Proper Implementation of the Exhaustion Theory for Increasing Benefit of Parallel Imports
Reggiannie Christy Natalia

Abstract

Parallel import merupakan suatu isu penting dalam perdagangan internasional. Para pebisnis membeli produk-produk original dari suatu negara dan menjualnya di negara yang menawarkan harga yang lebih mahal, tanpa seizin pemegang hak kekayaan intelektual produk tersebut. Praktek ini tidak selalu merupakan hal yang ilegal, karena negara-negara tertentu melindungi praktek ini dan jangkauannya tergantung pada jenis exhaustion theory yang mereka terapkan dalam hukum nasionalnya. Studi ini secara garis besar akan membahas mengenai jenis-jenis exhaustion theory yang ada, bagaimana teori tersebut mempengaruhi parallel imports and penerapan exhaustion theory oleh EU, WTO dan WIPO. Sehingga dengan membahas aspek-aspek tersebut, studi ini bertujuan untuk menemukan implementasi exhaustion theory yang tepat dan menyumbangkan saran yang sesuai untuk pelaksanaan parallel imports.

Kata kunci: impor paralel, exhaustion theory, perdagangan internasional dan kekayaan intelektual

Background

Parallel imports have been implemented from time to time by the international business society. In response, the law has provided a protection for the parallel imports it self which is called the “exhaustion theory”. Intellectual property law uphold the rights of the inventors, scientific progress and business investment, an it allows monopoly and the price control to the inventor for some period of time. The exhaustion theory restrict the inventors power to control the price of their inventions to some extent. Parallel trade comes in as a controversial issue between the intellectual property and competition law.1

Notwithstanding, parallel imports benefit the society. The practice of parallel imports is also considered as a combination of Intellectual property law and competition law efforts in enhancing consumer welfare.2 With a competitive price, customers are offered with similar goods in various prices. The market are forced to lower their price, in order to compete with the parallel imports products.

One of the most significant advantages of the parallel imports can be seen in the distribution of the patented pharmaceutical products. Hart defines patent as a monopoly right that is granted by the government to the inventor of a particular product or process. This right is aimed to provide an incentive for the innovation, stimulate the economic activity and to inform the public of the current

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technology. However, due to the parallel imports, now more and more people could access the medicine easily and with affordable price.

Many people have argued that, the patented medicines have breached human rights, due to the restriction to access for medication. The patented medicine likely to be sold at higher price and the people who are in need of the medication would not be able to afford or even access the medication. With the legalization of parallel import, the access to medicine would be easier and affordable. However, parallel imports is not always giving positive impacts. There are many business people that have been disadvantaged over parallel imports. Many developed countries have also suffered from economic lost, due to the underperformance of their local companies. It is common sense, consumers will purchase more affordable product given the choice of the products of the same quality. Traders will set low price for the sake of competition. However, if they could not survive from the competition, it would cause a great lost for them and impacting the economic of the country, job creation, which will deliver negative impact to the larger society.

Heath argues that the parallel import is a beauty of the international trade, however, a good law where the patentee would be benefiting of its own created goods is also needed. This argument is in favor of the parallel imports practices, but as well as raising an awareness to provide a sufficient protection for the Intellectual Property (IP) holders.

The purpose of the study is to find the most effective law mechanism to deal with the positive and negative impacts of parallel imports. Which then is likely to benefit more aspects of international trade, for both businesses and consumers. This study will be organized into four sections. First section will generally discuss about the parallel imports and the exhaustion theory. Section two will outline the European Union, WTO and WIPO rules and regulation governing the parallel imports. Section three will indicate variant dispute settlements for issues concerning parallel imports. At last, section four will give an overall summary and recommendation of what is seems as the most effective law mechanism to deal with parallel imports.

Section 1: Parallel Imports and the Exhaustion Theory

Kuptsove argues that the main reason of the high demand in parallel imports is due to the different prices of the same product in two different markets. This gives rise to imports from the low price market to the high price market. Nevertheless, the import activities are only possible and depend on the exhaustion regime that is implemented in their national law. Parallel import defines as “persons and companies with a common goal to make profits by involving themselves in the

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Within the parallel imports, the business people would be buying specific goods with a low price and sell it in another place with a higher market to gain profits.

The term exhaustion in the exhaustion theory means that once a good is released to the market by the inventor (directly or by his consent), his rights will be exhausted from further circulation of the product in the market. This also known as the “first sale doctrine”. This theory came into existence to ensure that there will be no monopoly activities from the IP holders after the goods had been legally purchased or be put in the market. By the existence of this doctrine, the right of the IP holder has been restricted to gain further profits from his inventions.

