international exhaustion open a low-price drug channel to the countries where serious epidemic and endemic diseases are prevalent, some worrisome problems are produced in parallel imports of medicines—the quality control of medicines and the supply of medicines. The quality control of medicines focuses on whether the quality of medicines conforms to the international safety standard of medicine, or whether there are some fake drugs mixed in the genuine ones. The supply of medicines indicates a suspicion about whether the volume of drugs via parallel imports is sufficient to meet the need in the countries that are fighting some serious diseases. The two problems show the possible threat and uncertainty caused by parallel imports of medicines under international exhaustion, when parallel imports are used as a means for humanitarian salvage. From this, parallel imports under international exhaustion is not a reliable approach because life saving cannot tolerate any uncertainty. According to some scholars' suggestion, the donation of drugs or money for resisting the serious diseases is a more pragmatic way to achieve the humanitarian goal.[127]

Fifth, although the international exhaustion policy is conducive to the export trades of the developing countries via parallel imports, it merely stimulates the export economy in the developing countries in a limited way. The exports via parallel imports under international exhaustion cannot completely account for the economic development in the developing countries because these products for parallel imports are usually developed by the industries of the developed countries. Even though the products are manufactured or assembled in the developing countries, they are put into the market for sale under the brand of the industries of the developed countries. The effective way to promote the export-oriented economy in the developing countries is to assist these countries in developing their own products and industry brands by technology transfer and transnational cooperation. It is evident that parallel imports under international exhaustion cannot help the developing countries create their own industry brands.

Finally, the prevention of misuse of intellectual property rights and the promotion of the international exhaustion policy are two separate and independent issues. To mitigate some misuses is merely an incidental effect in the adoption of the international exhaustion policy. Consequently, an incidental effect is actually not enough to justify the use of the international exhaustion policy in the cases of parallel imports. The cost that the international exhaustion possibly would bring about would surpass the benefit of curing the misuse of intellectual property rights.

b) Responses to Arguments against International Exhaustion

Some specious defects exist in the arguments against the international exhaustion policy that are worth scrutinizing. Regarding the price discrimination scheme, the opponents of international exhaustion believe that the scheme can provide the developing countries with affordable price for products and continuous product supplies. Under this opinion, the international exhaustion of intellectual property rights would destroy the mechanism of price discrimination so that the owner of intellectual property rights could be enforced to raise the product price or quit from the markets in the developing countries with a view to avoiding parallel imports. As a matter of fact, the mechanism mentioned above is merely established on a hypothesis that the manufacturer would execute the scheme according to the rational judgment. However, it is found that the actual practice of the scheme is not always consistent with the rational expectation. There are some occasions where the product price in the developing countries is higher than that in the developed ones.[128] That implicates the possibility that some manipulation is interfering with the operation of the price discrimination scheme according to specific business consideration rather than the rational judgment. Since the scheme is vulnerable to the artificial manipulation, the expected function of adjusting the price and supply in the developing countries becomes unreliable.

Second, the argument that the international exhaustion policy would encourage the commercial arbitrage via parallel imports is fragile and superficial. Under a thorough observation, the actual cause invoking the commercial arbitrage is either the change of the global economy or the price discrimination scheme of industries

[127] *See* Henry Grabowski, *Patents, Innovation and Access to New Pharmaceuticals*, 5 J. INT'L ECON. LAW 849, 857 (2002); F. M. Scherer & Jayashree Watal, *Post-TRIPS Options for Access to Patented Medicines in Developing Nations*, 5 J. INT'L ECON. LAW 913, 934-38 (2002).
[128] *See* Fink, *supra* note 107, at 179; Chard & Mellor, *supra* note 29, at 76-77.

about products. The change of the global economy usually works on the exchange rate of currencies to attract the arbitrage acts via parallel imports—for example the currency appreciation occurs in one country, but the product price in this country is not adjusted to meet the appreciation yet. Moreover, the pricing under the price discrimination scheme is also an important incentive for the arbitrage via parallel imports. From this, it is impossible for the parallel importer to conduct the arbitrage, provided that there is no or little price difference in the global markets, even if the international exhaustion policy is adopted.

Next, free riding is a serious problem in the cases of parallel imports. Nevertheless, this does not mean that free riding is a necessary element or characteristic of parallel imports. It is difficult to prove that the price difference of parallel imports comes from the free riding.[129] In view of globally marketing, the parallel importer has contributed to the administration and promotion cost of the products because the price by which it purchased source products in the foreign market is inclusive of allocated operating and advertisement expenditures for the products. Consequently, using the free riding to frustrate the justification of parallel imports under international exhaustion is unpersuasive. Additionally, the passing off of intellectual property rights, in particular trademark, seriously threatens the protection of customers and the intellectual property owner, as well as the intellectual property systems. Granting that it is possible for the parallel importer to bring the products with inferior quality to the domestic market under international exhaustion, there is no evidence that most cases of passing off are from parallel imports. From this, the passing off of parallel imports should be given the same treatment under law as that of other situations. In other words, parallel imports need not be overemphasized in the cases of passing off. Any product with inferior quality that possibly causes the likelihood of confusion would be examined by intellectual property right law or other related laws, even though the product can enter the domestic market via parallel imports under the international exhaustion policy. Because the international exhaustion policy never exempts the passing off situations from intellectual property law, there is no strong reason to assert that it aggravates passing off in the domestic market.

