

Nagoya University
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**PARALLEL IMPORTATION:
COMPARATIVE ANALYSIS OF
THE TRADEMARK LAWS OF THE UNITED STATES,
THE EUROPEAN UNION AND JAPAN, AND
LEGAL IMPLICATIONS FOR DEVELOPING COUNTRIES**

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Abstract

The rapidly changing conditions of the world trade have thrown countries into a quandary about the potential of parallel importation. Parallel importation of trademarked goods refers to the importation of the goods that are sold in oversea markets with legally attached trademarks into the domestic market where the trademarks are registered, when such importation is carried out without the consent of the trademark owners in the domestic market. This conduct takes place under the development of the world trade as an unavoidable event when two identical products are sold in different markets at different prices. In dealing with parallel imports, different countries have different treatments.

As to trademark rights, the United States follows a rule of international exhaustion among commonly controlled enterprises. The European Union applies a rule of regional exhaustion. Similar to the U.S, Japan appears to follow a rule of international exhaustion. With respect to trademarked goods, industrial countries with the support of statutory provisions, case law, and public policies from a well-made legal framework have already formed their treatment of parallel imports. Furthermore, the court systems with the supports of experienced judges and scholars are a guarantee for developed countries in dealing with parallel imports of trademarked products.

This activity has occurred in developed countries for many years and the legal mechanism in these countries has already solved many related cases. Meanwhile, parallel

importation of trademarked goods in developing countries is a new activity, consequently there are many issues of concern that have not yet been provided, such as the quality of imported products, lack of after-sales service, instructions in foreign language. To a certain extent, allowing parallel importation is a good choice for many developing countries in dealing with the shortage of their capacity of supplying. Besides the advantages of allowing parallel imports, there are also disadvantages that parallel imports can bring to the importing country. Because of the significant of parallel imports, to what extent a country should allow parallel imports is an issue that developing countries must resolve.

There are many important issues that developing countries should take into account when considering the advantages of allowing parallel importation of trademarked products. First, which rule of exhaustion of trademark rights should a developing country apply for the best benefits of the nation? Second, parallel importation also includes disadvantages therefore how to avoid these negative aspects while promoting positive aspects of this activity is very important. Also, in order to ensure that parallel importation develops properly, related issues should be resolved. With the current legal, economic and social structure, developing countries are having many problems that need solving.

After discussing the advantages and disadvantages that developing countries are cope with when allowing parallel importation of trademarked products. There are some proposals and recommendations on the proper treatment of parallel imports in developing countries. First, developing countries should apply the relevant exhaustion regime on trademark rights so that free trade can easily have an effective impact on the economic as

well as social spheres. Second, developing countries should focus on the regulations of related issues of parallel imports in order to develop an effective policy in their development process.

As to Vietnam, the recommendations presented above for developing countries in general also apply to the country. In addition, based on the specific conditions regarding economic, social and legal system, there are some recommendations on the proper treatment of parallel imports of Vietnam that the government should consider. First, Vietnam should modify Article 125.2.b. of the Vietnam Intellectual Property Law. Second, the government should supplement regulations on concerned issues of parallel imports in order to ensure parallel imports can develop effectively. Third, the Vietnamese court system should be enhanced in the context of interpreting and applying the laws.

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CHAPTER 1

INTRODUCTION

I. Introduction to existing problems

This dissertation concentrates on the issue of parallel imports of trademarked goods. Parallel importation of trademarked goods refers to the importation of the goods that are sold in foreign markets with legally attached trademarks into the domestic market where the trademarks are registered, when such importation is done without the consent of the trademark owners in the domestic market. When two identical products are sold in different markets at different prices, it is normal for trademarked products to flow from the low priced market to high priced market. Parallel importation is created for the differential benefit that parallel importers can make from markets. Trademark owners want to prevent parallel imports for various reasons. First, they lose control over the way in which their goods are sold and have a risk that their goodwill is undermined when the goods are sold in inferior quality or with poor or even without after-sales service. Second, there is a loss of exclusivity that undermines the trademark goodwill and makes it worthless. As a result of the loss of value of trademark, its owner will be discouraged from investing in developing new products which will result in a loss of choice for consumers. In the meanwhile, parallel importers argue that consumers should have the right as well as opportunity to purchase the goods at the lowest possible price and not at artificially inflated prices. In addition, parallel imports would increase intra-brand competition, by eliminating the possibility for a trademark owner to exploit exclusive position in his mark and to set higher prices in certain markets, and by increasing competition in the distribution of trademarked products.

As we will see later in detail, the rights conferred on the proprietor of a trademark are qualified by the principle of exhaustion of trademark rights. Under this principle, exhaustion of trademark rights refers to the situation in which the holder of a mark cannot use exclusive rights to prevent the further circulation of the trademarked products after first time putting the products onto

the market with or by his consent. In other word, after the first-selling of the products, the trademark owner has lost the right to control the further disposition of the products.¹ There are three regimes of exhaustion of trademark rights based on the geographic scope of application, namely national, regional and international exhaustion of trademark rights.² Countries can apply different policies in the field of parallel importation of trademarked goods, because according to Articles 6 of the TRIPS Agreement, WTO Members are free to establish their own regime of exhaustion of trademark rights. Different regimes of national or regional or international exhaustion of trademark rights definitely create different effects on the economic situation of a country.³ Therefore, the choice of the regime can have a significant meaning for developing countries.

Parallel importation is not a new topic for academic researchers, and many scholars have already discussed this and carefully ploughed through the problem with regard to developed nations. However, in the context of developing countries few studies have been carried out on this topic. Given the importance of this issue for developing countries, it is important for them to learn from the experience of developed countries. This paper aims to achieve that task.

A. Theoretical Problems

Parallel importation of trademarked goods takes place under the development of the international trade as an unavoidable event when parallel importers enjoy a difference in the price of products. Products that flow in the act of parallel imports are non-counterfeit products. Trademark

¹ Frederick M. Abbott, Thomas Cottier, and Francis Gurry, *International Intellectual Property in an Integrated World Economy* (Aspen Publishers, Inc., 2007), 270.

² David T. Keeling, *Free Movement and Competition Law*, Oxford EC law library (Oxford: Oxford University Press, 2003), 78.

³ *Ibid.*, 78-80.

owners therefore have no reason to prevent the further movement of these products when previously these products have been marketed with or by the consent of trademark owners.

There are many important issues that developing countries should take into account when considering the advantages of allowing parallel importation of trademarked products. First, which rule of exhaustion of trademark rights should a developing country apply for the best benefits of the nation? Second, parallel importation also includes disadvantages therefore how to avoid these negative aspects while promoting positive aspects of this activity is very important. Also, in order to ensure that parallel importation develops properly, related issues should be resolved. Parallel importation of trademarked products has occurred in developed countries for many years and the legal mechanism in these countries has already solved many related cases. Meanwhile, parallel importation of trademarked goods in developing countries is a new activity, consequently there are many issues of concern that have not yet been regulated, such as the quality of imported products, lack of after-sales service, instructions in foreign language. Developing nations have to pay more attention to such issues when allowing parallel imports.

B. Practical Problems

When a country allows parallel imports, it also means to lessen the profit that trademark owners can obtain from that market. However, from the perspective of consumers, when developing countries permit parallel importation of trademarked products, they have more benefits such as more opportunities to buy cheaper products, more chances to access needed drugs. How to balance the benefits of trademark owners, consumers and parallel importers as well as the public in such a situation is a question that needs answering. Especially, the extent to which developing countries should allow parallel importation of trademarked products so as to protect the legitimate benefits of all related parties is a complicated issue that needs considering.

With the current legal, economic and social structure, developing countries are having many problems that need solving. Parallel imports have taken place in developing countries for a long time as an indispensable result of international commerce, but the legal framework for this activity has not been well-established. Developing countries can overcome this problem by adopting provisions to regulate these issues. By analyzing the treatment of parallel imports in developed countries, developing countries can choose the most appropriate pattern that fits with their domestic conditions. The mistakes that developed countries made during the treatment of the problem of parallel importation of trademarked products can assist developing countries in avoiding committing the same mistakes.

II. Research Objectives

This study analyzes parallel importation of trademark products with the emphasis of what we can learn from the experiences of developed countries for the policies choices of developing countries. This study also provides a review of background concepts and practice necessary for understanding the meaning as well as impact of parallel importation of trademarked products. In addition, the paper includes an evaluation of the principle of exhaustion of trademark rights so as to have a thorough understanding of its relation to parallel importation. This research will also define the proper scope and limitations of which the regime of international exhaustion of trademark rights should be applied to developing countries.

In order to achieve these purposes, this research has the following objectives: (1) to identify the differences and similarities of statutory provisions as well as the methods by which cases related to parallel importation of trademarked products are handled in Japan, the United States, and the European Union; (2) to evaluate the advantages and disadvantages of allowing parallel importation of trademark goods in developing countries by taking into consideration the balancing of the interests of trademark owners, and consumers; (3) to propose an appropriate rule of trademark rights for

developing countries; (4) to propose a relevant measures for specific issues related to parallel importation such as quality control or repackaging or relabeling of parallel imported products; and (5) to make suggestions and recommendations for developing countries that are faced or will deal with these problems in their jurisdictions by taking into consideration the legal framework of the international agreements or conventions.

III. Research Methodologies

The main purpose of this dissertation is to solve both the theoretical and practical problems as mentioned in part I of this chapter. In order to solve these problems, the dissertation will make a comparative analysis of laws and practices in the United States, the European Union and Japan. This study will point out the similarities and differences in the treatment of parallel importation of trademarked goods in the three jurisdictions and identify the rationales for those similarities and differences. Based on the result of the comparative analysis, this study will try to propose appropriate rules and relevant measures concerning parallel importation in developing countries which will strike a balance among the interests of the trademark owners, parallel importers and consumers as well as meet the economic and social needs of such countries.

This dissertation consists of five chapters. Chapter 1 starts by introducing the theoretical and practical problems of parallel importation. This first chapter also shows the research objectives and methodologies as well as the scope of this research. Chapter 2 will mainly focus on the theoretical aspects of trademark law, such as the history and functions of trademarks and legal grounds for the protection of the marks. Chapter 3 discusses general issues related to parallel importation of trademarked products. Also this chapter analyzes the doctrine of exhaustion of trademark rights in the relationship with parallel imports. Chapter 4 introduces and analyses the statutory provisions, case laws, public policies related to parallel imports in the United States, the European Union and Japan identifying their similarities and differences. Chapter 5 will then turn to developing countries. That

chapter first points out the economic and legal situations of developing countries in general. Next, the chapter analyzes advantages and disadvantages of permitting parallel imports. Drawing lessons from the analysis in Chapter 4 Chapter 5 provides suggestions and recommendations for developing countries in dealing with parallel importation of trademarked products. The last section of Chapter 5 analyses the situation of Vietnam in dealing with parallel importation of trademarked products as a case study, and presents recommendations specifically for the law and measures in Vietnam. This paper ends with concluding remarks.

IV. Scope of the Research

Although parallel importation is a problem related not only to trademarks but also patents, copyrights and other forms of intellectual property this dissertation focuses on the issues involving trademarks. In order to do a comparative analyses, three developed countries and regions are selected for their special characteristics in the treatment of this problem: namely the United States, the European Union and Japan.

I chose Vietnam as a subject of a case study of developing country, because sufficient information on Vietnam was available for this research, and its situation, with many problems and need for reform, seems to be typical of developing countries.

CHAPTER 2

OVERVIEW ON TRADEMARK LAW

The idea of trademark is one of the most important aspects of intellectual property. This chapter introduces the basic history, functions, and issues related to the concept of trademark as an overview. It also discusses the relationship between the purpose of trademark law and functions of trademarks, which is deeply connected to the subject of this study.

I. History of trademarks

Trademarks have a long history.⁴ Trademarks existed approximately 4000 years ago⁵ when merchants who made and sold clothing or pottery started to mark their products so as to identify the makers. At that time, marks were intended to indicate ownership, and gradually trademarks were intended to indicate the source of goods.⁶

From the very beginning of the trademark history, marks were used as indicating tools to show the ownership status of goods or as a communication method. As time went by the trademark developed and started to describe property.⁷ Over a long progressive of time marks became a protected subject matter under intellectual property law. In its history of development, trademark law appeared much later

⁴ Frank Schechter, *The Historical Foundation of The Law Relating to Trade Marks*, Columbia University Press, 1925

⁵ Robert P. Merges and Peter S. Menell, Mark A. Lemley, *Intellectual property in the new technological age* (New York: Aspen Publishers, 2006), 529.

⁶ Paul Goldstein, *Copyright, Patent, Trademark, and Related State Doctrines: Cases and Materials on the Law of Intellectual Property* (Foundation Press, 2004), 220.

⁷ Bentley Lionel, "From Communication to Thing: Historical Aspects of the Conceptualisation of Trade Marks as Property," in *Trademark Law and Theory: A Handbook of Contemporary Research*, ed. Graeme B. Dinwoodie and Mark D. Janis (Edward Elgar Publishing, 2009), 16.

than the marks themselves. It is stated that “trademarks extend for at least for at least four thousand years but that of trademark law, hardly four hundred.”⁸

Currently, trademarks have become the most precious asset of enterprises. The more famous the trademark is, the greater value it possesses. Each year the Best Global Brands Report generates increasing amounts of interest from companies and practitioners associated with brands, and it lists the top 100 valuable brands worldwide.⁹ In business there are a couple of terms which are used to indicate the value as well as the effect created by the trademarks such as whether or not brands are life-enhancing or death defying.¹⁰ Moreover the role of trademarks in the economy is significant when “stock markets take more and more notice of the distinct value which is attributed to successful marks.”¹¹

A. Proprietary or possessory marks

In the mediaeval period, marks were used to indicate the ownership of goods.¹² During this period, marks appeared on household tools and other items in order to identify the owner and allow for

⁸ Beverly W.Pattishall, “Two Hundred Years of American Trademark Law,” in Foundations of Intellectual Property, ed. Robert P. Merges and Jane C. Ginsburg, Foundations of law series (New York, N.Y.: Foundation Press, 2004), 452.