Exhaustion aims in the balance between the public and the IP owner’s interests. In other words, it would benefit both sides by setting a limitation of the IP owners’ rights to its invention uses. This doctrine can be separated into three categories; national exhaustion, regional exhaustion and international exhaustion.

- National exhaustion is whereby the IP holder could oppose the parallel imports from the other countries, because the national of the law of the country does not recognize the parallel imports. In this regards the law seems to be more in favor of the IP holders rather than weighing on the competition law. Some countries apply this type of exhaustion to promote their national brand.

- Regional exhaustion is whereby the parallel imports are permitted between the region member states, however, restricted the parallel imports form the non-member states. The most appropriate example of this type of exhaustion can be seen from the European Union countries. The member states are freely exporting and importing goods without being subjected to any barrier, including parallel imports.

- International exhaustion is whereby a country allows parallel imports from any countries. This is the most controversial type of exhaustion whereas, the IP owner would be put in the position of competing with the re-seller who bought their goods from a cheaper price and having no right to ban it. The developed countries are likely to suffer more lost if the international exhaustion is applied. Nevertheless, the developing countries are likely to benefiting more, due to the competitive price, especially when it comes to the pharmaceutical and food industries.

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5 Avgoustis (n1)  
7 ibid  
8 Bonadio (n7)  
9 ibid  
10 ibid
From the above types of exhaustion there are several points that should be considered before letting parallel imports meet the exhaustion rights. This article would indicate several issues caused by the parallel imports.

- For an instance, if Apple store in the UK sells to the resellers in the UK “AB” product for 500 pounds and sell the “AB” product to Greece resellers for 400 pounds. In this case, if the parallel imports occur, UK resellers as the second party will be more likely to suffer from the loss instead of the patentee as the first party. Which means, the doctrine of exhaustion has successfully managed the anti monopoly regime, nevertheless, seems to set aside the interest of the second party.

- It is also argued that parallel imports should have never been in place because every country requires different marketing approaches. For example Apple in the UK doing most of the advertisement to sell the iphone 6 and in result the price of iphone 6 in the UK is more expensive because it has to cover the marketing budget.\(^{11}\) When then the parallel importers brought the same iphone 6 to the UK with lower price, they would not have to care about the advertisement and marketing budget over the chattel. They could immediately put the product in the market and obtain the most benefit without having to promote it. In this case, the apple distributors would suffer a tremendous loss.

- On the other hand, parallel imports often come with a different quality, due to the cost of production. However, the consumers may not have the information of the different quality of the product.\(^{12}\) In the light of the quality difference there are 2 possible circumstances that might likely to arise. Firstly, the reputation of the brand would be bad in the eyes of the consumers. Secondly, the poor quality of the product will lead to complain or customer suing for the poor quality. In this case, the domestic branch of the chattel will be the one who has to deal with the unpleasant situation.

1.1 Pro and Contra about Parallel Imports

Combating the price discrimination, whereby a manufacturer gives different prices in different market. For example, MSD Pharmaceuticals launched a diabetes drug called “Junuvia” and was priced it for approximately $1 per tablet in India and $5 per tablet in the U.S.\(^{13}\)

It is true that how corporations pricing their goods in every country are variant. As discussed above, the differentiation of pricing could be indicated as price discrimination. However, before

\(^{12}\) ibid p. 564
manufacturers are accused of price discrimination, several aspects should be considered. For example, the fact that the living standard in the US is way higher than the living standard in India. Even if $1 in India and $5 in US seems to be a big difference, however, the citizen in India due to the lower income would still feel that the price of the tablet is quite expensive. The people in the US would consider the $5 per tablet is as expensive as the Indian citizen feels about the tablet price. From this perspective, price difference of the tablets is not considered as price discrimination.

In 2010, President Obama endorsed International exhaustion for parallel imports in pharmaceutical sector to drive down the US medication price. This means that, people or company outside the US are protected to import pharmaceutical products to the US and the patent holder no longer have the right to ban or contest the action due to the International exhaustion. However, it is also estimated that the U.S. might likely to stop the parallel imports due to the bad quality of the imported products.

It appears that, parallel imports are likely used by the government to control the national market price. From the US implementation of parallel imports it can be seen that parallel imports do not have to be applied in all kinds of sectors. Even if the national law of the country chooses to exercise national exhaustion, however, certain sectors that likely to enhance the public good should be considered to allow parallel imports and the other sectors should remain the same. On the other hand, consumers should be notified about the products that they will purchase. This is to ensure that they are aware if the product is parallel imports product or not. Thus, they should be ready with the consequences if the quality is different even if the product is also genuine.