The fourth counter argument against the opponents of international concerns the product warranty and the services after sale. It is theoretically known that the products through parallel imports usually are not associated with the product warranty and the services after sale. However, it is not always the case in the real practice of parallel imports. There are two factors driving the parallel importer to provide the product warranty and the services after sales. One is market competition. As the consciousness of consumers is raised, the product warranty and the services after sale have become the critical consideration of consumers in choosing products for purchasing. Under the pressure of competition, the parallel importer would be bound to cover competitive warranty and service conditions to maintain its product advantages. Another factor is sale law. According to sale law, the implied warranty of sales is not precluded in advance.[130] In other words, the parallel importer would be responsible for the legal warranty of sales under law, provided that the parallel importer is as a seller under law.

Regarding the argument that the incentives of the intellectual property owners are discouraged by the parallel imports under international exhaustion coming from countries where no patent protection exists for products, the conclusion ignores a fact that this situation is not inevitable. That is, when planning the global market, the owner of intellectual property rights has a chance to survey the protection of intellectual property rights about the products for marketing in any possible market, evaluate all benefits and costs resulting from marketing in any country, and make up a final decision about what countries are suitable for markets to the industry's best interest. As a result, the disadvantage in the parallel imports coming from countries without patent protection can be avoided in advance through the market evaluation of the owner of intellectual property rights. Any choice to market in the countries without patent protection by free volition and commercial judgment should not be a reason to object to parallel imports under international exhaustion.[131]

[129] *See the OECD Report*, *supra* note 39, ¶ 24, at 9; Staaf, *Free-Riding*, *supra* note 39, at 234-35.
[130] *See* U.C.C. §§ 2-314 to -315(2001).
[131] This is an important position in the judgment of *Merck v. Primecrown, Inc.*, *supra* note 26 and *Merck v. Stephar*, *supra* note 113.

Finally, the problem of the black market under intellectual property laws—the prohibition of the illegal reproduction— is set as a prioritized goal to achieve because the existence of the black market directly shakes the foundation of intellectual property rights. Relatively, the problem of the gray market or parallel imports has broader room to deal with—the prohibition of parallel imports depends upon what exhaustion policy is applied—because the two interests of free trade and intellectual property rights would be considered jointly. For this perspective, the problem of the black market and that of the gray market should be treated differently under intellectual property laws. It is an inappropriate approach to use intellectual property laws to prohibit the gray market overall in order to prevent the invasion of the black market. To adopt the national exhaustion policy with a view to avoiding the illegal copies of products entering into market via parallel imports under international exhaustion is a concrete showing of treating the problem of the gray market in the same way with that of the black market.

3.4 Economic Arguments: International Exhaustion in Terms of Parallel Imports

3.4.1 Economic arguments for International Exhaustion in Terms of Parallel Imports

a) Comparative Advantage Theory

Generally speaking, the economic arguments for the international exhaustion policy are based on the theory of comparative advantage in international trade.[132] Since parallel imports under international exhaustion have a price advantage over same products in the local market, they could be conducive to opening free trades efficiently.[133] However, some scholars argued against this position by thinking that the pricing of products protected by intellectual property rights should be rested on the owner of intellectual property rights, rather other the market.[134] From this perspective, it seems that comparative advantage theory should be revisited to determine whether it may be applicable in the cases of parallel imports under the international exhaustion policy.

b) Customer Surplus and Wealth Redistribution

Since the adoption of the international exhaustion policy would result in some impacts in national economy through parallel imports, it is necessary to make a cost-benefit analysis about the changes of policy to measure the national welfare.[135] As far as importing countries are concerned, parallel imports bring much consumer surplus because the price in the importing country about the same product has fallen.[136] Relatively, from the side of the firms and workers producing the same products in the importing countries, the loss would occur when the demand for the original products has decreased.[137] The focus is shifted toward the exporting countries. In the export countries, the customers suffer a loss in the price, given that the increase of exports via parallel imports would decrease the supply of the products, and the product price would be compelled to increase.[138] However, the positive effects, in contrast, come to the firms and workers in the exporting countries.[139] In other words, the firms and workers producing the products enjoy the advantage in increasing the products with a higher price to correspond to the increased demand of products due to parallel imports. After the cost-benefit analysis in both importing countries and exporting countries, it is expected to conclude that the net impact on the national welfare

[132] *See* Abbott, *First Reports*, *supra* note 21, at 622.
[133] *See* Alan O. Sykes, *Comparative Advantage and the Normative Economics of International Trade Policy*, 1 J. INT'L ECON. LAW 49, 49-50 (1998).
[134] *See* Abbott, *Second Report*, *supra* note 73, at 26-27 (Claude Barfield's presentation record).
[135] *See* Sykes, *supra* note 133, at 57.
[136] *See id.* at 63.
[137] *See id.* at 62.
[138] *See id.* at 63.
[139] *Id.*

under international exhaustion would be positive,[140] because the customer gain is higher than the loss to firms in the import countries,[141] and the customer loss is lower than the gain of firms in the export countries.[142]

In terms of the global welfare, the international exhaustion policy could have an allocation effect of wealth and resources between developed and developing countries.[143] It makes the developing countries have a chance to access the patented products, and then create their own productive capability through further research and development while the patentees in the developed countries never license the products or the manufacturing technologies to specific developing countries. The parallel imports under international exhaustion have significant meaning in serving a substitute of the transfer of technologies. Consequently, the effects of wealth redistribution would be reflected in the global welfare.