⁹ “Best Global Brands 2009”, <http://www.interbrand.com/en/knowledge/best-global-brands/best-global-brands-2009.aspx>. For example top three brands in 2009 were Coca Cola, IBM and Microsoft with 68,734(\$m), 60,211 (\$m) and 56,647 (\$m) respectively.

¹⁰ William Rodolph Cornish, Intellectual Property: Omnipresent, Distracting, Irrelevant? (Oxford University Press, 2004), 83.

¹¹ Ibid.

¹² Sidney A.Diamond, “The Historical Development of Trademarks,” in Foundations of Intellectual Property, ed. Robert P. Merges and Jane C. Ginsburg, Foundations of law series (New York, N.Y.: Foundation Press, 2004), 444-446.

claims when such marked items were lost or taken away. Gradually, the idea of branding to the house marks became the foundation for branding cattle and other animals.¹³

Farmers in very early eras used brands as the indicating tool for their ownership status by burning or carving marks onto cattle.¹⁴ The word “brand” in English is derived from the Anglo-Saxon verb meaning “to burn.”¹⁵ The first kind of marking on animals was the cattle body branding. The branding method was used to mark cattle when there was no existence of a reading or writing system in order to identify the cattle belonged to specific owners. This practice is portrayed in early Stone Age cave drawings and in wall paintings.¹⁶

The literal earmarking of livestock animals appeared long after the branding of cattle.¹⁷ With the branded cattle method, the livestock animals were branded on their body; however, the earmarking method originated in the 16th century as livestock animals were distinguished by cutting or marking on the ear serving as a sign of ownership.¹⁸

B. Source liability

Earmarks were used for indicating the ownership of the livestock animal or earmarking of sheep. Branding was used to identify the source of goods and the liability associated with the products.

¹³ Ibid., 444.

¹⁴ Deven R. Desai, “A Brand Theory of Trademark Law,” SSRN eLibrary (April 6, 2010), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1585327.

¹⁵ Sidney A. Diamond, “The Historical Development of Trademarks,” 444.

¹⁶ Ibid., 445.

¹⁷ Jeanne Sahadi, “Earmarks: Myth And Reality,” CNNMoney.com, March 11, 2009, http://money.cnn.com/2009/03/11/news/economy/earmark_primer/index.htm?postversion=2009031111, “...The term earmark originated in ancient England when farmers tagged - or marked the ears -- of their livestock mixed among the village herd...”

¹⁸ “Definition of earmark,” <http://www.etymonline.com>.

Identifying source of goods was one of the reasons for the appearance of guilds in Europe. The rise of the guilds commenced around the 14th century and was a remarkable feature in the history of trademark. The development of the guilds was to ensure a satisfactory quality of goods produced by their members by tightly controlling their members. At the same time, the members of the guilds had to use a compulsory mark for the guilds' products. As to this requirement, the mark was to fix the guilds with their responsibility and also to exclude the poor quality products made by non-member producers. Thus, a mark in this period not only was to demonstrate the membership in a specific guild but also was used as a "liability mark."¹⁹ Because it permitted guilds to identify the infringing goods of outsider and thus enforced restrictions on the retail selling of its products.²⁰ Therefore, the guild marks were not only the source indicating liability but also used to control the industry.²¹ Guild marks were the origin of the modern certification marks seen today.²²

C. Indicator of quality

In the 17th and 18th century, the Industrial Revolution began with the huge growth of technology in which manual labor and the draft-animal based economy was replaced by machine-based production. Modern manufacturing played an important role in increasing production capacity. Products were manufactured more quickly and in a greater amount. The result of the development was the concentration of production capacity in larger units, and this in turn required the development of methods of distribution to get the goods to the consumer. In other words, as industrialization developed, marks were applied to mass-produced goods, and traders or manufacturers began to use

¹⁹ Sidney A. Diamond, "The Historical Development of Trademarks," 446-447.

²⁰ Timothy H. Hiebert, *Parallel Importation in U.S. Trademark Law* (Greenwood Publishing Group, 1994), 8.

²¹ Sidney A. Diamond, "The Historical Development of Trademarks," 447.

²² Hiebert, *Parallel Importation in U.S. Trademark Law*, 10-11.

their marks in advertising.²³ In addition with the development of advertisements is the increasing amount of the distribution of those goods. Consuming public with the availability of the goods on the market therefore also develop. As goods were mass-produced, trademarks were associated with the manufacturers as an indicator of quality. The development of international trade created a greater use of trademarks all over the world and in several different aspects of life.²⁴

II. Definition of trademark

A. What actually is a trademark?

In general, trademarks are signs or symbols that distinguish the goods or services of one enterprise from another in commerce.²⁵ Protectable subject matter that can be registered as trademarks are generally similar under the trademark laws of different countries. Namely, protectable subject matters may consist of virtually any form of sign including letters, words, figures, colors and shapes. However, the differences in the background of the countries such as national socio-economical conditions as well as the legislative standards of each nation lead to differences in specific provisions concerning the protectable subject matters of trademark law in some specific situations. Accordingly, some of the things that can be protected as trademark in one country cannot be protected in another country.²⁶ Whether or not an item can be registered as a trademark depends on the national legislation of a respective nation. Each national legislature has its own method in defining the concept of trademark. As noted, a

²³ Catherine Seville, *EU Intellectual Property Law and Policy*, Elgar European law (Cheltenham: Edward Elgar, 2009), 210.

²⁴ See, Shahid Alikhan and R. A. Mashelkar, *Intellectual property and competitive strategies in the 21st century* (Kluwer Law International, 2009), 11.

²⁵ Abbott, Cottier, and Gurry, *International Intellectual Property in an Integrated World Economy*, 8.

²⁶ In fact, as to some specific kind of marks which are also called as non-traditional trademarks (i.e. sounds, single colors, and scent) the provision vary from country to country. Sound marks, for instance, can be protected as trademarks under the U.S Trademark Law (Lanham Act), but cannot be protected as a trademark under the Japanese Trademark Act.

trademark is a distinctive word, symbol or other signs capable of distinguishing or identifying goods or services produced by a producer from the goods and services of other producers.

B. Rationale of trademark protection

The protection of trademark originated from the necessity to protect the interests of consumers from fraudulent or deceptive products, and to defend the goodwill and monopoly of the guilds.²⁷ The true basis of such protection occurs when there is a likelihood of confusion as to the source of the products, or the use of a trademark or name may cause some discredit and financial liability with other marks.²⁸ A trademark tells consumers about its source or origin, from which consumers can identify that producer from others in the same area. The likelihood of confusion of consumers can easily occur when there are many manufacturers that exist in the same industry, and there is a similarity in the trademark or the trademark use whereby would cause the public to think the products bearing the same name were made by the same trademark owner.²⁹

If the same trademark can be used on different classes of goods it might cause confusion as to the source of the two (or more) different products. Therefore, the trademark owner must keep the uniqueness or individuality of the trademark.³⁰ The uniqueness of a trademark has a strong impact in indicating to the public a constant and uniform source of satisfaction, which also influences the scope of protection of that trademark. In such a situation, the scope of trademark protection expands to other classes, or area of products.³¹ Once a trademark becomes famous, the trademark owner can prevent others from using similar trademark even among non-competitive products that would not create a

²⁷ Frank I. Schechter, "The Rational Basis of Trademark Protection," *Harvard Law Review* 40, no. 6 (April 1, 1927): 819.

²⁸ *Ibid.*, 821.

²⁹ *Ibid.*

³⁰ *Ibid.*, 822.

³¹ *Ibid.*, 823.

likelihood of confusion or constitute trademark infringement or unfair competition.³² The situation occurring under §43 of the American Lanham Act is also called as “theory of trademark dilution.” Trademark dilution occurs when a second user adopts the mark in a manner or for use with products or services that will “erosion the uniqueness” of that trademark. Trademark dilution will lessen the trademark value of the trademark and should be proscribed.³³

C. Measures to achieve trademark protection

The protection of a trademark is important because it not only prevents consumer confusion as to the commercial origin of purchased goods or services but also protects the trademark owner’s investment in the trademark’s goodwill.³⁴ The idea of goodwill can be thought of as surplus benefit that a trademark owner has received when they invested into their mark and made it known widely. The investment of the trademark owner includes an investment in the creation of the mark, in the advertising and promoting of products in association with the marks.³⁵

An owner of a trademark does not have to register the trademark for using it. Nonetheless, registration of a trademark gives certain rights which are not available when a mark is un-registered. Registration not only gives the owner the exclusive right to use a specific mark but also allows the holder “considerable advantages in terms of legal certainty, enforceability, and the ease with which it can be

³² M. John Sterba, *Legal Opinion Letters: A Comprehensive Guide to Opinion Letter Practice* (Aspen Publishers Online, 2003), 9.62.

³³ S Welkowitz David., “Trademark Dilution and The Evolution of Trademark law,” in *Intellectual Property and Information Wealth: Trademark and Unfair Competition*, ed. Peter K. Yu (Greenwood Publishing Group, 2007), 281.

³⁴ Maxim Grinberg, “The WIPO Joint Recommendation Protecting Well-Known Marks and the Forgotten Goodwill,” SSRN eLibrary, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=701504.

³⁵ Merges and Lemley, *Intellectual Property in The New Technological Age*, 532.

assigned or licensed.”³⁶ Registration of a trademark also provides the owner the exclusive right to prevent any third parties from using the identical or similar signs for goods and services without consent. According to the TRIPS Agreement, “the nature of the goods or services to which a trademark is to be applied shall in no case form an obstacle to registration of the trademark.”³⁷

In order to be protected from trademark infringements, the holder of a trademark has to register the mark to the competent institutional body. Registration is the popular measure to achieve the protection in the countries which apply the first-to-file principle.³⁸ However, registration is not the measure that is taken in the United States which adopts the first-to-use principle. Under the Lanham Act 1946, trademark protection is granted to those who were the first to use a distinctive mark in commerce.³⁹

III. Trademark functions

When a sign is a mark, its primary function is to identify the goods or services offered by the trademark owner.⁴⁰ The trademark owner has an exclusive right to use the mark and to prohibit any third persons from using it without proper consent. In modern times, the rapid growth of international trade and distribution systems meant that trademarked goods could reach every corner of the world.

³⁶ Keeling, *Free Movement and Competition Law*, 148.

³⁷ The TRIPS Agreement, Art. 15.4.

³⁸ First-to-file principle is where two or more applications for registration are filed by different parties for the registration of marks identical with or confusingly similar to each other, or for identical or similar goods or services, a protection title may only be granted to the valid application with the earliest priority or filing date amongst applications which satisfy all conditions for the grant of a protection title. (Art. 90.1 of the Vietnam Intellectual property law).

³⁹ Section 1051 (a) of the Lanham Act 1946.

⁴⁰ Ono Shoen, *Overview of Japanese Trademark Law*, 2nd ed. (Yuhikaku, 1999), chap. 7, http://www.iip.or.jp/e/e_publication/ono/index.html.

The idea of trademarks functions vary on different ways of understanding. However, there are three functions most commonly mentioned: 1) the original function plays important role in identifying the source from which the goods or service come; 2) the quality function of a trademark means the mark is the tool that indicating the goods or service will be of an expected standard, or the mark is the guarantee for the quality of the goods or services bearing that trademark; 3) the advertising function of a trademark means that trademark is synthesizing all the elements which used for promoting the trademark or brand. A trademark will therefore be widely known and the goodwill of the owner will create an attractive force to consumers.⁴¹ Recently, these functions are often explained from an economic point of view.⁴²

A. The origin function of trademarks

The origin function of trademarks is the starting point for legal protection.⁴³ The origin function of a trademark helps consumers to identify and distinguish the goods or services from others in the marketplace that are supplied by a trader. By indicating the source of manufacturing origin of a goods or a service, trademarks provide cognitive signals to consumers who will purchase the same products again when satisfied with a products' quality.⁴⁴ In order to receive protection, a trademark does not need to be new, original, or unused but it must be distinctive and be able to represent to consumers the source of goods or service identified.⁴⁵ From a trademark, consumers can locate the product that they need among the similar goods in the market. Any use of the trademark without the

⁴¹ Cornish, *Intellectual Property*, 89.

⁴² William Cornish and David Llewelyn, *Intellectual Property: Patents, Copyrights, Trademarks and Allied Rights*, 6th ed. (Sweet & Maxwell, 2007), 620.

⁴³ Cornish, *Intellectual Property*, 89.

⁴⁴ Margaret Chon, "Marks of Rectitude," SSRN eLibrary, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1369922. *Fordham Law Review* Vol.77 (2009)

⁴⁵ Merges and Lemley, *Intellectual Property in The New Technological Age*, 634-635.

consent of the owners creates a liability that jeopardizes the guarantee of the origin function, and the owner must be able to prevent this from happening.