Section 2: European Union, WTO and WIPO regulation with regards to parallel imports.

2.1 European Union

European Union legalization of parallel imports is a product of the internal market and the free movement principle of the union. It started from the establishment of the European Economic Community in 1957 and the further amendment to the Treaty of Lisbon 2007. With the aim to create a single market for the bloc, the union set aside the internal barriers of trade which includes the abolition of customs and national tariffs. The European Union adopted the regional exhaustion. Once the inventor has put his goods in the European Union countries circulation, they have directly exhausted their rights over the goods. No further action can be taken to prevent the circulation of

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14 ibid
15 ibid
16 Avgoustis (n1)
the goods. This concept has been applied to the European countries\textsuperscript{17}. For an instance, the UK has adopted this under the section 12 of the Trade Marks Act 1994.

EU law protects parallel imports as a tool for achieving and maintaining a single market. In result, parallel imports has increased consumers welfare in the EU. Import goods from low price countries force sellers in the destination countries to reduce the price. Competitive market is ensured all over europe, yet it causes conflicts between the parallel importers and the local business people in the destination countries.

Article 26 of the Treaty on Functioning of the European Union (TFEU)\textsuperscript{18} stipulates that in order to uphold the single market, an area without internal barriers, free movement of goods, services and person should be ensured. Means that, it is essential to uphold the free movement principle, in any kind of sectors.

Exception for the free movement of goods relies on the article 30 of the TFEF whereby there will be a restriction on importation if it likely to be in breach of public morality, security or security\textsuperscript{19}. Nevertheless, article 30 and the national intellectual property law of the member states shall not restrain the parallel imports\textsuperscript{20}.

It appears that, as long as the importation within the European Union countries do not violate the article 30 of TFEF, then the practice of the parallel imports could be legally performed within the region. The right of the parallel importers are protected under the free movement principle and the IP holders’ right would be exhausted within the region once he put his good into the European circulation. The EU gives a strong protection for the parallel imports without limitation to any sectors.

2.2 World Trade Organisation (WTO)

The WTO has its own agreement related to the Intellectual Property rights, which also covers parallel imports. The agreement was signed in Marrakesh 1994\textsuperscript{21} and called as the Trade Related Intellectual Property Rights Agreement (TRIPS).

It is enshrined under the article 6 of TRIPS agreement that “nothing in this agreement shall be used to address the issue of the exhaustion of intellectual property rights”.\textsuperscript{22} Nevertheless, if any

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\textsuperscript{17} Hart (n2) p. 275
\textsuperscript{18} a. 26 of the Treaty on Functioning of the European Union
\textsuperscript{19} s. 3 of the Treaty of Rome 1958
\textsuperscript{21} <https://www.wto.org/english/tratop_e/trips_e/t_agm0_e.htm>
\textsuperscript{22} a. 6 of Trade Related Intellectual Property Rights Agreement
\end{flushleft}
issue of intellectual property emerges, an immunity of legal action would not be in place. WTO is not willing to interrupt in its member states exhaustion of rights issues, nor it is willing to be involved in exhaustion related to dispute settlement.

In addition, paragraph 5(d) of Doha Declaration on the TRIPS Agreement and Public Health supports the above article which allows the member states to freely establish its own exhaustion regime for the intellectual property rights. From the two articles governing the exhaustion regime above, it can be seen that the WTO is reluctant to intervene on how the member states regulate the exhaustion of intellectual property. Which means that, the legality of the parallel imports activities in every WTO member states would be different depends on the types of exhaustion that the member states included in the national law.

Bonadio argues that an international exhaustion regime would be consistent within the WTO principle and provision. The international exhaustion within the WTO countries would be more likely to get rid of any artificial and detrimental barriers, as well as to stimulate the commercial and economic integration between the WTO member states.

Some of the WTO least developed and most developed countries have exercised the international exhaustion regime, considering it as an opportunity to stimulate their economic growth. For example Japan, India and US have implemented the international exhaustion in their pharmatical sectors, Australia applies international exhaustion for cars and books.

The less developed countries who need to be provided with affordable products can gain profits from international exhaustion and developed countries can make use of international exhaustion to control the market and to benefit their middle to low income citizens.

The fact that WTO does not force its member states to imply particular exhaustion regime was based on good considerations. One of the main purpose of WTO is to create the same level of playing field for the member states, the WTO decision is also respecting its member states sovereignty. The member states within their own discretion and national interests to choose the types of exhaustion that will be suitable for their economy. Because if WTO were to force its member states to implement particular types of exhaustion, some of the member countries might be disadvantaged from the provision.