3.4.2 Arguments against International Exhaustion in Terms of Parallel Imports

a) International Price Discrimination

In economic analysis of the international exhaustion policy, the analysis of the free-riding phenomenon of parallel imports and that of the international price discrimination scheme of the intellectual property holder are two important aspects. The negative impact of the free-riding phenomenon of parallel imports is well known.[144] Nevertheless, since the free-riding phenomenon is not easy to detect and prove in the issue of parallel import, its strong position against the international exhaustion policy is shaken.[145] Compared with the free-riding phenomenon, the price discrimination may be observed from the pricing structure in the global markets. As a result, the economic analysis of the international price discrimination becomes important in objecting to the international exhaustion policy. The stronger the extent of justification of the international price discrimination is, the weaker stand the international exhaustion policy would take. Certainly, there are some predicaments in the economic analysis of the international price discrimination because the price difference in all national markets does not always originate from the price discrimination scheme—the price difference can be caused by the changes of the exchange between currencies or the government's intervention.[146] If that is the case, the justified effects of the economic analysis of the international price discrimination would be influenced. [147]

b) The National Welfare and The Global Welfare

In respect of the national welfare of international price discrimination, if parallel imports are prohibited, the countries with more demand elasticity to price—developing countries—enjoy the gain by which the markets in

[140] *Contra* Chard & Mellor, *supra* note 29, at 77-79 ("…we conclude that the overall balance of the effects of parallel trading is probably adverse.").
[141] *See id.* at 62 ("…the attendant gain to domestic consumers is greater than the attendant loss to domestic firms and workers.")
[142] *See id.* at 63 ("…the attendant loss to domestic consumers is smaller than the attendant gains to domestic firms and workers.")
[143] *See* Abbott, *First Reports*, *supra* note 21, at 624.
[144] *See* JONG-SAY YONG, FREE RIDING AND THE WELFARE EFFECTS OF PARALLEL IMPORTS, DISCUSSING PAPER NO. 06/00, DEPARTMENT OF ECONOMICS OF MONASH UNIVERSITY (AUSTRALIA) 17-19 (2000); Hilke, *supra* note 95, at 76-78. *Cf. the OECD Report*, *supra* note 39, ¶ 28, at 9 ("…*if there is vigorous competition in all pertinent markets, free-riding on marketing support can be presumed to have a negative effect on welfare. Where competition is considerably less vigorous, free-riding could have ambiguous effects*….") (original emphasis).
[145] *See the OECD Report*, *supra* note 39, ¶ 24, at 9 ("The less direct the involvement of authorised licensees in free-riding, the more difficulties an IPR holder could face in trying to control parallel imports…."; Staaf, *Free-Riding*, *supra* note 39, at 235 ("The free-rider argument is thus weakened by the evidence that parallel importers pay a lower price than the U.S. authorized dealers."); Hilke, *supra* note 127, at 91 ("…the available empirical evidence is inconsistent with the strong form of this hypothesis that links all gray market activity to free-riding.").
[146] *See* Staaf, *Price Discrimination*, *supra* note 34, at 313, 327-28.
[147] According to Dr. Staaf's opinion, the price difference coming from reasons other than the price discrimination scheme forms a room for the arbitrage of parallel imports. The arbitrage would enhance the welfare of customers. *See id.* at 325-328.

the countries continue serving the products with a lower price.[148] However, the countries with less demand elasticity to price—rich industrialized countries—would suffer a loss because they are charged with a high price for the product under the price discrimination scheme which would be otherwise lower under the price uniform scheme or the situations where parallel imports are allowed.[149]

As to the analysis of the global welfare, the net effects through comparing the gain in the countries of high demand elasticity with the loss in the ones of low demand elasticity must be determined. The effect, as a matter of fact, is obscure. In other words, it needs to be measured by considering other external factors. Usually, the continuous expansion of the production in the countries with high demand elasticity would compensate the loss in the ones with low demand elasticity.[150] Moreover, according to the research of economists, the global welfare of the international price discrimination varies with the extent of demand dispersion in countries.[151] The larger the demand dispersion is found between countries, the more global welfare the international price discrimination would produce.[152] In addition, the markets with significant competition enhance the global welfare of the international price discrimination.[153] It also implicates that the low level of market power held by the owner of intellectual property rights is conducive to the welfare extent.[154] Another point that needs to be emphasized is that the volitional price discrimination would produce more global welfare than the planned one conducted according to the government regulation.[155]