The origin function also indicates ownership,⁴⁶ and origin with respect to goods means not only for producers but also includes owners, sellers, processors and importers.⁴⁷ In fact, indicating origin and ownership is one of the fundamental functions of a trademark that is usually used by the courts in trademark infringement cases. In the *Arsenal* case⁴⁸ (2003), for instance, the European Court of Justice (ECJ) emphasized the importance of the origin function in order to respond to the query from the English High Court:⁴⁹ “the essential function of a trade mark or to guarantee the identity of origin of the marked goods or services to the consumer or end user by enabling him without any possibility of confusion, to distinguish the goods or services from others which have another origin.”⁵⁰

B. The quality function of trademarks

A trademark symbolizes quality standards for goods or services that guarantee meeting the consumer expectations.⁵¹ A trademark ensures a consistent level of quality in the goods and services purchased by consumers.⁵² In this sense, a registered trademark guarantees the quality of the products

⁴⁶ See Thomas Hays, *Parallel Importation Under European Union Law* (London: Sweet & Maxwell, 2004), 36.

⁴⁷ Ono, *Overview of Japanese Trademark Law*, chap. 1.

⁴⁸ *Arsenal Football Club Plc v Reed* (C-206/01) [2003], E.T.M.R.19.

⁴⁹ Po Jen Yap, “Case Comment Essential Function of A Trade Mark: from BMW to O2,” *E.I.P.R.* 2009, 31 (2), 81-87.

⁵⁰ *Arsenal Football Club Plc v Reed* (C-206/01) [2003], E.T.M.R.19 at [48].

⁵¹ Cornish and Llewelyn, *Intellectual Property*, 620.

⁵² McCarthy, 2-3 (4th ed. 1999).

which not only protects consumer interests and expectations⁵³ but also protects the goodwill of the traders.

This specific function of trademark is also known as the quality guarantee function.⁵⁴ The quality of the product is one of the several elements that give certain impression about the products in minds of consumers. When consumers purchase a product they take into consideration many different elements such as price, the features, shape, and size of the available products in the market. In such a circumstance, consumers rely on the trademark to identify specific goods or services that meet their expectation. When products bearing a trademark are used or purchased repeatedly, it means that consumers expect the products under same mark to possess the identical quality. Producers or manufacturers have to focus on policies and strategies so as to maintain or enhance the quality of the goods or services associate with their trademarks.⁵⁵

C. The advertising function of trademarks

The functions of trademark are not limited to indicate the source of products (origin function) or to playing a role in guaranteeing their quality (quality function). In fact, advertising is also a crucial function in differentiating the product in the minds of consumers. The advertising function of a trademark turns the mark into a legal vehicle for maintaining prices at a higher level than the products made by other competitors.⁵⁶

⁵³ Cornish and Llewelyn, *Intellectual Property*, 620.

⁵⁴ Ono, *Overview of Japanese Trademark Law*, chap. 7. Mohammad Amin Naser, “Re-Examining the Functions of Trademark Law,” *Journal of Intellectual Property* 8 (2009 2008): 99. See 田村善之、*商標法の保護法益、公開講座 第2回平成18年6月5日* (Tamura Yoshiyuki, *Legal interests protected under the Trademark Act, 2nd open lecture on 5 Jun 2006*) .

⁵⁵ Ono, *Overview of Japanese Trademark Law*, chap. 1.

⁵⁶ Cornish, *Intellectual Property*, 101.

When products are in fact similar or identical, advertising may have affect consumers in making their final purchasing decision.⁵⁷ Advertisements can affect the awareness of consumers about the existence of certain products among thousands of similar products in the market. This also explains why consumers tend to choose a product or service that they have made into habit or are based on the globally-recognized standards or on the advertisements. The connection between trademark and the attached images may have the effect on consumers which help them to remember the products or services. In such situations the role of trademark is going far beyond the mere quality function of the products.⁵⁸ Therefore, trademark plays an important role in supplying the necessary information to consumers via advertisements. Thus, consumers can verify a trademark by inspecting the product before they buy it.⁵⁹

A trademark is created by the investment of its owner and investment in its turn advertises and promotes the goods or services in association with the trademark. In fact, consumers always evaluate goods or services that were made by a producer based on the information of the marked product. If the producers do not pay attention in protecting their trademarks, then the potential risk of free riding to their marks by any third party could be very high. Such infringement could easily ruin the goodwill associated with the original trademarks, and the reputation of these marks can decrease.

Consumers not only buy a product for its feature and quality but also purchase the brand images or stories behind a brand.⁶⁰ Once consumers have the habit of using products of a brand or when consumers have a connection with a brand, they tend to pick up other products offered by that

⁵⁷ Merges and Lemley, *Intellectual Property in the New Technological Age*, 533.

⁵⁸ *Ibid.* See also Ono, *Overview of Japanese Trademark Law*, chap. 1.

⁵⁹ Robert P. Merges, Peter S. Menell, and Mark A. Lemley, *Intellectual Property in New Technological Age*, 4th ed. (Aspen Publishers, 2007), 533.

⁶⁰ See, Desai, "A Brand Theory of Trademark Law." ("...Companies use brands to connect with consumers and provide them with stories and images related to personality, patriotism, self-worth, the environment, sustainability, and more so that consumers are purchasing a brand image rather than a product") <http://ssrn.com/abstract=1585327>.

brand.⁶¹ Therefore, producers focus on their trademark by spending a significant amount of money on advertisements. Especially for well-known or famous trademarks, companies thus invest in advertisement and allocate an enormous amount of money in their substantial finance expenditure for commercials.⁶² As a matter of fact, a large portion of the value of a trademark is that as an advertising asset.⁶³ Protection of trademark rights is to protect the business associated with that trademark.⁶⁴ Trademark right is recognized as a valuable advertising asset and that is one of reasons for its protection.⁶⁵

D. Economic explanation of the functions of trademarks

From the economic perspective, a trademark is the main symbol that allows consumers to identify goods or services that have met their specific requirements in the past. Trademark allows consumers to repudiate products that have not met their demands. From the economic point of view, trademarks consist of functions that: (1) assist and protect consumers in identifying the source of products and improving ability to judge quality; and (2) provide a property right to the trademark

⁶¹ For example, one who has into habit of using ipod tends to choose iphone, ipad and Macbook as all of the products are under the Apple brand, <http://store.apple.com/jp/>.

⁶² Top 10 Companies for Advertising Expenditure in FY 2008 (Consolidated Basis) in Japan, Sony placed the first position with 436,412 million yen, Toyota Motor ranked the second place with 389,242 million yen, <http://www.nikkei-koken.com/surveys/survey06.html>.

⁶³ Ono, Overview of Japanese Trademark Law, 1.

⁶⁴ Article 1 of Japanese Trademark Act provides “The purpose of this Act is, through the protection of trademarks, to protect the goodwill of entities that use trademarks and thereby to protect the interests of consumers.”

⁶⁵ See Port, Trademark and Unfair Competition Law and Policy in Japan, 107.

owners by prohibiting use of their marks so that their investment in product development and quality are protected, the expenditure in creating a brand image of a product is rewarded.⁶⁶

1. Trademarks encourage enhanced quality

Producer responsibility for the quality of a product always goes along with their trademarks. Trademarks allow the purchasers to trace back the responsibility of the producers when the quality of the product fails or in case that there is something harmful or negative that happens to buyers during the use of the products. In the developed market economy, the trademark has played a fundamental role in the foundation of competition that is essential for a fair trading market. Trademark is a communication method that connects producers and consumers. It would be impossible for buyers to trace back the responsibility of the producer if the products have no marks. Without trademarks, producers have no motivation or incentive to produce high quality goods because consumers will have no clue in knowing the source of the products. Consequently, manufacturers would make no effort to maintain the stable quality for products.⁶⁷ Furthermore, without trademarks, purchasers could not be protected nor the appropriate authorities could protect the social interests. Therefore, purchasers do not choose non-trademark products.⁶⁸ By exercising their responsibility, producers enhance their positions on the mind of the consumers as well as their positions in the market.

⁶⁶ NERA, SJ Berwin and IFF Research, *The Economic Consequences of the Choice of a Regime of Exhaustion in the Area of Trademarks* (NERA, London, 1999).

⁶⁷ Keeling, *Free Movement and Competition Law*, 147.

⁶⁸ It should be noted that once trademark-less or non-trademark products were very popular in Vietnam in the late of the 1970s until 1980s, before the Doimoi (Renovation) in 1986 under the central planned economic. At that time state organs played a leading role in the economy through physical output targeting, allocating resources to production units, and taking care of the distribution of products to consumers and other production units. Products were made under the Vietnamese government orders but not from the market demands. Trademarks also were not so important within this period of time.

Manufacturers or producers use trademarks to provide product information to consumers so that they can find the brand products they desire. Furthermore, through trademarks a person can more easily trace back the source of the product. A trademark is a useful means that allows consumers to protect their legitimate interests better. With the trademark, consumers can identify from whom the products are made and who would take liability for the trademarked quality.

2. Trademarks reduce searching cost

Professor Landes and Judge Posner presented the “search cost” theory more than twenty years ago.⁶⁹ Search cost theory was a watershed in giving an economic approach to trademark.⁷⁰ According to the theory, trademarks help to reduce consumer costs of a search and therefore enhance the efficiency of the economy.⁷¹ The trademark of products is the tool used to identify goods manufactured or supplied from different producers. In addition, trademarks allow purchasers to identify a specific product in case there are different versions of the product. Once consumers gain the habit of using certain products, they bear in mind the characteristic as well as the distinct features of that product.⁷²

Suppose that consumer B has experience with using a trademarked product X. One day B wants to buy the product X again. Instead of reading all of the printed information from various product labels to determine whether or not to purchase this brand over another, or to see if the product is the one that B desires among similar products that are available on the shelves of the supermarket. B

⁶⁹ William M. Landes and Richard A. Posner, *The Economic Structure of Intellectual Property Law* (Cambridge, Mass.: Belknap Press of Harvard University Press, 2003).

⁷⁰ Chad J. Doellinger, “A New Theory of Trademarks,” *Penn St. L. Rev.* 111 (Spring 2007): 837-839.

⁷¹ Graeme B. Stacey L. Dogan & Mark A. Lemley, “A Search Costs Theory of Limiting Doctrine In Trademark Law,” in *Trademark Law and Theory: A Handbook of Contemporary Research*, ed. Mark D. Janis (Edward Elgar Publishing, 2008).

⁷² Doellinger, “A New Theory of Trademarks,” 825.

can rely on the trademark to choose the product which will meet his need and tastes. As to B, the reliance on the trademark is less costly in two ways:

- 1) It is less costly regarding time and effort because B already has a positive impression of the product's quality symbolized by the trademark; and
- 2) It is less costly regarding money because B does not need to try different versions of the products (produced by the same trademark owner) or different products (made by different trademark owners) by different brands.

In such a case, the trademark is the means that helps B to find the desired product among all similar products.⁷³ The idea of trademark awareness holds that consumers will remember a brand and repeat their purchase of these products because of the history of experience of using the products they had in the past. Repeat purchasing not only occurs to the trademark in general but also occurs with a specific brand.⁷⁴ In fact, consumers tend to buy products that they have experience of using or are familiar with the trademark through other sources.⁷⁵ If a trademark is famous or well-known, then the possibility that consumers will purchase their products again is higher than other similar products.⁷⁶ From this point, the direct connection between the source or origin and the quality guarantee function is clear. Furthermore, there is an indirect connection between the quality guarantee function and advertising function of a trademark. The advertising of a mark plays an important role in building up the goodwill or good image of a mark. Good reputation of trademark will persuade consumers choose the products. Nonetheless, this indirect relationship is not always clear and somehow is illusory. The advertising function is not always visible as are the other functions.

⁷³ Ibid., 839-840.

⁷⁴ See Desai, "A Brand Theory of Trademark Law.", "...consumers often will purchase a product for reasons beyond the functions aspects of a product and possibly pay a higher price for a good regardless of quality."

⁷⁵ Frederick Breitenfeld, When is a "Family of Trademarks" Effective?, 52 Trademark Rep.(1962), 351.

⁷⁶ Peter K. Yu, Intellectual Property and Information Wealth: Trademark and Unfair Competition (Greenwood Publishing Group, 2007), 273-274.

There is no legal mechanism or legal structure to guarantee that trademark owners use the same trademark for the same quality goods. Logically, if trademark owners produce lower quality products, then there is no harm for them under the trademark law except for the number of customers they lose. In such a situation the quality of the same marked products cannot be guaranteed and buyers will be the one who suffer from the low quality products.

For example, a company in country A give a license to a company in country B to manufacture and sell product X in country B. Suppose, the quality of the product X marketed in country B is lower than the product marketed in country A. If the price of X in country B is cheaper than X in A. Because there is a price differential between A and B, there may be incentives for a third party (parallel trader) to import the cheaper product from country B into country A. This type of business endeavor is known as the “round trip” importation of trademarked goods.

The mark might lose its significance through uncontrolled licensing, which means that when an owner licenses the mark to a licensee without controlling trademark products’ quality this then defeats the function of the mark. The consumer normally buys the products because of their experience with using the trademarked products or on the reputation of the manufacturer. Trademark owners are explicitly entitled to prescribe quality standards to their licensees. The circulation of products, which do not meet these standards, is no more regarded as a matter of contract breach but as trademark infringement. When the products do not meet the standards not only the licensee but also a third person who re-circulates the products of low quality are liable for the inferior quality and are infringers of trademark rights. The same applies to cases where the licensees circulate outside the scope agreed upon in the license contract. In such cases, third circulators also may be held liable for trademark infringement.

The theories on the functions of trademark plays a significant role for the courts in solving trademark infringement cases, especially those relating to parallel importation of trademarked goods. By analyzing trademark functions, the courts can identify and consider the legality of the parallel

importation of goods. The significant role of trademark functions in parallel importation cases is undeniable. In fact, functions of trademark are the elements that the courts usually take into account in considering whether or not consumers are misled or confused or if the goodwill of trademark owners is damaged from the infringement. Out of the different functions of trademarks described above, the original function and the quality function are especially treated as primary functions in actual court cases involving parallel imports,⁷⁷ as we will see later in this study.