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23 Bonadio (n7)
24 para. 5(d) of the Doha Convention on the TRIPS Agreement and Public Health
25 Bonadio (n7)
26 ibid
2.3 World Intellectual Property Organisation (WIPO)

WIPO as a world organization that specifically govern Intellectual Property had researched and gathered data from the WIPO member states on their implementation of the exhaustion for patent rights. The session was held in Geneva, on the 3rd to 7th of November 2014. WIPO considered exhaustion as an exception and limitation to patent rights.\(^{27}\)

From the data gathered, the WIPO member states are exercising the exhaustion differently. Reportedly, 27 member states are exercising national exhaustion, 22 member states with regional exhaustion, 19 member states with international exhaustion, 4 member states with mixed exhaustion and 4 member states that are still uncertain.\(^{28}\) It appears that WIPO is still in progress on regulating the exhaustion and parallel imports practice within its member states. WIPO member states have the freedom to determine the kind of exhaustion that seems to be suitable for their own interests and economic developments. However, WIPO is open to hearing the parallel imports cases within the member states.

Among the three international organizations, only the European Union has rigid regulation governing the parallel imports for its member states due to the implementation of the free movement principle. The Union has its own harmonized law system in IP related aspects.

On the other hand, WTO as one of the most powerful international trade organizations is not willing to intervene in its member states parallel imports issue. Furthermore, it does not allow itself to be involved and being a mediator in parallel imports issues.

WIPO as an organization that focuses on Intellectual Property as well does not yet firmly regulating about the parallel imports and involved in its member states application of the exhaustion. From all of the WIPO documents, they have indicated the variant types of the parallel imports, however, the WIPO is not in favor in any types of them. It is also seemed that, the WIPO still depends and more referring it itself to the WTO’s rather than having its own rules and regulation.\(^{29}\)

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28 Ibid

Section 3: Dispute Settlement

3.1 European Union Dispute Settlement

Civil and commercial matter in relation with IP in the Europe is regulated and determined under the EC No.22/2001 of 22 December 2000, which is adopted based on the Brussels Regulation.30

Basic rule relies on the article 2 of the Brussels Convention 1986 stated that “the defendant should be sued in the country where he is domiciled and he would be bound to his country national rule”. This article would likely to lead the defendant to a bias judgment, considering that the court that is hearing the case is in his own country. There will always be a speculation that the judgment would be in favor of its own citizen.

Furthermore, even if the court has rendered a reasonable and fair decision, due to the differentiation in law and background the claimant might still have unsatisfactory feelings against the rendered judgment. It is also likely that, a different claimant with the same issues will be rendered with a different enforcement due to the different applicable national law in every European Union countries.

In addition to the above convention, the Article 5 of the Brussels Convention gives an exception regarding the appropriate jurisdiction for the defendant for IP cases. The defendant could be sued in another jurisdiction if the case is associated with the following offense: with regards to a contract (the court where the obligation is in question) and with regards to a tortious act (the court where the harmful event occurred or may occurs).31 This article allows the defendant to be brought to another jurisdiction other than his country of origin, and rendered an IP decision to two or more defendants at the same time.

3.2 World Intellectual Property Organisation Dispute Settlement

WIPO has its own Alternative Dispute Resolution (ADR) body that deals with the intellectual issues through mediation and arbitration. The WIPO ADR Centre was established in 1994 and can be used to settle an international commercial dispute within private parties. WIPO ADR has been widely recognized to be specifically appropriate in the IP cases involving the intellectual property related issues.32

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31 a (5) of the Brussels Convention 1986
The Centre facilitates the parties with mediator with a wide experience in intellectual property issues. The Centre in terms of the cost and time proceeding effectiveness would monitor the cases.\(^{33}\) Stone defines mediation as a process where the parties would be helped by a third party called mediator to help them resolve the dispute.\(^{34}\) The main purpose of the mediation is to reach a voluntary settlement and gives the parties much flexibility in terms of the time and place. This settlement is likely to be less formal, less in writing and non-binding agreement.

Mediation could be an excellent option as the first attempt of the dispute resolution before the case is brought to the arbitration or the other level of dispute settlement, to its flexibility and less formality. The non-binding agreement would likely to caused the settlement to be unreliable for serious issues. The flexibility might lead to time ineffectiveness.