Finally, in order to make the global welfare under international price discrimination go further, it is suggested that the price discrimination should be established among the groups of counties where all member states have close per capita income, and parallel imports can be allowed within each group due to the low transaction cost.[156]

4. Overall Examination and Evaluation of and the Exhaustion Doctrine and Parallel Imports in Terms of Globally Harmonized Perspective—Establishing the Globally Optimal Legal Model for Exhaustion of Intellectual Property Rights

4.1. Whether International Exhaustion Should Be Adopted

4.1.1 Conclusion from Policy Argument

Under the arguments of Chapter three against the international exhaustion of intellectual property rights, it might be found that the opponents of international exhaustion are mainly concerned with the economic disadvantage and the unfair competition caused by international exhaustion.[157] The economic disadvantage is reflected in the cheaper price of the product protected under intellectual property rights led by international exhaustion through parallel importation. According to the arguments against international exhaustion, the advantageous price would not only undermine the price discrimination mechanism built by intellectual property owners for international

[148] *See the OECD Report*, *supra* note 39, Annex III ¶ 6, at 44.
[149] *See id.*
[150] *See the OECD Report*, *supra* note 39, ¶ 32, at 10; Malueg & Schwartz, *supra* note 34, at 190 "The beneficial effect of higher output under discrimination from continuing to serve low-demand markets outweighs the misallocation effect of discrimination."
[151] *See* Malueg & Schwartz, *supra* note 34, at 190.
[152] *See id.* "…we found that when demand dispersion is large enough, welfare is higher under discrimination."
[153] *See the OECD Report*, *supra* note 39, Annex III ¶ 8, at 45.
[154] *See id.*, ¶ 35, at 12.
[155] *See id.*
[156] *See* KEITH E. MASKUS & YONGMIN CHEN, VERTICAL PRICE CONTROL AND PARALLEL IMPORTS—THEORY AND EVIDENCE, DEPARTMENT OF ECONOMICS, UNIVERSITY OF COLORADO AT BOULDER 31 (2000); Malueg & Schwartz, *supra* note 34, at 191-92.
[157] *See supra* note 144-156 and accompanying text.

marketing, but also frustrate the incentive of the intellectual property owners to develop new inventions, commercial products and creations. On unfair competition, the arguments against international exhaustion focus on the problems of free riding and passing off with the possible attribution to international exhaustion through parallel importation.

In this author's opinion, the concerns mentioned above of the opponents of international exhaustion have been built on some misconceptions about intellectual property system. The misconceptions come from ignoring the reward through first sale for intellectual property owners and equating the adequate award of intellectual property owners with the commercial success.

Although the actual reward for the intellectual property owners under intellectual property system has been difficult to be calculated by a uniform model, the sale revenue of the products protected by intellectual property rights for the first marketing, at least, should be considered the reward in terms of the distribution of the protected products. Regardless of the common law system or continental system, intellectual property laws all tend to release the exclusive right of intellectual property owners over the future distribution of the protected products after the first sale of the products has been made in the markets, even though it is still under dispute whether the exclusive right over distribution remains to be against parallel importation from the foreign markets. In terms of legal evaluation under intellectual property laws, to secure the legal entitlement of intellectual property rights to seek the sale revenue of the protected products for the first marketing is the price of giving away the future interference about the distribution of the products. As a result, unless the alternative approach will be developed in the future to calculate the actual reward for intellectual property owner to balance the abandoning exclusive right over distribution, the access to the sale revenue is the only indicator about whether intellectual property owners have generated the reward for distribution of the protected products. The reward, under intellectual property laws, justifies the concession of the exclusive right over the future distribution of the protected products after the first marketing. In other words, the intellectual property owners never lose the future control over the distribution of the protected products after the first marketing, provided that the position to access the sale revenue of the protected products has been impeded. On the contrary, the accessing of intellectual property owners to the sale revenue of the protected products will lead to the assumption under law that the adequate reward about distribution of the protected products has been obtained.

The reward from the first sale of the protected products, depending upon the access to the sale revenue, should not be influenced by the geographical scope of the first marketing. As long as the intellectual property owners can directly or indirectly access the sale revenue of the first marketing—the first marketing was conducted either by the intellectual property owners or the distributors through the licensing or other related agreements—the reward under intellectual property law would be assumed. From this perspective, when the

reward has been assumed by intellectual property laws, the incentive of intellectual property owner about inventing, marketing and creating is also simultaneously considered satisfied under law. It must be clarified that the incentive mentioned by the opponents of international exhaustion that would be damaged by parallel importation is not protected by intellectual property laws. Instead of the necessary reward for the first marketing, the incentive argued is connected with the commercial success—maintaining the price discrimination scheme. Nonetheless, the legislative purpose of intellectual property laws is to promote the scientific or cultural development and the fair competition in the market by granting the necessary reward, not by guaranteeing the commercial success. Evidently, it cannot be justified under law to take advantage of intellectual property laws to block parallel importation of the protected products through opposing international exhaustion merely for the sake of securing the commercial success on the price discrimination scheme. Furthermore, even though international exhaustion can be opposed to prevent the parallel imports of the protected products under intellectual property laws, it does not mean that the commercial success of the price discrimination scheme would be assured. In addition to the possible challenge from competition law, the management and discipline of the international marketing network and the strategy of the competitors also play significant roles in deciding the maintenance of the advantageous price discrimination scheme. In view of the uncertain factors out of intellectual property laws influencing the commercial success of the price discrimination scheme, it seems an

abrupt policy decision to disallow international exhaustion under intellectual property laws to prevent parallel importation.