⁷⁷ Ilanah Simon Fhima, "The Functions of Trade Marks and Their Role in Infringement Cases - What Can the EU and Japan Learn from Each Others' Experiences," SSRN eLibrary: 5-7, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1156780.

CHAPTER 3

GENERAL DISCUSSION ABOUT PARALLEL IMPORTATION

This chapter explores the meaning of parallel imports and its relationship to trademark rights. Scholars and courts have shown various theories, doctrines, and policies concerning the relationship between parallel imports and trademark rights. This chapter focuses on specific points regarding the principle of exhaustion of trademark rights and parallel imports, with respect to particular examples of legal and economic integration. The first part of this chapter will briefly consider the concept of exhaustion of trademark rights and the latter part will concentrate on the notion of parallel imports of trademarked products.

The chapter will start with what parallel importation is and why it occurs. Next, treatments of parallel imports of trademarked goods will be discussed. Also, the effects of parallel importation, especially those on consumers will be discussed.

I. Parallel Importation of trademarked products

The term “parallel imports” of goods refers to trademarked products that are first legally marketed by or with the consent of the trademark owner but later are imported and sold in another market without the consent of the owner who has the trademark rights in the importing country. The products bearing trademark are legitimate genuine goods from overseas, and this means that they are manufactured by, or under license from the trademark owner, but bypassing the authorized distribution channels in the importing country.⁷⁸ However, the products also may have been

⁷⁸ Vautier Kerrin, “Economic Considerations of Parallel Imports,” in *Parallel Imports in Asia*, ed. Christopher Heath (Kluwer Law Intl, 2003), 1.

manufactured and packaged for a particular market and then imported into a market which is different from the one originally planned by the trademark owner.

Parallel trade obviously differs from traditional trade (direct sale). The direct sale of a product occurs when a licensee or assignee conducts business sales directly into the determined territory based on a license or assignation. In the meanwhile, a parallel import takes place when the licensee or assignee first places the goods into the market in the territory where he or she is allowed to do business, and a third party purchases the products and exports them to another territory for profit.⁷⁹ Parallel importation occurs when an intellectual property owner or the licensee sells protected goods in one market under such circumstances that these goods can be purchased for export and then are imported into another market for sale against the wishes of the owner and in competition with similar goods enjoying equivalent protection in the second market.⁸⁰ However, a parallel import is considered legal when the same goods were placed originally into the market by or with the consent of the trademark holder.

Parallel imports have two forms: the passive and active forms.⁸¹ A passive parallel importation is the most common form in which the parallel importers buy trademarked products from an overseas market and sell them in a domestic market. In contrast, active parallel importation is less common, and this occurs when a foreign licensee or foreign distributor of the owner enters the domestic market to compete with the trademark owner (or with authorized distributor). Regardless of being passive or active both occur for the aim of getting from the price gap between the overseas

⁷⁹ Keeling, *Free Movement and Competition Law*, 93.

⁸⁰ W.Conish, *Intellectual Property: Patent, Trademark...*

⁸¹ Enrico Bonadio, "Parallel Imports in a Global Market: Should a Generalised International Exhaustion Be the Next Step?," SSRN eLibrary: 153, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1762900.

market and domestic market. Also, both forms just like regular imports, are subject to the same border measures which consist of tariffs, quantitative restriction, and technical standards.⁸²

Parallel importation is still debated in countries that focus on the extent to which a trademark owner should be able to maintain control over his mark. Trademark owners try to use their exclusive rights to restrict the importation of goods after the goods have been put on the market somewhere else by or with their consent, or by another person who owns rights in the jurisdiction where the goods originated.⁸³ If the trademark owners can prevent the further circulation of their products after the first sale then there would be no free movement of the products on the market. Parallel importation of trademarked products will not occur. However, under the theory of exhaustion of trademark rights, when the trademarked products have been put legally in a market by or with the consent of the owner, then the owner cannot prevent the further sale, use or transfer of that product because of the exhaustion of their rights.⁸⁴ Therefore, parallel importation of trademarked products becomes a legal activity. In fact, each country has its own way to regulate parallel importation of trademarked products and some of these differences will be discussed in Chapter 4 of this paper.

II. Economic concept of parallel imports

The fundamental purpose for many countries to allow parallel importation is for a social benefit that could result directly or indirectly from such imports. The selling prices of the same product may vary from country to country for a great variety of legitimate reasons, such as differences

⁸² Carsten Fink, "Entering the Jungle of Intellectual Property Rights Exhaustion and Parallel Importation," in *Intellectual Property and Development: Lessons from Recent Economic Research*, ed. Keith E. Maskus (World Bank Publications, 2005), 171.

⁸³ International Trademark Association, "Position Paper on Parallel Imports", July 2007, www.inta.org/Advocacy/Documents/INTAParallelImports2007.pdf.

⁸⁴ Donna M. Lach, "Note and Comment: The Gray Market and the Customs Regulation -- Is the Controversy Really Over After *K Mart Corp. V Cartier, Inc.*?", *Chi.-Kent L. Rev.* 65 (1989): 228.

in regulatory requirements, technological level, environmental standards, labor costs, labor skills, material costs, government subsidies and taxation systems. The gap in prices brings about parallel importation of trademarked goods when importers can buy products in a market where they are relatively cheap and sell them where the price is higher.⁸⁵

From the point of view of developing countries', there are many advantages that are created by allowing parallel importation.⁸⁶ Parallel trade enhances competition of the market and consumers thereby have a larger distribution of trademarked products at lower prices.⁸⁷ Permitting parallel imports helps low-income people to buy a quality product at cheaper prices. At the same time, the price of the products can be adjusted as the monopoly position of some dominant producers in that market is no longer available. Therefore, consumers gain good opportunities to diversify their consumption by with lower priced products. Parallel importation therefore is a useful tool to empower the economy. The effects of parallel importation of trademarked products to developing countries will be analyzed in Chapter 5 of this paper.

However, to many developed countries allowing parallel imports is not necessarily a policy that is highly accepted. For example, the United States stated during the negotiation of the TRIPS Agreement that there was a "need to defend the research' possibility of enterprises that want to patent their inventions." From this argument parallel imports can harm the research capability of enterprises because this capability needs a suitable exploitation of the patent, and parallel importation from countries where the product's price is lower can damage this utilization. Although this concern of the U.S. is related to patented products rather than trademarked products the attitude of the U.S. towards parallel imports in general is not much different.

⁸⁵ Kerrin, "Economic Considerations of Parallel Imports," 3.

⁸⁶ See Chapter 5.

⁸⁷ See Carlos María Correa, *Intellectual Property Rights, the WTO, and Developing Countries: the TRIPS Agreement and Policy Options* (Zed Books, 2000), 83.

Trademark owners are concerned that parallel importers have little or no incentive to maintain the goodwill of the mark because there are neither legal nor economic boundaries between parallel importers and trademark owners.⁸⁸ The main concern of parallel importers is to maximize profits as they will not care enough to maintain the goodwill of the trademarks. More importantly, parallel importers are incapable of providing post-sale service to consumers as would the legitimate trademark holders could. Thus, the images of trademarks is damaged or affected in the minds of consumers.

The quality of a product is also another concern of the trademark owner when opposing parallel imports. Accordingly, the quality designed for different markets is also different because consumer habits in using the products, their living standards, religious and economical conditions vary from country to country. Consumer expectations for a product bearing a trademark in different markets are also different, and when the expectations of the consumers have not been met and this ruins goodwill of the trademark owner.⁸⁹

Although many countries in the world have permitted parallel importation of trademarked goods as legal, still little uniformity exists in the overall approach to this problem. The controversy over parallel importation of trademarked goods mainly focuses on one point, which is the extent or scope that trademark owners control their mark. This controversy centers on the problem of trademark owner using their exclusive rights in a country (or a group of countries) to restrict the importation of goods into the country after the goods have been marketed in other places by the trademark owner or with his consent.

III. The principle of exhaustion of trademark rights

⁸⁸ International Trademark Association, "Parallel imports," http://www.inta.org/index.php?option=com_content&task=view&id=222&Itemid=153&getcontent=3.

⁸⁹ Roger E. Schechter and John R. Thomas, *Intellectual property : the law of copyrights, patents and trademarks*, Hornbook series (St. Paul: Thomson/West, 2003), 734.

A. Definition

1. Definition of exhaustion of intellectual property rights

The German scholar Joseph Kohler first introduced the theory of exhaustion of intellectual property rights which was then applied by the German Supreme Court.⁹⁰ Exhaustion of intellectual property rights refers to the situation in which the intellectual property rights holder cannot use exclusive rights to prevent the further circulation of intellectual property rights of covered products. The theory of exhaustion has been used in an effort to ensure that the intellectual property rights owners do not acquire the exorbitant of their exclusive rights.⁹¹ From this point, the primary meaning under the exhaustion of right theory is to harmonize the public interests by allowing free trade between countries and that of the intellectual property rights owners.⁹² In other words, the goal of the exhaustion of intellectual property rights is to find a way to balance the benefits of both-side. The exhaustion of intellectual property right benefits the public in the availability of high-value commodities at cheap prices. On the other hand, the intellectual property rights owner should get an adequate reward for the rights owner for their creative efforts, or have their goodwill protected in a proper way.⁹³

Under the principle of exhaustion, once a product protected by an intellectual property right has been marketed either by the owner or by his consent the rights of commercial exploitation over this given product can no longer be exercised by that owner as they are “exhausted.”⁹⁴ “Exhaustion” here means that the right to control further market distribution or commercial exploitation of the rights

⁹⁰ Christopher Heath, “Legal Concepts of Exhaustion and Parallel Imports,” in *Parallel Imports in Asia*, ed. Christopher Heath (Kluwer Law Intl, 2003), 18.

⁹¹ Keeling, *Free Movement and Competition Law*, 73.

⁹² Marco Slotboom, *A Comparison of WTO and EC Law: Do Different Objects and Purposes Matter for Treaty Interpretation?* (Cameron May, 2006), 180.

⁹³ Peter Ganea, *Exhaustion of IP Rights: Reflections from Economic Theory* (Institute of Innovation Research, Hitotsubashi University, February 2006), <http://ideas.repec.org/p/hit/iirwps/06-02.html>.

⁹⁴ See Hays, *Parallel Importation Under European Union Law*, 8-12; Paul Torremans, *Holyoak and Torremans Intellectual Property Law* (Oxford ; New York: Oxford University Press, 2005), 417-418.

owner has ceased to exist upon the first legal marketed, but not on the intellectual property rights. In other words, “exhaustion” does not refer to the existence of the intellectual property right but to the limits in exercising such rights for specific products. In such a case, the possibilities of intellectual property owners to exercise the right are exhausted as to the particular products, not the rights themselves.⁹⁵ In cases where the sold items were not legally marketed, the intellectual property rights owner has the right to control the subsequent circulation of those items, as their rights are not exhausted.⁹⁶

The exhaustion doctrine exists not only in the sphere of trademark rights but also in the sphere of copyrights and patent rights. Every country has its own way to handle legal treatment with exhaustion of intellectual property rights. For example, the European Union applies regional exhaustion of rights to trademark, patent and copyrights. In the meanwhile the United States applies national exhaustion with respect to patent rights but international exhaustion with respect to trademark rights.⁹⁷ The impact on world trade may expand when countries chose the regime of international exhaustion of intellectual property rights to apply over national exhaustion regime. Given that the preponderance of goods traded in world commerce is identified by a trademark, and the far fewer goods are patented, the doctrine of national exhaustion may have a broader impact on world trade if it applies to trademarked goods than if it is limited to patented goods.⁹⁸

2. Definition of exhaustion of trademark rights

⁹⁵ Christopher Heath, “Legal Concepts of Exhaustion and Parallel Imports,” 18.

⁹⁶ Peter Ganea, Exhaustion of Intellectual Property Rights: Reflections From Economic Theory, IIR Working Paper WP#06-02.

⁹⁷ Abbott, Cottier, and Gurry, International Intellectual Property in an Integrated World Economy, 278.

⁹⁸ Ibid.

According to trademark law, the owner of a trademark has exclusive rights to use it or to prohibit the use of the trademark by third persons. The exhaustion of trademark rights occurs when a product (particularly a batch of products or goods) has been placed on the market by the proprietor or with their consent (i.e. by licensee, distributor or agent or affiliate). The trademark rights in association with that batch of products appear exhausted and the trademark owner can no longer exercise any rights to prevent the further commercial exploitation over that batch of trademarked products.

When products are marketed, the producers always expect they can sell the products entirely. In fact, the buyers are not always the consumers of these products as sometimes the buyers re-sell these goods for profit (i.e. parallel trader). Thus, a proprietor of resold trademarked products cannot complain of trademark infringement. If a proprietor could rely on his exclusive rights to prevent the further circulation of these products then he would use it as a tool to control the market by dividing the market, applying differential pricing, or decreasing the competitive behavior.⁹⁹ Also, as a result of this, the buyers would have the two options of either to buy or not to buy the products at an exorbitant price.

The theory of exhaustion of rights is also called the “first sale doctrine” (in the United States) and the theory of “placing on the market”¹⁰⁰ or “free movement of the goods” (in the EU). A trademarked product is exhausted after it is first sold or put into the market, and consequently the trademark owner no longer is allowed to control the subsequent distribution or circulation of that product. Also, the trademark proprietor cannot prevent the resale of the products sold with or by his consent. Unless otherwise specified by law, the subsequent acts of resale, rental, lending or other forms of commercial use by third parties can no longer be controlled or opposed by the intellectual property owner. As such, the doctrine of exhaustion of trademark rights solves a very fundamental point at which the owner’s controls over the goods or service terminate. The termination of control is the vital function of any market economy as it allows the free movement of the goods and services.