On the other hand, according to Stone Arbitration is a system where the parties agreed to submit their dispute to the third party. Once the issue has been settled, the rendered decision would be final and binding.\(^{35}\) The decision can only be appealed if there is an indication of fraud or misconduct of the arbitrator. Arbitration would be a great alternative to settle disputes within two different jurisdictions. The neutrality of the judgment would be more significant rather than the neutrality of the national courts. None of the parties should be bound to another jurisdiction’s rules and regulation. However, arbitration as the first and final stage of judgment could somehow bring positive or negative impact. The positive side is that once the decision is rendered that no further action could be taken, then an immediate enforcement could be made. The negative point is if the losing party has further evidence or not satisfied with the decision, no further action could be made.

WIPO Arbitration and Mediation Centre would be an appropriate option to deal with the intellectual property dispute, specifically in parallel imports. Firstly, the WIPO ADS Centre could provide non-bias decision, which may not be provided by the national courts. Secondly, the Centre not only provides an ADS mechanism, however they are actively involved in monitoring the effectiveness of the proceeding. Thirdly, it provides intellectual property experts to deal with the ongoing dispute.

**Section 4: Conclusion and Recommendation**

The right to exercise parallel imports is gained by application of the exhaustion theory. Exhaustion would restrict the inventor rights to its own invention when the product has been put

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\(^{33}\) ibid


<http://moodle.bcu.ac.uk/pluginfile.php/481058/mod_resource/content/1/Alternative%20Dispute%20Resolution.pdf> accessed 19 September 2015

\(^{35}\) ibid
into circulation. Once the right of the inventor has been exhausted, the parallel imports would be seen as a legal practice and protected by the law. The exhaustion itself is being distinguished into three types: national exhaustion, regional exhaustion, and international exhaustion. The national exhaustion does not allow any parallel imports from another countries. The regional exhaustion allows parallel imports within the region while international exhaustion allows parallel imports from all over the world.

High demand in parallel imports occurs due to the price differentiation in every country. The same product has significant price difference in country A and country B. This leads to the lower price country to import the product to the country with a higher price. It is undeniable that parallel imports benefit the economy and the society. Nevertheless, it has also brought a lot of disadvantages for the business of the developed nations.

The European Union is exercising the regional exhaustion within the union. This is due to the free movement principle of the union, which ensure that no barrier should be in place in regards of the regional trade or free movement of the goods should be in place. The only exemption of the free movement principle is if the imported goods violate public good or national security of the imported country.

On the other hand, World Trade Organization does not restrict the member states to adopt any particular exhaustion. WTO gives the freedom to its member states to implement the most appropriate exhaustion regime within their jurisdiction. This makes the WTO member states implementing variant types of exhaustion. WTO is not only reluctant to harmonize the exhaustion regime, but it is also not willing to be involved and settle any exhaustion-related disputes.

Nevertheless, the World Intellectual Property Organisation does not play a big role in regulating the exhaustion practice of its member states as well. The WIPO also gives freedom to its member states to implement the most suitable exhaustion regime for their country. Notwithstanding, the WIPO is open to assist the member states in parallel imports disputes. In relation to the intellectual property and parallel imports disputes settlement European Union and WIPO has its own way to deal with parallel imports issues. The EU is using the Brussels regulation to settle the disputes and referring the national courts to render the decision. However, WIPO provides an Arbitration and Mediation Centre as an alternative dispute resolution that specifically deal with intellectual property related issues.

In order to achieve the most effective law mechanism in relation to parallel imports, everyone should be benefiting from the parallel imports, not just some part of the society. To enhance the effectiveness of the parallel imports law mechanism, this journal recommends that:
• The consumers should be well informed of the product that they are going to purchase. The seller should inform the consumers if the product is a parallel imports good or not and how the quality might be different even if both are genuine products.

• A freedom to determine the types of the exhaustion implementation should be given to every country, since not every country could obtain the same advantages of the parallel imports.

• Some sectors of intellectual property should be made mandatory to international exhaustion. Mixed exhaustion should be put in consideration.

• An international exhaustion should be implemented in pharmaceutical sector, due to the access of medicine of the world society. The medicine should be accessible and affordable for all the people.

• An intellectual property law with regards to the parallel imports and exhaustion should be made and harmonized. Even though the countries have the freedom exercise their own type of exhaustions, however, harmonization of intellectual property law would make it easier for the predictability of international trade.

• An International dispute settlement like WIPO Arbitration Centre should be mandatory not just and option for the parallel imports disputes.

The above recommendations would hopefully serve as the solution of parallel imports problems in International Trade and increase the benefit of the parallel imports. The recommendations also indicate proper implementation of the exhaustion theory as the facilitator and the legal basis of the parallel imports.

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