The concerns about fair competition caused by free riding and passing off are also examples of misconceiving that the protection of commercial success is under intellectual property laws. From the angle of the international marketing, the promotion acts for the products are involved within the international market network, though there is some discrepancy existing in the contents of advertisement to meet specific economic and cultural circumstances in each country. When the parallel importer has the protected products by paying the sale price in the foreign country, the price has contained the related cost about the promotion acts of the product in this country. Moreover, the lower price of the protected products under parallel importation is the necessary result of the price discrimination scheme. In terms of contribution to the promotion of the protected products in the international market network and pricing the products of parallel importation according to the price discrimination scheme, it is hard to think that the parallel importer was free riding on the promotion cost and held any unfair advantage in entering the domestic market. Although it is admitted that the absence of product service and warranty after sale in the products under parallel importation would enhance the price advantage in the domestic market, the price is not the only factor for the prudent consumer to decide whether the products in the gray market are worth purchasing, especially since, nowadays, the image of the products in the gray market connected to the lack of the product service has been well established in the minds of the consumers due to the rapid spread of commercial information. After comprehending the benefit from the lower price and the cost from the lack of the product service, it is unclear to know whether the products of parallel importation would prevail in the market by the price advantage. As a result, it is far-fetched to resort to intellectual property laws to prevent parallel importation for the reason of free-riding.

The concern of passing off is mainly reflected in the cases of the protected products with inferior quality through parallel importation. The protected products under parallel importation were basically manufactured according to the authorization of intellectual property owners. Unless the parallel importer altered the protected products without the consent of intellectual property owners before entering the domestic market, any defect or inferior quality of the protected products should be attributable to intellectual property owners, other than parallel importers. Consequently, based on the reason that intellectual property owners must bear all disadvantages resulting from the incomplete process of manufacture and quality management, the genuine protected products under parallel importation would not produce any extra unfair competition against intellectual property owners, even though the likelihood of confusion or the damage on goodwill is not avoidable. Intellectual property laws are not designed to mitigate the risk that intellectual property owners would bear due to the flawed or intended manufacture process, given the elimination of the risk to safeguard the interest of intellectual property owners is merely a kind of commercial success, not relevant to the necessary reward protected under intellectual property laws. Consequently, it is unreasonable to prevent the passing off under parallel importation by denying international exhaustion under intellectual property laws.

Relying upon the positive arguments for international exhaustion under Chapter three and finding unconvincing the concerns of the opponents objecting to international exhaustions, this article, in terms of policy consideration, concludes that the international exhaustion doctrine is the optimal legal model to balance the interests existing in intellectual property rights and international free trade.

4.1.2 Conclusion from Economic Argument

The main economic argument asserted by the opponents of international exhaustion under Chapter three is the focus on the positive welfare effect of the price discrimination scheme.[158] As a matter of fact, apart from arguing that the price discrimination adopted by intellectual property owners is not usually perfect

[158] *See supra* note 164-188 and accompanying text.

discrimination, not always, as a result, holding higher welfare effect than the uniform pricing system, the fundamental phenomenon should be disclosed that the theoretical effect of the price discrimination cannot be reflected in the commercial practical operation. From the angle of the empirical observation, it is often found that the poor or developing countries where the people have lower consumption capability and strong product demand are charged higher prices for the protected products than the rich or developed countries, especially about medication to fight prevailing epidemics. This phenomenon has been contradicting the theoretical design of the price discrimination scheme that intends to achieve the goal of international marketing by compensating the possible loss from marketing in the countries charged lower price with the gain from marketing in the countries charged higher price. The original welfare effect built upon the balance between the interest of intellectual property owners and the access to the protected products would be also broken down as the incomplete operation of the price discrimination scheme. As a result, in terms of the current practice of international trade, it is highly doubtful whether the anticipated welfare effect of the price discrimination scheme would be made.

Additionally, it might be also observed that the manipulation for commercial success has invaded the operation of the price discrimination scheme. Not only would intellectual property owners hold the surplus by charging the high price in the developed countries, but they also would establish the market monopoly by charging unaffordable prices to people with the tendency of the price sensitivity in the developing countries. If intellectual property laws support the theoretical welfare effect of the price discrimination to oppose international exhaustion, ignoring the actual manipulation in the commercial practice, it would make no difference to endorse the commercial success of intellectual property owners. Under this policy, all cost caused by the failure of intellectual property laws to balance the interests between intellectual property owners and the public—the excessive price over what is needed for incentive is charged in the developed countries, and the access of new products is blocked in the developing countries—is certain to be borne by the consumers in the international markets.