⁹⁹ Keeling, Free Movement and Competition Law, 75.

¹⁰⁰ Hays, Parallel Importation Under European Union Law, 217.

Therefore, if there is no exhaustion of trademark doctrine, the original holder of that mark would continuously exercise his control over the sale, transfer or use of a product, which would also control economic life.¹⁰¹

The ultimate purpose of the exhaustion rule is to prevent the phenomena called the “partition the market”, where the intellectual property owners or in this case particularly trademark owners may use their exclusive rights to divide the market into different portions.¹⁰² The exhaustion of right doctrine addresses an important issue of the extension of owners’ control over the market circulation of products. Therefore, the principle of exhaustion of right is a crucial tool in harmonizing the exclusive rights of the trademark owners as well as the needs of the markets. For the importance of this principle, if there is no principle of exhaustion of trademark rights, then the original owner would perpetually exercise control over the sale, transfer or use of a good or service associated with the trademark, and would control economic life.¹⁰³ In the European Union, for example, the exhaustion of goods occurs, besides when the trademark owner himself puts the trademarked product in the market, in the following cases (the issue of the geographic scope is not mentioned here.):

(1) Sales by members of the same economic group: when the goods are placed on the market by undertakings which belong to the same economic group;

(2) Sales by an agent or distributor: when trademarked products are put on the market on behalf of the trademark owner by an agent or distributor the trademark rights;

(3) Sales by licensees: when the trademark owner grants a license authorizing another person to exploit his rights in a given territory; and

(4) Assignments: the existence of an economic link or legal link between assignor and

¹⁰¹ Abbott, Cottier, and Gurry, *International Intellectual Property in an Integrated World Economy*, 270.

¹⁰² Keeling, *Free Movement and Competition Law*, 78.

¹⁰³ Abbott, Cottier, and Gurry, *International Intellectual Property in an Integrated World Economy*, 271.

assignee.¹⁰⁴

3. Exhaustion of trademark rights under the TRIPS Agreement

In actuality, there is no international multilateral treaty directly dictating a standard of national, regional, or international exhaustion. The Paris Convention does not regulate this issue and the Agreement on Trade-Related Aspects of Intellectual Property (hereinafter the “TRIPS” or the “TRIPS Agreement.”)¹⁰⁵ takes a neutral position in dealing with this concept.¹⁰⁶ Article 6 of the TRIPS Agreement provides as follows:

For the purposes of dispute settlement under this Agreement, subject to the provisions of Articles 3 and 4 nothing in this Agreement shall be used to address the issue of the exhaustion of intellectual property rights.¹⁰⁷

Article 6 leaves room for the World Trade Organization (WTO) members with the freedom to choose and apply the principle of international exhaustion of rights in its national legislation. Whatever solution a member chooses and applies, that choice cannot be brought and claimed by another member under the Dispute Settlement (DS) system of the WTO as long as the measure does

¹⁰⁴ Keeling, Free Movement and Competition Law, 82-95.

¹⁰⁵ The TRIPS Agreement is Annex 1C of the Marrakesh Agreement Establishing the World Trade Organization, signed in Marrakesh, Morocco on 15 April 1994.

¹⁰⁶ Jeffery Atik and Hans Henrik Lidgard, “Embracing Price Discrimination: TRIPS and the Suppression of Parallel Trade in Pharmaceuticals,” SSRN eLibrary, 1044 http://papers.ssrn.com/sol3/papers.cfm?abstract_id=956682.

¹⁰⁷ The principles of National Treatment and Most-Favored-Nation treatment are provided at Articles 3 and 4 of the TRIPS Agreement respectively.

not violate the non-discrimination rules of the most favored nation and national treatment.¹⁰⁸ At this point, the TRIPS Agreement illustrates that it is not a one-size-fit-all regime for all of its members.

Furthermore, the main issue concerns the admissibility of the principle of exhaustion of intellectual property right, namely, the possibility of importing into a country products or goods protected by intellectual property rights, after the products or goods have legally been placed on the market. The recognition by the TRIPS Agreement of the principle of exhaustion of intellectual property rights can be considered as an indispensable result of the process of economic globalization. National boundaries are disappearing with the rapid development of e-commercial, the progress in transportation, as well as the convenience in communications, together with the reduction of tariffs and non-tariff barriers all over the world.¹⁰⁹

From the economic perspective, global development has many advantages. First, the competitive ability of the local or national companies has to be stronger unless they would lose their position on the market. The quality of the products produced by the domestic companies must be higher and the price must be lower in order to maintain their positions in the market share. As a result, the place of the domestic monopolistic manufacturers is limited. Second, consumers can purchase high quality products at reasonable prices. The diversification of the products available on the market, regardless of whether they are national or foreign manufactured, benefit consumers. Therefore, the legitimate rights of the consumers are served and protected better when countries allow parallel imports.

Countries adopt exhaustion rules across the spectrum of intellectual property rights in different ways because they need not, and often do not, use the same rule for all intellectual property rights.¹¹⁰ In other words, the scope of adoption of exhaustion rule totally depends on the conditions of

¹⁰⁸ See Correa, Intellectual property rights, the WTO, and developing countries, 83.

¹⁰⁹ Ibid., 85.

¹¹⁰ Abbott, Cottier, and Gurry, International Intellectual Property in an Integrated World Economy, 278.

each country, and therefore the application of this rule has many regimes. For example, the European Union chooses the regional exhaustion rule for copyright, patent, and trademark. Meanwhile, Switzerland follows the rule of international exhaustion for copyright and trademark but selects the rule of national exhaustion to patent. The United States follows a rule of national exhaustion with respect to patent, rules of international exhaustion for trademark, but for copyright it has not made a definitive determination.¹¹¹

As seen above, each WTO member can decide on whether or not a holder of a trademark right may block the sale or importation of a protected good that was produced by or under the authority of that trademark right holder.¹¹² When the trademark owners are permitted to block the importation of such products, then the trademark right on further commercial exploitation of the products is not exhausted. On the contrary, if the trademark owners are not permitted to prevent the importation of such goods, then it means that the right on further commercial control of the goods is exhausted.

These provisions of the TRIPS Agreement on exhaustion and its effect toward parallel imports have been subject of legal debates among scholars in many countries. Member States, particularly developing countries, can take advantage of these provisions by developing their own national regulatory rules of exhaustion of right with respect to intellectual property in a way that fits their national economic and political preferences.¹¹³ As with other objects of intellectual property rights, trademark rights are exclusive and territorial. The TRIPS Agreement, by allowing each member to have its own determination of approaching on exhaustion regime, has created a conflict between the exclusivity and territoriality of trademark rights and between rules of international trade and competition.

¹¹¹ Ibid.

¹¹² Atik and Lidgard, "Embracing Price Discrimination." 1042

¹¹³ Keith Eugene Maskus, *Intellectual property rights in the global economy* (Peterson Institute, 2000), 209.

B. Geographic scope of exhaustion of trademark rights

As to the geographical scope where the exhaustion of trademark rights is recognized, there are three different regimes: i.e., national, regional and international exhaustion regimes. Each of them has different impacts to the development of a country. Thus, countries have to take into consideration which regime is the best for them based on their own economic, social, and legal situation.

The first regime refers to a national exhaustion of trademark rights, in which a country places into the market a trademarked product by or with the consent of the trademark owner in that country.¹¹⁴ The second level of trademark exhaustion refers to a regional exhaustion. In this regime the trademark proprietor rights are exhausted in a region after the goods were put into the market by the trademark owners or with their consent in any country member of that region. Thus, the mark proprietors cannot use their exclusive rights to prohibit the free movement of the products within that region after the products were lawfully put on any market of a member country or on the community market of that region.¹¹⁵ Third, the last regime of trademark exhaustion of rights is international exhaustion or global exhaustion whereby the trademark rights are exhausted once a trademark product has been put into any market in the world by or with the consent of the trademark owner. When international exhaustion applies, the trademark owner cannot prevent the further circulation of that trademarked product after it has legally entered the market. Therefore, a trademarked product can freely flow cross borders or from market to market without any opposition from an owner or without any consideration of an infringement.

¹¹⁴ Keeling, Free Movement and Competition Law, 78-80.

¹¹⁵ Ibid., 114-146.

1. National exhaustion of trademark right

In this regime of exhaustion, the trademark owners cannot use their trademark rights to prevent the further distribution of such goods in the same country, but may prevent such distribution in other countries. If the same goods bearing the trademark are subsequently sold in another country, then the trademark owners can rely on their exclusive rights in this specific country to prevent the further sale of the goods. In this situation, the selling the products in another country is seen as lacking the consent to such subsequent sale.¹¹⁶ National exhaustion of a trademark right can be considered as an essentially minimum in terms of the geography scope.¹¹⁷

It is interesting that the term “national” from the viewpoint of the International Trademark Association (INTA) is of a different understanding compared to normal way of understanding a nation. From the INTA interpretation, moreover, the notion of “national” is wider than that of in the normal way in which national refers to an independent country. Therefore, according to the INTA there are two types of exhaustion of trademark rights, namely national and international. According to the resolution of the INTA on the exhaustion of trademark right and parallel importation on May 1999, the term national refers to:

...an independent country or group of countries which have adopted a single, common market with an overriding governmental authority, which operates rules and regulations in the field of intellectual property for the common market, and which operates a court system which has the ultimate authority on the interpretation and enforcement of those rules and regulations. The European Community (or by special treaty the European Economic Area) and the U.S are examples of such single markets. Treaties ruling free trade in a given area may not fall under

¹¹⁶ International Trademark Association Position Paper on Parallel Imports, July 2007.

¹¹⁷ Keeling, Free Movement and Competition Law, 78.

this definition.¹¹⁸

There is also a major legal debate on the principle of national exhaustion of trademark right. On the one hand, the principle of national exhaustion of trademark right should create artificial barriers against trade and restricts movement of goods that comes into direct conflict with the international character of trade and commerce.¹¹⁹ On the other hand, there are opinions in support of the principle of national exhaustion of trademark rights. Accordingly, this principle is considered to be necessary to protect the expectations of the customer with respect to their trademarks and also protect the goodwill of the trademark owners. From these standpoints the INTA strongly supports the national exhaustion regime and in appropriate cases the regional exhaustion of rights.¹²⁰ The INTA is an organization striving “to protect and promote the rights of trademark owners.”¹²¹ Therefore, the INTA is in favor of protecting the trademark owners or enterprises.

2. Regional exhaustion of trademark rights

In the European Union, Article 13(1) of Regulation No 40/94 on the Community trademark, exhaustion of trademark rights provides as follows:

A Community trademark shall not entitle the proprietor to prohibit its use in relation to goods which have been put on the market in the Community under that trade mark by the proprietor or with his consent.¹²²

¹¹⁸ International Trademark Association, “Exhaustion of Trademark Right and Parallel Importation,” http://www.inta.org/index.php?option=com_content&task=view&id=222&Itemid=153&getcontent=3.

¹¹⁹ Ekaterina Shekhtman & Evgeniy Sesitsky, Exhaustion and Parallel Importation in The Field of Trademarks, working paper,8.

¹²⁰ International Trademark Association Position Paper On Parallel Imports, July 2007.

¹²¹ About International Trademark Association, http://www.inta.org/index.php?option=com_content&task=view&id=14&Itemid=37&getcontent=4

¹²² Article 13(1) of Regulation No 40/94 on the Community trademark

With the regional regime,¹²³ the owners cannot use their trademark rights to prevent the further distribution of such goods within a group of countries, but may prevent such distribution outside the region. For instance, the European Union has adopted a policy known as “Community exhaustion,” meaning that once goods have been placed on their market, the holder of the trademark rights no longer has the right to restrict the further movement of the goods anywhere inside the union.¹²⁴ This is the significant difference from the national intellectual property law of countries in the European Union. Some jurisdictions in the past (e.g. Belgium, France and the United Kingdom) had different provisions on parallel trade.¹²⁵

In the United Kingdom, for example, when a proprietor allowed his or her products to be marketed abroad bearing the trademark, then he or she was deemed to have consented to the further commercial exploitation of those products, including export or re-sale into the United Kingdom. On the contrary, if the goods sold abroad were subject to an export restriction and were in different quality, the trademark holder could object to their resale in the United Kingdom.¹²⁶ In the *Colgate Palmolive Ltd.*, case, the defendant without authorization imported and sold a different quality toothpaste made in Brazil (particularly inferior) for the Nigerian market but then later diverted it to the United Kingdom.¹²⁷

The UK provisions of intellectual property law gave exporters who possess a trademark the right to ask the competent authority to block such a parallel trade, or exporters have the right to prohibit such trade under the theory of passing off. Countries usually applied their methods by simply

¹²³ International Trademark Association, “Exhaustion Of Trademark Right And Parallel Importation,” http://www.inta.org/index.php?option=com_content&task=view&id=222&Itemid=153&getcontent=3.

¹²⁴ Tommaso M. Valletti and Stefan Szymanski, “Parallel Trade, International Exhaustion and Intellectual Property Rights: A Welfare Analysis,” SSRN eLibrary, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=951835.

¹²⁵ Christopher Stothers, *Parallel Trade in Europe: Intellectual Property, Competition and Regulatory Law* (Portland, Or.: Hart Publishing, 2007), 40.

¹²⁶ Keeling, *Free Movement and Competition Law*, 77.

¹²⁷ *Colgate- Palmolive Ltd vs Markwell Finance Ltd* [1989] RPC 497.

marking or labeling the good “not for resale in the United Kingdom” or “not for resale in France”¹²⁸ or did not accept the different quality products bearing the same trademark to stop the resale of the products or goods. Under the current provisions of the Trademark Directive on Community exhaustion, a French exporter cannot prevent the resale of trademarked products in the United Kingdom back into France because the trademark right is already exhausted. The regional exhaustion of a right is also called as “Community-wide” exhaustion of right.

3. International exhaustion of trademark rights

Diametrically contrary with the national exhaustion of trademark rights is the international exhaustion of such rights. Regarding the international regime, the owners cannot use their trademark rights to prevent the further distribution of such goods anywhere in the world. Once trademarked goods are legally launched into the market, the owner cannot stop or prevent the further distribution of those products anywhere else in the global market. In this regime of exhaustion the intellectual property right is consumed as goods and are placed in the market, so that they can be freely circulated in the global market.

The principle of international exhaustion of trademark right has become the prevailing tendency these days as many jurisdictions have recognized and introduced it into their national legislation.¹²⁹ In addition to the advantages and optimistic expectations from the benefits that the international regime bring to consumers, there also exist arguments aimed at the disadvantages that the international exhaustion regime has created for both consumers and trademark owners.¹³⁰ Trademark law protects consumers from being misled to purchase a product in question; however, consumers are

¹²⁸ Valletti and Szymanski, “Parallel Trade, International Exhaustion and Intellectual Property Rights.” working paper, 8-9.

¹²⁹ Keeling, *Free Movement and Competition Law*, 79.

¹³⁰ International Trademark Association Position Paper on Parallel Imports, July 2007.

not misled when they buy “genuine products” which have been marketed in other countries by or with the trademark owners’ consent. If the expectations of the consumers toward the bearing trademark products are not met as these products are designed for another market with a different or inferior quality or feature, then this harms the goodwill of trademark owners¹³¹

Free movement of goods under the principle of international exhaustion of trademark right has shown a manifest demand from the current circumstance of the world. The principle of international exhaustion of trademark rights does not create restrictions of the free movement of goods. This principle works on the assumption that there is only one market: that is the world market. National markets therefore no longer act independently as they have become a component of the global market. Once trademarked products enter any part of the global market by or with the consent of the owner, the rights have been exhausted over these products.

C. The effects of parallel imports

1. The effects of parallel importation on trademark owners

At first glance, parallel imports appear to have a large effect in reducing the profits of the intellectual property right holders in general and the trademark owners in particular.¹³² Therefore, during the negotiation of the Doha Conference, the U.S attempted to protect the pharmaceutical industry by preventing parallel imports because of the damage that was caused to the U.S

¹³¹ Exhaustion of Trademark Rights and Parallel Importation, Request for Action by INTA Board of Directors, May 26, 1999, http://www.inta.org/index.php?option=com_content&task=view&id=222&Itemid=153&getcontent=3

¹³² Noriaki Matsushima and Toshihiro Matsumura, “Profit-Enhancing Parallel Imports,” *Open Economies Review* 21, no. 3 (July 2008): 2.

pharmaceutical manufacturers when adopting such imports.¹³³ Parallel importation becomes a big threat to trademark owners who carefully considered whether or not to distribute or supply their products for developing countries.

In an effort to protect the domestic trademark owners from parallel importation of trademarked products, developed countries have different point of views. For example, Japan raised the issue of necessity to allow the trademark owners to exercise their rights against parallel imports of goods sold with the consent in another country. Trademark owners should be compensated for the establishment and maintenance of their goodwill in a market. Different levels of goodwill in different markets may lead to different prices because of the well-known or famous level of the trademark. For their contribution and investment, the trademark owner should be allowed to prevent parallel imports.¹³⁴

From the trademark owners' point of view, parallel importation of trademarked products should not be allowed in the markets of developing countries. When there were no parallel imports, trademark owners could manufacture the same quality products for different markets with a different price. In this case, the trademark owners could possibly set up the price of the products for the foreign market higher than that of the domestic designed products. If there were no parallel imports, there would not be free movement of goods or products between the nations. Therefore, the trademark owners could freely set up the price for products in different markets. Under such situations, the resulting losses for consumers in developing countries would not be difficult to foresee.

On the other hand, one argument is that the incentives for the trademark owners could become limited when countries allow parallel imports. Hypothetically, when parallel importation of

¹³³ Frederick M. Abbott, "The Doha Declaration on the TRIPS Agreement and Public Health: Lighting a Dark Corner at the WTO," SSRN eLibrary: 482, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1493725.

¹³⁴ Summary report, International Exhaustion of Industrial Property Rights, AIPPI Congress in Melbourne 2001, <http://lists.essential.org/pipermail/hague-jur-commercial-law/2001-December/000385.html>.

trademarked goods is banned, then trademark owners can gain more benefits. Meanwhile, when parallel importation is allowed, arbitrage is the main factor which has negative effects to reduce the innovation of the manufacturer in maintaining or investing in the quality of the products.¹³⁵ Nevertheless, the argument is that the incentive of the trademark owners in investing into potential R&D activities for new products is also not clear and not convincing.

However, if the principle of exhaustion of trademark rights is not allowed, then trademark owners could control or divide a segment of the market or markets based on their exclusive rights. As a consequence of not allowing the principle of international exhaustion of trademark rights, the free movement of products cannot occur, in addition with the restriction of the international trade. Thus, the significant role of the principle of exhaustion of intellectual property (trademark particularly) rights is undeniable. Without the exhaustion of trademark rights principle, the owners would perpetually exercise their exclusive rights to control the sale, transfer, distribution, use or other activities which hinder the further commercial exploitation of the relevant products.¹³⁶

When parallel importation is allowed, trademark owners no longer maintain their monopoly status on the market. If the price of a product in the domestic market is lower than that in the overseas market, the importers will take their opportunity price differential between markets. As a result, trademark owners suffer a loss in the domestic market. The trademark owners, in their attempts to control the movement of their products from the overseas market to domestic market, have carried out many measures to prevent parallel imports of their trademarked products. One of the measures that trademark owners use to reduce the loss that caused by the parallel imports is to eliminate the difference in prices of products between overseas and domestic markets. Moreover, trademark owners can manufacture and supply goods and services of high quality by maintaining their business goodwill. Also, trademark owners should maintain good business relationships with suppliers, licensees and distributors, and urge them to control the supply of the product so that parallel imports would not

¹³⁵ Valletti and Szymanski, "Parallel Trade, International Exhaustion and Intellectual Property Rights," 505.

¹³⁶ Bonadio, "Parallel Imports in a Global Market," 153.

happen. However, under the rapid change of international trade, trademark owners find it difficult to restrain parallel imports. The more flexible the trademark owner can be, the less loss the owner will suffer.

Another measure is to eliminate the causes from which the parallel imports rose. The main reason for parallel imports is profit or arbitrage gained from price differences between markets. If there is no chance for profit, then parallel imports of trademarked products from a low priced market to a high priced market will not occur. Trademark owners can reduce prices in countries which face parallel imports.¹³⁷ Even if they cannot eliminate the price gap, the minimization of the difference in price might lead to the prevention of parallel importation.

Another fact which is found concerning parallel imports is that unauthorized distributors take a free-ride on the trademark owner investment and goodwill by supplying parallel imports trademarked products with cheaper prices while not offering the pre-sale and post-sale services provided by authorized distributors.¹³⁸ Some critics argue that because parallel imported products are genuine trademarked goods, there is no of confusion of the origin or source of the goods to consumers. Moreover, consumers buy parallel imported products because of the goodwill of the trademark owner as well as the quality of the products that made by the trademark owner, not the goodwill of the authorized distributors.

2. The effects of parallel imports on consumers

When parallel imports are allowed, consumers have a greater chance to acquire high quality products at a lower price. In low-income countries, the importation of parallel imports (which are

¹³⁷ Stothers, *Parallel Trade in Europe*, 184.

¹³⁸ Bernard M. Hoekman, Aaditya Mattoo, and Philip English, *Development, Trade, and the WTO: A Handbook* (World Bank Publications, 2002), 377.

sometimes called “gray market products”) is a good alternative source of supply for their domestic need. Previously, the opponents worried that permitting parallel imports would lead to trade in counterfeit goods and pirated goods.¹³⁹ However, the parallel imports are neither counterfeited nor pirated products but are genuine ones which were distributed in foreign markets lawfully. For this reason, such arguments were not relevant in the common understanding of parallel imports.

Proponents argue that the importation of gray market goods protects consumer interest not only by promoting the market competition but also maintaining low prices on importing market.¹⁴⁰ Consumers or end-users will be the ultimate subjects who best profit from parallel imports when they can buy genuine products from trustable sources with lower prices. Low priced is one of the most important beneficiaries that end-users could gain from parallel imports, especially when the counterfeit products are popular in developing countries. In these countries it is easier to buy counterfeit goods than authentic ones, because counterfeits are available at popular markets plus big supermarkets and luxury shops and beyond the control of the government competent authorities.¹⁴¹

Many benefits accrue to consumers when a developing nation accepts parallel importation. The largest advantage that consumers in developing countries gain when adopting parallel imports includes the accessibility of consumers to essential pharmaceuticals for combating epidemics and serious diseases such as HIV and AIDS, malaria, tuberculosis.¹⁴² However, in general, there is the possibility of consumer deception when lower-quality parallel imports are marketed as legitimate versions of higher-quality products. Legislation in developed countries such as the U.S. or Japan have

¹³⁹ K. E Maskus, “Parallel Imports in Pharmaceuticals: Implications for Competition and Prices in Developing Countries,” Final Report to World Intellectual Property Organization (2001): 4.

¹⁴⁰ Donna M. Lach, “Note and Comment: The Gray Market And The Customs Regulation -- Is The Controversy Really Over After K Mart Corp. V Cartier, Inc.?” 65 Chi.-Kent L. Rev. 221, 228.

¹⁴¹ Nguoi lao dong, It’s easier to buy counterfeit than real goods,
<http://vietnambusiness.asia/it%E2%80%99s-easier-to-buy-counterfeit-than-real-goods/>.

¹⁴² Krithpaka Boonfueng, Parallel Imports in Pharmaceuticals: Increase Access to HIV Drugs, accessed March 12, 2011, <http://www.thailawforum.com/articles/hivdrugs1.html>.

allowed parallel imports only in cases where the quality of the imported products were comparable or the imported products were materially or physically non-different from the genuine products on the market as a method to protect the domestic trademark owners. At present, the legislation of developing countries does not pay attention to this issue of quality of imported products.

When an inferior version of trademarked products is sold in a developing country due to the deficiency of the legislation in the trademark area, consumer expectations fall. When purchasing a specific imported product, the consumer pays for the known expected quality of that product; hence, the legitimate benefit of that purchaser is not guaranteed when the product has lower quality. Provisions on quality control are necessary because an imported product must meet certain conditions in order to circulate in the market. In other words, quality control is a useful tool to determine whether a gray market product is qualified or not. In order to protect consumers, the lawmakers of developing countries should take the quality control issue into consideration when making regulations on parallel imports.

Furthermore, the protection of the legitimate benefits of consumers should be preferably solved by invoking the related provisions or laws, such as law of consumer protection or unfair competition law¹⁴³ because of the imperfection of the legislation of developing countries. The legitimate interests of consumers can be protected better with a combination of these regulations.¹⁴⁴ We will come back to these points again in Chapter 5.

¹⁴³Christopher Heath, "Legal Concepts of Exhaustion and Parallel Imports," 18.

¹⁴⁴Pham Duy Nghia, "Exhaustion and Parallel Imports in Vietnam," in *Parallel Imports in Asia*, ed. Christopher Heath (Kluwer Law Intl, 2003), 85-93.

CHAPTER 4

PARALLEL IMPORTS AND TRADEMARK RIGHTS IN THE UNITED STATES, THE EUROPEAN UNION AND JAPAN

Each country or area has its own approach towards the issue of parallel imports of trademarked products. This chapter focuses on the laws and practices related to parallel importation of trademarked products in the United States, the European Union and Japan. We will see how these countries and region apply their respective regimes of exhaustion, and tackle with specific problems accompanying each regime.

First, this part of the paper finds the answer to the question whether or not national or regional trademark laws permit the trademark owner to prevent parallel importation of trademarked products. If the answer is yes then to which extent the parallel imports is accepted. Basically, parallel importation of trademarked products is accepted in these jurisdictions with different ways of application, which suitable in each condition.

Second, the scope of applying the principle of exhaustion of rights in the U.S., the EU and Japan are also different. As to trademark rights, the United States follows a rule of international exhaustion among commonly controlled enterprises.¹⁴⁵ The European Union applies a rule of regional exhaustion. Similar to the U.S, Japan appears to follow a rule of international exhaustion.¹⁴⁶ Because of these differences in the applicable rules of exhaustion, the relevancy of location where the trademarked products were legally marketed is very important. Considering the different features in

¹⁴⁵ Abbott, Cottier, and Gurry, *International Intellectual Property in an Integrated World Economy*, 278.

¹⁴⁶ Ibid.

applying the principle of exhaustion of trademark rights in each jurisdiction, determining the first place where the products were marketed is necessary to identify whether or not the trademark rights are exhausted.

Third, when trademarked products are transferred from one jurisdiction into the market of another jurisdiction, in some circumstances the parallel importers have to alter the package of the products so as to sell them in the importing country. In such a situation, whether or not the trademark owners have the right to oppose such imports on grounds that the imported product was modified or repackaged without consent requires full inquiry. A full analysis the consent of the trademark owners in parallel import case is necessary in determining which situation the consent must be positively expressed, and in which situation implied consent is enough.

Fourth, the courts of those territories have dealt with issues concerning quality control and contractual restriction in parallel imports. In fact, each country has its own way to deal with these problems. In general, when the imported products were manufactured beyond the scope of the quality control by the trademark owner, the owners can prevent the importation of such products.