The transaction cost is also a concern for the opponents of international exhaustion. The different economic development in the global community would raise the transaction cost for adopting the international exhaustion doctrine. It is recommended in terms of economic analysis that the international exhaustion doctrine would achieve the highest welfare effect by being applied in the customs union or trade area where the member countries have similar economic conditions. However, from the observation of this author, the transaction cost for international exhaustion has been gradually reduced since the WTO was established. Given that the issue of exhaustion of intellectual property rights is related to international trade and intellectual property laws, the relevant trade agreements and the TRIPS agreement play a decisive role in reducing the transaction cost for international exhaustion. While the trade agreements under the WTO function to eliminate the trade barriers and produce the adequate circumstances for international free trade, the TRIPS agreement is engaged in harmonizing national intellectual property laws to secure the necessary reward to stimulate the incentive for intellectual property owners in the global community. Therefore, the argument against international exhaustion based on the high transaction cost seems to get weakened when considering the contributions of the WTO in international free trade.

Finally, it is well established that the free-riding acts conducted by the importer would damage the welfare effect of international exhaustion. Nevertheless, the free riding act is difficult to prove, often serving as an argument against international exhaustion for the purpose of commercial success, rather than the adequate reward of intellectual property owners. Through acknowledging the current circumstances for international trade, it might be found that the benefit brought by the international exhaustion doctrine is definite, but the cost of the free riding acts is unclear. As a result, it is unreasonable to object to international exhaustion by considering the uncertain cost of the free riding acts and ignoring the free competition effect of the international exhaustion doctrine.

On account of the arguments of comparative advantage and wealth redistribution in Chapter three and what is mentioned about clarifying the concerns of the opponents about the international exhaustion doctrine, this

article, in terms of economic analysis, concludes that the international exhaustion doctrine is the optimal legal model to balance the interests existing in intellectual property rights and international free trade.

4.2 How International Exhaustion Should Be Applied

4.2.1 International Exhaustion and Subject Matters of Intellectual Property

A core inquiry made about the application of the international exhaustion doctrine is whether the international exhaustion doctrine should be applied overall and indiscriminately, or differently according to the attribute of each intellectual property rights. This author thinks that the overall and indiscriminate application of the international exhaustion doctrine is the best consideration to work the function of the international exhaustion doctrine under intellectual property rights.[159] There are three main reasons to support the opinion of this author. The first reason is that there has been no sufficient evidence indicating the connection of the different attribute of intellectual property rights with the application of the international exhaustion doctrine. To take patent for example, even though the higher R&D and maintenance cost must be involved in the application of patent, it is not necessarily inferred that the opposition of the international exhaustion doctrine would secure the incentive of the patentee for the future inventions. As mentioned above under the conclusion from the policy argument, the concern about the application of the international exhaustion doctrine to undermine the incentive of the patentee is built upon the commercial success that is not the goal of intellectual property laws. As matter of fact, the commercial success resulting from avoiding the advantageous price of parallel importation under the national exhaustion doctrine is not invulnerable to the price competition of other legal similar products and other market changes. It is unconvincing to argue that the incentive of the patentee for future inventions would be protected by prohibiting the application of the international exhaustion doctrine under patent law.

The second reason focuses on the necessary reward for intellectual property owners' inventions, new products or creative works under intellectual property laws. As mentioned about under the conclusion for the policy argument, the access of intellectual property owners to the sale revenue of the protected products for the first marketing, regardless of whether the sale market is domestic or foreign, is assumed under intellectual property laws as necessary reward for the intellectual property owners to give up the control over the future distribution of the protected products. The incentives of intellectual property owners have been considered satisfied under intellectual property laws, when the intellectual property owners are granted the necessary reward. From this perspective, instead of the respective attribute of intellectual property rights, the necessary reward under intellectual property laws influences the incentives of intellectual property owners in the future inventions, new products, or creative works. It is evident that it is not necessary to allow the adoption of the national exhaustion doctrine to specific intellectual property right to secure the incentives of intellectual property owners.

The most significant reason for this author to oppose the discriminating application of the international exhaustion according to the different attributes of intellectual property rights is rested upon the prevention of misuse of intellectual property rights. Nowadays, according to the development of modern technologies and the need of the consumers, the products tend to be complex and delicate. It is possible for a product to be embodied with varied intellectual property rights—for example, a product is simultaneously protected under patent law, trademark law and copyright law, or a patented and trademarked product has an attached copyrighted label or package. When both the international exhaustion doctrine and the national exhaustion doctrine are applied under law according to the different attributes of intellectual property rights, the misuse of intellectual property rights would happen as a result of manipulating nominally one unexhausted intellectual property right to stop the parallel importation for the real purpose of enforcing the exhausted right, provided the products under parallel importation are embodied with varied intellectual property rights—while some rights are exhausted according to the international exhaustion doctrine, others remain unexhausted under the national exhaustion doctrine. The

[159] *Contra supra* note 88-91 and accompanying text (the opinion of Professor Cornish); *cf.* Tomas Cottier, *The Exhaustion of intellectual Property rightrs—A Fresh Look*, 39 IIC755,756-57 (2008).

result would damage the legislative purpose of the international exhaustion doctrine balancing the interest of intellectual property owners and the access of the public to the protected products in the specific intellectual property right, and also would make intellectual property laws tend substantially to adopt the national exhaustion doctrine. Another cost in this misuse is reflected in the unfair competitive benefit in the domestic market from avoiding parallel importation by using the unexhausted right to resurrect the exhausted right under intellectual property laws, even though the intellectual property owner has received the adequate reward to abandon the exhausted right.