The above-mentioned issues prove to be important in establishing a legal framework related to parallel importation. The development of intellectual property rights on the worldwide scale through the free trade tendency has shown the impacts of intellectual property rights on the actual situation of international economy.¹⁴⁷ International agreements such as the GATT or the TRIPS as well as the intellectual property laws of developed national or regional jurisdictions such as the U.S, the EU and Japan have shown the ongoing tendencies of the exhaustion of trademark rights and its effect to the international free trade.

¹⁴⁷ Graeme B. Dinwoodie, *International Intellectual Property Law and Policy* (Newark, NJ: LexisNexis, 2008), 1082.

A possible paradox occurs when on the one hand the trademark laws are focusing on international free trade, but on the other hand intellectual property rights in nature they are territorial rights. Therefore, such issues have become the most frequently controversial and debated among scholars. The exhaustion doctrine of intellectual property rights in general and trademark rights in particular also contains this apparent paradox. If international free trade of trademarked goods is recognized widely, then countries will apply the international exhaustion doctrine of trademark rights. Can trademark owners prevent parallel importers from undertaking parallel imports of their products?. If the answer is yes, then to what extent and when do the owners have right to prevent the third person market their products from importing these products into a jurisdiction for the arbitrage benefits?¹⁴⁸

I. Parallel imports and trademark law in the United States

In the United States, the trademark owners cannot act against or prevent the domestic reselling of the products they placed on the market or with their permission. Since a trademark is exhausted by the first sale, it is called “first sale” doctrine of the goods or service embodying that mark.¹⁴⁹ According to the basic idea of this doctrine, the trademark owners already paid for what they had invested into the trademarked goods when the product was sold. The trademark owner therefore no longer has control over the further distribution of those products on the market. The buyers or transferees of the trademarked goods or service are entitled to use and dispose of the products without any further restriction.¹⁵⁰

¹⁴⁸ Ibid., 1082-1083.

¹⁴⁹ Abbott, Cottier, and Gurry, *International Intellectual Property in an Integrated World Economy*, 270.

¹⁵⁰ Ibid.

Part A of this section provides a general introduction into the legal provision of the U.S. Law on parallel importation including provisions of the Tariff Act and Lanham Act. Part B discusses issues related to parallel imports of trademarked goods by looking at the purposes of the law. In this part, issues closely related to parallel importation such as gray market and unfair competition, genuine products, repackaging and relabeling, contractual restriction and quality control are analyzed. A summary at the end of this chapter will highlight the occurring situations with parallel imports of gray market goods in the U.S.

A. Introduction to the U.S statutory provisions related to parallel imports

This part of paper starts with an imagination of two packs of chocolate put on a supermarket shelf somewhere in the United States. These packs of chocolate are virtually identical; they bear the same label, the same ingredients, the same producer from the same factory located in America. While there are many similarities between two packs of chocolate, there exists a difference. One of these packs of chocolate was sold by a U.S. producer to a domestic distributor for sale in the local market while the other was sold by the same producer to a foreign trader for sale outside of the country. For some reasons, the latter chocolate was imported back into the U.S. for sale in the domestic market by a third person whom had purchased the products from the trader. The price of the imported chocolate is cheaper than the chocolate that was sold in the domestic market. Price of products is a key element for consumers in making a purchasing decision even when the same two products are made by the same producer, bearing the same trademark, and made of the same ingredients.

The importing of such products back into the U.S market is called as “parallel imports” and is also referred to as “gray market goods.” Parallel imports and gray market goods are interchangeable terms, although case law favors use of the term "gray market.”¹⁵¹ Gray-market goods are foreign-

¹⁵¹McCarthy, § 29:46.

manufactured goods bearing a valid United States trademark that are imported or sold without the consent of the U.S trademark holder. The European Community and Japan also have dealt with authorized importation of trademarked product, and the term “parallel imports” was chosen instead of using the term “gray market.”

Importation of gray market goods refers to acts in which a third party other than the designated exclusive U.S. importer buys genuine trademarked goods outside the U.S. and imports them for re-sale in the domestic market in competition with the exclusive U.S. importer.¹⁵² Gray market goods are genuine trademarked goods and either imported or sold without the permission of the local trademark owner.¹⁵³ In fact, gray market products are genuine trademarked products and they are neither fake nor counterfeit products.

The controversial debate on parallel importation of trademarked products mostly focuses on questions such as whether the transaction related to gray market products constitute trademark infringement, when the quality of the genuine imported products and products that were designed for selling on the domestic market are not different.

A controversial debate in the economics literature exists on permitting gray market importation into the United States.¹⁵⁴ There are two main schools of opinions. One school of thought supports the restriction on parallel imports, and the arguments mostly focus on the importance of encouraging investment in trademark quality by retailers and distributors. The main concern of this school of thought is that the quality of the products varies from country to country with different

¹⁵²Ibid.

¹⁵³ Seth E. Lipner, *The Legal and Economic Aspects of Gray Market Goods* (Greenwood Publishing Group, 1990), 1.

¹⁵⁴ Merges and Lemley, *Intellectual Property in The New Technological Age*, 819.

international quality standards even when they bear the same trademark.¹⁵⁵ Distributors have to invest not only in capital but also time and effort into advertising, marketing and other activities in order to introduce, to build up the consumer awareness of the products, and to establish the effective distribution channels before selling the products.¹⁵⁶ With contributions to the trademarks, authorized U.S distributors can prevent parallel importation because such importers “free ride” on the goodwill generated by such activities.¹⁵⁷

The second school of thought supports parallel imports. The argument is that parallel imports will undercut the retailers’ price, and the unnecessary fees such as advertising and promoting expenses will be eliminated, lowering the prices.¹⁵⁸ As to the “free-ride” issue, the parallel importers argue that the goodwill claimed by the retailer in fact belongs to the trademark owners or manufacturers.¹⁵⁹ For instance, if a consumer wants to buy a bottle of Channel No.5 perfume it could be because the consumer is aware of the quality standard as well as the special features of that specific perfume or has the habit of using this product and not because of the reputation of the distributor. Therefore parallel importers cannot take advantage or take free ride on the goodwill of the trademark owner.¹⁶⁰

Furthermore, protecting the U.S authorized retailers by preventing the importation of genuine products indirectly creates barriers for trading activities to other traders. Consumers in this situation

¹⁵⁵ Ibid.

¹⁵⁶ Hiebert, *Parallel Importation in U.S. Trademark Law*, 2.

¹⁵⁷ Ibid.

¹⁵⁸ Merges and Lemley, *Intellectual property in the new technological age*, 819.

¹⁵⁹ Hiebert, *Parallel Importation in U.S. Trademark Law*, 2.

¹⁶⁰ Ibid.

cannot access cheaper price products with the existence of the trade barriers.¹⁶¹ Parallel imports open a new door for consumers when the products are genuine and there is no confusion. Consumers have what they want with a cheaper price and no one's reputation is harmed, neither the manufacturers nor retailers. In order to prevent parallel imports, manufacturers have no choice but to establish an international pricing scheme which limits or removes any incentives for parallel importers arbitrage.¹⁶² Parallel imports or gray market goods take advantage of the arbitrage situation, allowing competitors to exploit the price discrimination.¹⁶³

1. Tariff Act 1930 section 526 (a)

Section 526 of the Tariff Act of 1930 was enacted “to protect Americans from ruinous foreign competition”¹⁶⁴ and in order to shelter important industries of the United States.¹⁶⁵ Under the Tariff Act, any American trademark holder could demand exclusive rights at customs of genuine products which were produced overseas, regardless of the relationship between the domestic trademark holder and foreign trademark holder. Section 526 of the Tariff Act states as follows:

...it shall be unlawful to import into the United States any merchandise of foreign manufacture if such merchandise or the label, sign, print, package, wrapper, or receptacle, bears a trademark owned by a citizen of, or by a corporation or association created or

¹⁶¹ Ibid., 2-3.

¹⁶² Ibid., 3.

¹⁶³ Merges and Lemley, *Intellectual property in the new technological age*, 819.

¹⁶⁴ Hiebert, *Parallel Importation in U.S. Trademark Law*, 48-49.

¹⁶⁵ Abbott, Cottier, and Gurry, *International Intellectual Property in an Integrated World Economy*, 343-344.

organized within, the United States, and registered in the Patent Office by a person domiciled in the United States ...¹⁶⁶

There are some conditions or requirements that could be inferred from this provision. First, the gray market goods must have been manufactured outside of the U.S. and imported into the U.S. market without the consent of the U.S. trademark owner. Second, the authorized goods must have been manufactured in the U.S. Third, the trademark owner must be an American citizen or American corporation. Fourth, the trademark must be registered with the U.S. Patent and Trademark Office (USPTO).

American Tariff Act prohibits the importation of any goods bearing a registered United States trademark without the consent of the domestic trademark owner, even when the goods are genuine and even when they are imported by a licensed manufacturer who locate overseas.¹⁶⁷ From the language of the amendment, the Tariff Act § 526 absolutely prohibits the importation of a product that bears a trademark owned by a citizen of the United States and is registered in the USPTO. However, this article has not been applied the prohibition to all gray-market goods.¹⁶⁸ The Tariff Act is limited in its application and provides protection to those trademark owners who are U.S citizens and from a different entity than the foreign manufacturer (that is they are not under any parent-subsidiary relation with the original manufacturer). Therefore, if the trademark is owned and registered in the U.S by an exclusive distributor who is independent of the foreign manufacturer and has gained a separate goodwill in the goods sold in the domestic markets, then that distributor is entitled to prevent importation of gray market goods produced by the same foreign manufacturer.¹⁶⁹

¹⁶⁶ Section 526 (a) of The Tariff Act 1930.

¹⁶⁷ Merges and Lemley, *Intellectual Property in The New Technological Age*, 817.

¹⁶⁸ Abbott, Cottier, and Gurry, *International Intellectual Property in an Integrated World Economy*, 344.

¹⁶⁹ 794 F.2d 850, at 47.

While Customs' regulations do not define the full scope of the Tariff Act § 526, some courts have interpreted it to have the same scope as the regulations of the Customs Service regulations upheld by the Supreme Court. The provisions of the Customs Service stipulates in general that “foreign-made articles bearing a trademark identical with one owned and recorded by a citizen of the United States or a corporation or association created or organized within the United States are subject to seizure and forfeiture as prohibited importations.”¹⁷⁰ However, the “common control” exception is the landmark regulation when permitting the entry of gray-market goods manufactured overseas by the trademark owner or through its affiliate.¹⁷¹

This provision of the Tariff Act does not deal with cases in which the products have been made in the U.S. but designed for another market with different formula. When these products were put onto the domestic market after being launched from the overseas market, material differences exist in the imported products and the domestic genuine products. If the first condition of the Tariff Act § 526 is “the parallel imported goods must have been manufactured outside of the U.S.” then this situation is out of the scope of the provision.

Regarding parallel imports in trademarked products, U.S. provisions allow owners to stop the parallel imports into the U.S. when the “common-control” exception is not applicable.¹⁷² The “common control” exception is also known as the “same person” exception. It means that trademarked merchandise may be imported into America when both the foreign and U.S. trademarks are owned by the same person or business entity or other words the foreign and domestic firms are in a parent-subsidary relationship. When a parent company cannot perform control over its distribution, then the

¹⁷⁰ 19 CFR §133.21(b) (1987).

¹⁷¹ Abbott, Cottier, and Gurry, *International Intellectual Property in an Integrated World Economy*, 344.

¹⁷² Mattias Ganslandt and Keith E. Maskus, “Intellectual Property Rights, Parallel Imports and Strategic Behavior,” *SSRN eLibrary* (March 12, 2007), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=982241.

trademark holder must demonstrate that the imported goods are not identical in quality to the original products and could cause confusion among consumers.¹⁷³

In *Kmart v. Cartier* (1998),¹⁷⁴ the Supreme Court showed that the provision of Tariff Act § 526 generally did not stipulate the preventing or blocking of the importation of trademarked products which had been placed on foreign markets by entities under common control with holders of U.S registered trademarks. The court also ruled that this provision did not provide for stopping the importation of trademarked products that had been placed on foreign markets by authorized licensees of U.S registered trademarks.¹⁷⁵ The interpretation of the U.S. Supreme Court about the material difference between gray market imported products and genuine products is analyzed in the latter part of this section in order to identify the legitimate of the imported products.

2. Lanham Act Section 42

The Lanham Act prohibits the importation of goods bearing a mark which can "copy or simulate" a registered trademark regardless of whether or not that manufacturer is a domestic or foreign entity. According to this provision, registered trademark owners can have counterfeit products seized by customs at the U.S. border in order to protect their legitimate benefit as well as their exclusive rights. In other words, Lanham Act § 42 is used for the importation of the goods bearing copy or simulates registered trademarks. However, section 42 of the Lanham Act does not prohibit the importation of genuine products associated with the original trademark. Regarding this issue, there are different ways to understand the courts in the United States. In fact, the Second and Third Circuits

¹⁷³ Ibid.

¹⁷⁴ *K Mart v. Cartier* 486 U.S. 281 (1988).