4.2.2 International Exhaustion and Types of Parallel Importation

Compared with the importation of the counterfeit products, the parallel importation is made to carry the lawful genuine products that were manufactured with the authorization of intellectual property owners. Generally, the parallel importation has varied types according to the factors of the patterns of the authorization and manufacture, the manufacture place and the relation of the importer with the manufacturer. Since the application of the international exhaustion doctrine concerns the consent of the intellectual property owner about the first marketing of the protected products in the foreign market, and the access to the sale revenue for first revenue marketing as the reward in exchange for giving up the future distribution right, each type of parallel importation must be examined under intellectual property laws prior to the application. From this perspective, the types of parallel importation would not directly influence the application of the international exhaustion doctrine.[160] As long as the consent of the intellectual property owner for the first marketing in the foreign market could be found, any type of parallel importation would be protected under the international exhaustion doctrine from the further interference of the exclusive distribution right.

However, U.S. copyright law tends to distinguish the parallel importation of the protected products made in the U.S. from that of the protected products made outside the U.S. under the application of the international exhaustion doctrine. It might be inferred from *Quality King* of the U.S. Supreme Court that the latter could be excluded from the application of the international exhaustion doctrine. The conclusion, as mentioned above under the overall observation of legal system, is not beyond criticism. The manufacture place is not connected with the determination of the necessary reward for intellectual property owners to abandon the exclusive right over the future distribution of the protected products. In addition, the real purpose of adding the condition of manufacture in the U.S. to the application of the international exhaustion doctrine is suspected to point to the protection of the local employment and manufacture economy. Intellectual property laws obviously cannot endorse this purpose.

4.2.3. International Exhaustion and Types of Goods Embodied with Intellectual Property

It is significant to clarify whether the international exhaustion doctrine shall be applied to all kinds of goods, or limited to specific goods. If the concern is put about what goods under the adoption of the international exhaustion doctrine can produce the best welfare effects, and what goods cannot, it is necessary to conduct the international good survey under parallel importation completely and thoroughly. Although there have been some national governments and scholars engaged in the empirical studies of parallel importation of goods, these surveys are confined to specific geographical scope (a state or a customs union) and particular goods that have the economic significance in the market.[161] The empirical results of these surveys based upon the restricted good

[160] *See supra* note 28-30 and accompanying text.

[161] Generally speaking, the empirical studies are often restrained by the territoriality of sampling and the preference of related issues. For example, John C. Hilke chose the research samples within the U.S., and his study is focused on the free-riding problem; however, Professors Chard and Mellor established their samples in the U.K., and their study is not limited to trademark, reaching out the analysis about prejudice to innovation through parallel imports. Regarding the comment on the two empirical studies, see ROTHNIE, PARALLEL IMPORTS, *supra* note 24, at 567-78. In addition, in terms of the empirical studies conducted or entrusted by governments, the particular economic structure and environment of nation or region are considered in the empirical studies about the issue of parallel import and the exhaustion doctrine. For example, the Swedish research report emphasized the impact on the economy of Sweden that the EU regional exhaustion doctrine of trademark would bring about; the EU study paid much heed to the possible economic consequence within the EU, provided the regional exhaustion of trademark is revised to the international exhaustion. *See* Swedish Competition Authority, *Parallel Imports —*

data and national or regional economic interest orientation would not be conducive to the decision of the internationally harmonized policy about the international exhaustion doctrine. Owing to the difficulty to find the optimal survey and assessment method—how to exhaust the types of goods on data collecting and how to assess the global welfare of each type of good—no complete international good survey about the adoption of international exhaustion doctrine has been conducted up to now. The feasibility of the international good survey is not sanguine. In addition, even though the predicament of the method on the international survey is overcome, the empirical results could not be guaranteed to be equal to the future changes in the international markets. It can be anticipated that as the international demand and supply of specific goods are changed and new goods are developed in the international markets, the global welfare effect of goods under the original international good survey about the adoption of the international exhaustion doctrine would be certainly influenced. From this perspective, to seek the discriminating application of the international exhaustion doctrine to different types of goods would be involved in high cost on policy decision—the establishment and maintenance cost about the international good survey—and would lead to the uncertain policy benefit—the vulnerability of empirical result for policy consideration to the future market changes.

5. Conclusion

The exhaustion of intellectual property rights is the balance mechanism between the maintenance of international free trade and the protection of intellectual property rights. The spirit of the exhaustion doctrine is reflected in granting the intellectual property owners the opportunity to directly or indirectly access the sale revenue of the first marketing of the protected products as the price to abandon the exclusive right to control the future circulation of the protected products. Under the law equation, the balance between the public interest and the private interest has been assumed under the exhaustion doctrine. The interest balance mechanism is never affected by the geographical scope of the first marketing, as long as the domestic intellectual property owner has the opportunity to access the sale revenue for the first marketing as a reward in exchange of exhaustion effect. From this perspective, the adoption of the international exhaustion doctrine would leave the interest balance mechanism intact. In addition, as mentioned in Chapter Seven, it is concluded from examining policy arguments, economic arguments and legal experience that the international exhaustion doctrine is the optimal legal model on the exhaustion issue for the global community. Since the international exhaustion doctrine is built upon the basis of the interest balance, according to the best interest for the global community, it is strongly justified to position this doctrine as a globally harmonized legal model in the global community.

Besides the advantageous characteristics of the international exhaustion doctrine, there are two main reasons to promote the establishment of the globally harmonized legal model for the exhaustion issue.[162] One reason is to avoid the manipulation on the exhaustion issue through the international trade negotiations. On the surface, without the globally harmonized legal model, it seems that each country in the global community may adopt the exhaustion doctrine best meeting the demands of the national economic development. However, it can be anticipated that the developed countries with stronger economic bargain power would force those developing countries to change their interest consideration to follow the exhaustion doctrine of the developed countries through bilateral or multilateral trade negotiations.[163] Under this situation, not only would the absolute national discretion on the decision of the exhaustion doctrine be destroyed, but the interest balance mechanism under the exhaustion doctrine would also be jeopardized, given that the compulsory adoption of the national exhaustion doctrine would make the domestic intellectual property owner enjoy double reward for the exhaustion effect—

Effects of the Silhouette Ruling, Report Series 1999:1 (1999); NERA, *The Economic Consequences of the Choice of Regime of Exhaustion in the Area of Trademarks*, Final Report for DG XV of the European Commission (1999).

[162] *Contra* Vincent Chiappetta, *The Desirability of Agreeing to Disagree: The WTO, TRIPS, International IPR Exhaustion and a Few Other Things*, 21 MICH. J. INT'L L. 333, 391 ("[T]he economic costs of preserving diversity may be a small price to pay to avoid the arbitrary homogenization of values that choosing (or forcing) a single approach inevitably entails.").

[163] *See* Frederick M. Abbott, *Political Economic of the U.S. Parallel Trade Experience: Toward a More Thoughtful Policy*, in INTELLECTUAL PROPERTY: TRADE, COMPETITION, AND SUSTAINABLE DEVELOPMENT 177-87 (Thomas Cottier and Petros C. Mavroids eds., 2003).

one from the first marketing in the foreign country and another from importation to the domestic market. In this author's opinion, the globally harmonized legal model for the exhaustion issue can prevent this defect.

Another reason for the establishment of the globally harmonized legal model for the exhaustion issue is rested upon the justification of determining the adequate protection scope of intellectual property rights. It is undeniable that the absence of the globally harmonized legal model for the exhaustion issue provides each country in the global community with the policy flexibility on the decision of the exhaustion doctrine by considering the national political, economic, and social developments. However, in this author's opinion, this flexibility also blurs the boundary for the protection of intellectual property rights. In other words, the decision of the exhaustion doctrine is vulnerable to the interest considerations beyond intellectual property laws that would break down the interest balance mechanism under the exhaustion doctrine—for example, the adoption of the national exhaustion doctrine is with the aim of securing the commercial success, or the local industries. These policy purposes out of intellectual property laws should be fulfilled by other legislation or administrative means, rather than the exhaustion doctrine. The application of the exhaustion doctrine produced beyond the consideration of intellectual property laws would distort the real function of the exhaustion doctrine, increasing unnecessary social costs. Consequently, this author thinks that the establishment of the globally harmonized legal model for the exhaustion doctrine would be conducive to assuring the adoption of the exhaustion doctrine within the gist of intellectual property laws.

After the necessity of the globally harmonized legal model for the exhaustion issue has been determined, the next step is concerned with what forum is optimal to endorse and enforce the harmonized legal model. Since the exhaustion issue of intellectual property rights involves the strained balance between the protection of intellectual property rights and the maintenance of international free trade, the WTO functioning to promote free trade, eliminating the unnecessary barriers and assuaging the impact of intellectual property rights on free trade should be the proper international forum to regulate the harmonized exhaustion doctrine. Currently, although Article 6 of the TRIPS under the WTO has tended to give the discretion to the member state to decide the adoption of the exhaustion doctrine due to the difficulty in settling the interest conflict among states by a uniform exhaustion doctrine, this author believes that the firm justification of the international exhaustion doctrine would be amenable to any examination from the member states and eventually would be expected to break through the present stalemate to form the harmonized legal model in Article 6 of the TRIPS under the WTO[164]. Certainly, it is worth noting that the cooperation of the WIPO system with the WTO system is indispensable to the establishment of the globally harmonized international exhaustion doctrine in the global community.

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[164] *See* Abdulqawi A. Yusuf, *TRIPS: Background, Principles and Geberal Provisions, in* INTELLECTUAL PROPERTY AND INTERNATIONAL TRADE: THE TRIPS AGREEMENT 20 (Carlos M. Correa & Abdulqawi A. Yusuf eds., 2d. ed., 2008).