¹⁷⁵ Abbott, Cottier, and Gurry, *International Intellectual Property in an Integrated World Economy*, 342.

have held that the Lanham Act is not ground to prevent parallel imports. According to the language of Lanham Act §42 there is no violation when there is an importation into the U.S. of genuine trademarked goods that are originally sold abroad by the parent of the American distributor and trademark owner.¹⁷⁶

The D.C. and the First Circuit on the other hand have had different ways of applying this act. These courts have indicated that some gray goods may violate the Lanham Act § 42 and they contended that the interpretations made by the Second and Third Circuits only apply when the gray market goods were not materially different. This interpretation can also be understood as suggesting that where the gray market goods are not genuine, because they differ from the authorized goods, then the Lanham Act bars importation regardless of the fact that such goods were made by an affiliate of the U.S. trademark owner.¹⁷⁷

In the *A. Bourjois & Co., Inc v. Katzel* (1923)¹⁷⁸ case, the central point concerned the issue of customer confusion as to the source or origin of the trademarked products. In this case, the plaintiff, a U.S. corporation called Bourjois, paid a premium to a French manufacturer of face powder in exchange for the goodwill of that company and for the rights to use the trademark JAVA. The plaintiff then registered the newly purchased trademark under its own name in the U.S and continued to import the powder from the French manufacturer and sold the products domestically. The defendant imported the same face powder from the French manufacturer into the U.S. domestic market for selling under a virtually identical trademark. As a result of the defendant's actions, the plaintiff brought a complaint for trademark infringement because the box that the defendant used to contain the products was similar to the plaintiff's. The Supreme Court held that such importation tends to cause confusion as to

¹⁷⁶ McCarthy, §29.50

¹⁷⁷ Ibid.

¹⁷⁸ *A. Bourjois & Co., Inc v. Katzel* 260 U.S 689 (1923).

the origin of the products by applying the principle of territoriality in its judgment and in considering the source of the products. By the trademark the public understand that the products come from the plaintiff even though in fact they did not produce them.

The Lanham Act § 42 prevents parallel imports bearing a trademark which induce the public to believe that a foreign trademarked product is made in the United States. In order to protect the consumer from misunderstanding the source or origin of product, it became mandatory under the labeling provisions of the U.S Customs rules.¹⁷⁹ According to this rule, the importing products must be marked with the “country of origin” information. If the parallel importer fails to fulfill this requirement to his gray market products when putting them into the U.S market, he could possibly violate the Lanham Act § 43 (a).¹⁸⁰

B. First sale doctrine and exhaustion of rights

1. First sale doctrine

The exhaustion rule is also referred to as the "first-sale doctrine" because of its similarity with the first- sale doctrine of copyright law. The fundamental idea in this doctrine is that once a trademark obtained an economic return from first selling the product (or placing the product in the market) the other buyer or consumers of the trademarked products is entitle to use and dispose of it without the further restriction from that trademark holder.¹⁸¹ Without this doctrine, a trademark owner would exercise exclusive rights to control over the sale, transfer and use of a product associated with that

¹⁷⁹ 19 USCA 1304(a).

¹⁸⁰ Bonsei Enterprises Co v Porteous Fasterner Co 441F.Supp 162 (1977)

¹⁸¹ Abbott, Cottier, and Gurry, International Intellectual Property in an Integrated World Economy, 270.

trademark. Without this doctrine, trademark owner would also control economic life.¹⁸² Not only the economy of a nation but also the world trading system cannot develop when trademark owners can use their rights to create artificial barriers that prevent the free movement of products.

In the U.S., the trademark owner cannot prevent the domestic reselling of products after they legally enter the market for the first time. The same applies when the products were manufactured under license between the trademark owner and a licensee with the consent of the owner. The main issue of gray market products that has raised debate among scholars concerns the first sale doctrine and the doctrine of exhaustion of rights in the international scenario as to trademarked products. Under the first sale doctrine once a trademark owner makes a sale, the owner has exhausted their trademark rights with respect to the products sold to the market.

The trademark allows its owner the exclusive right to decide where and when to place the good on the market. However, trademark does not allow its owner to exercise the exclusive right by controlling all uses of the trademark. The U.S. trademark law follows the international exhaustion of trademark rights because once the products legally circulate in the domestic market the trademark rights of those products are internationally exhausted. By selling the trademarked product for the first time the economic rights of the trademark owner has already been rewarded. The trademark owner cannot oppose any further commercial exploitation on that product unless they have legitimate reasons.

2. Exhaustion of trademark rights

The United States applies international exhaustion with regard to trademarks as the "Lanham Act § 42 is not a basis to prevent parallel imports."¹⁸³ However, parallel imports do not apply to all

¹⁸² Ibid.

¹⁸³ McCarthy § 29:50.50.

products, parallel importation of trademarked products into the U.S. market is accepted only when these products satisfy certain requirements.

Under Section 526 of the Tariff Act, any unauthorized import of foreign manufactured trademarked products that bear a registered U.S. trademark owned by an American corporation is prohibited, unless the foreign manufacturer of the goods is an affiliate of the trademark owner. When trademarked products that are manufactured overseas by a trademark owner or its affiliate can be imported into the domestic market, then the foreign and US trademark owners have a legal or economic relationship. In other words, if they are owned by the same owner or business entity or if the foreign and the U.S. domestic trademark owners are in parent or subsidiary relationship or subject to common ownership or control, then the importation of gray market products is accepted. Although the U.S follows the international exhaustion of trademark rights, Section 526 of the Tariff Act sets up certain limits to parallel imports of trademarked products into the domestic market.

Nonetheless, the Lanham Act 42 can be used to block imports even when they were manufactured abroad by the trademark holder or an affiliate. The block could occur when domestic consumers consider the foreign manufactured products different from the domestic products. More precisely, the imported products are deemed not genuine when the courts conclude as physical or material difference from the domestic selling products. In fact, the same products can be produced in different countries and therefore can have a different quality due to the national or local health requirements, or simply because the ingredients are different in different countries.

The Lanham Act contains no direct reference or regulation on the principle of exhaustion of trademark rights, rather the rule of exhaustion of trademark rights is a legal concept deriving from the practice of case laws which applied by the courts. Mainly, it referred to trademark infringement activities when the unauthorized person resold or distributed genuine products bearing the trademark which belongs to others. As long as the defendant can prove that the products are genuine, the trademark rights as to these products are exhausted. The further distribution of the trademarked

products is not considered as trademark infringement. Therefore, the status of the gray imported products is important to parallel imports of trademarked products. The term gray market products requires: (1) the quality control of the U.S domestic trademark owner, an adequate control on the gray product before they were put into the U.S market, and (2) there is no material or physical difference between the genuine and gray market products which bearing the same trademark. Many courts have held that "[t]he plain language of the statute does not bar importation if the goods are genuine...."¹⁸⁴

In general, trademarked products may be imported into the U.S. domestic market when they are from an affiliate company of the U.S trademark owner and the imported product is not materially different from those circulated in domestic market. When a trademarked product is in materially or physically different, then the product cannot be recognized as genuine. As a result, the importation of that trademarked product will be considered as trademark infringement.

C. Issues related to parallel imports of trademarked goods

1. Gray market and unfair competition

The U.S. Federal Supreme Court found that gray market goods arose in three different contexts. In the first context, a foreign firm sold to an independent U.S. entity the rights to register and use the foreign firm's trademark in the U.S. to import and distribute goods in the U.S. The U.S. firm discovers that the foreign firm is importing the trademarked goods and distributing them in the United States itself or selling them to a third party abroad who imports them to the United States.¹⁸⁵ In this scenario, the U.S. trademark purchaser is known as the "gray-market victim."¹⁸⁶ Parallel importation occurs when the products which manufactured oversea and tagged the same trademark with products

¹⁸⁴ Ibid, § 29:50.50 (quoting *Olympus Corp. v. United States*, 792 F.2d 315 (2d Cir. 1986)).

¹⁸⁵ *K Mart Corp. v. Cartier, Inc.*, 486 U.S. 281, 286 (1988).

¹⁸⁶ Ibid.

in U.S, are imported to the U.S. As a result, consumers would be confused about the origin of the goods because normally, trademark is the indicating tool helps consumers to know where the goods are come from. In the second context, the U.S trademark for goods manufactured aboard is registered by a domestic firm that is either (a) subsidiary of the foreign manufacturer, (b) the parent of the foreign manufacturer or (c) the same as the foreign manufacturer. When the foreign and domestic entities were under common control, then parallel import is allowed.¹⁸⁷ In the third context, the allegedly infringing imports bore a registered U.S. trademark and were manufactured by an independent foreign entity under the authorization of the trademark. This situation typically arose when an American entity owned the same mark in the U.S. and in foreign countries and licensed use of the mark to a foreign manufacturer in the foreign countries. Usually, the U.S. trademark holder authorizes to the foreign manufacturer an exclusive right to use the trademark in a particular foreign market. Thus, conditioning the right of use on the foreign manufacturer's promise not to import the product into the United States. Again, if the foreign manufacturer or a third party imports the goods into the United States, the foreign-manufactured goods compete on the gray market with the U.S. trademark holder's domestically produced goods.¹⁸⁸

These different contexts play an essential role in identifying where the products were made and the relationship between a foreign manufacturer and the U.S. trademark owner. Depending on the nature of the relationship between the trademark owner and the foreign manufacturer in each case, the legal treatment to each of case is not the same. Therefore, the legality of the parallel imports of trademarked products in each case is also different.

¹⁸⁷ Ibid.

¹⁸⁸ Joseph Karl Grant, "The Graying of the American Manufacturing Economy: Gray Markets, Parallel Importation, and a Tort Law Approach," *Or. L. Rev.* 88 (2009): 108. See Hays, *Parallel Importation Under European Union Law*, 343.

2. Genuine products

This part of the paper will discuss issues related to the definition of a genuine good. The material difference will affect to the legality of the gray market goods when these products are parallel imported into the United State market. Therefore if genuine goods are materially different from domestic goods, legal treatments are also different between those goods. In fact, there are many cases, the differences between the gray market products and the authorized goods are such that the rule favoring parallel importation no longer applies, even though the imported products in question in some respects are genuine.¹⁸⁹

a. Define genuine goods

Genuine goods are produced or selected by the owner of a trademark, to which the owner affixes the trademark or in connection with which the owner uses the trademark (as in advertising). This phrase simply serves to distinguish the goods that are produced and marked with a trademark by or with the consent of the trademark owner from goods marked by someone not authorized to use the mark (i.e., someone other than the owner or licensee of the owner).¹⁹⁰ A definition of genuine trademarked product in the U.S legislation is found in the court's interpretation. For example, the court in *Yamaha Corp., of America v. U.S.* (D.C. Cir. 1992) defined genuine goods as follows:

Genuine goods are goods that are in fact manufactured by the same manufacturer that supplies the U.S. trademark holder. In other words, they are to be distinguished from goods

¹⁸⁹ Prah Dennis, "Exhausted and Gray, but Still Going Strong: A Comparative View of Parallel Imports from the Trademark Perspective - Contents", 8, http://www.ladas.com/IPProperty/GrayMarket/GrayMa_c.html.

¹⁹⁰ Lipner, *The Legal and Economic Aspects of Gray Market Goods*, 1-2.

that “copy or simulate” the genuine article; they are the genuine article, although they may not have been intended for distribution in the U.S. market.¹⁹¹

The goods intended for foreign sale that are physically different from those sold within the United States are not genuine goods from the perspective of American consumers.¹⁹² When there are physical or material differences, the mark is not “genuine” from the viewpoint of the American consumer. Even when there is a legal or economic relationship between the trademark holder and affiliate this in no way reduces the confusion that result to consumers.¹⁹³

For example, the holding of the court in the *Original Appalachian Artworks v. Granada Electronics* (1987) case¹⁹⁴ established the way for several other courts to adopt what has now become the approach followed by almost all U.S courts. That is: if there are material differences between the gray market imports and the authorized imports, then the gray market imports are not "genuine" goods and can create a likelihood of confusion.¹⁹⁵ When these products are different from those sold in the U.S under the same trademark, they could possibly create, mislead or confuse consumers about the nature or quality of the products that they are going to purchase. With the imagination in mind about the products' quality or features consumers will assume or expect that the product to be the same with the domestic products and be disappointed when they are not.¹⁹⁶

b. Material difference

¹⁹¹ Yamaha Corp. of America v. U.S 961 F.2d 245 (D.C. Cir. 1992).

¹⁹² Lever Bros. Co. v. United States 981 F.2d 1330, 25 U.S.P.Q.2d 1579 (D.C.Cir.1993).

¹⁹³ McCarthy, § 29:51.75.

¹⁹⁴ Original Appalachian Artworks v. Granada Electronics.

¹⁹⁵ McCarthy, §29:51.75.

¹⁹⁶ Ibid., §29:51.75.

Under the “common control” exception in the U.S law, if there is any economic or legal link between the domestic trademark owner and the foreign producer then the Lanham Act cannot be used to block the parallel imported products, which are manufactured abroad by the affiliate. However, when the American consumers consider the foreign products different from those of the domestic manufactured, the products are deemed not genuine. This is an appropriate reason for the U.S trademark owner to oppose the parallel import or to commence an infringement lawsuit in order to protect legitimate goodwill as well as prevent consumers from being confused. In fact, a product commonly has different materials or ingredients or quality in different countries.

The U.S law concerns the protection of the goodwill of the trademark owner. The trademark owner has to invest time, capital, and effort in order to develop their mark as well as to make their product known and remembered in the minds of public. If the gray goods bear the same trademark as the genuine trademark products and are materially different, then this may create confusion for the consumer;¹⁹⁷ therefore, the “material difference” rule is applied to parallel imports.

The main aim of the material differences test is to determine whether or not the gray goods are likely to damage the goodwill developed by the trademark owner for the products. The likelihood of confusion as to quality as well as the nature of the trademarked goods may occur to the consumers when the gray products are bear the same trademark but in fact are materially different. If there are material differences between the gray market imports and authorized imports, then the gray market import is considered not a genuine good. Non-genuine goods can cause confusion among the consumers.¹⁹⁸ Several courts have adopted the understanding the material difference test and this became accepted by most of the courts.¹⁹⁹ Consumer expectation as to the quality as well as the nature of the trademarked products cannot be met when purchasing gray market imports products that are

¹⁹⁷ Elizabeth Brasser, “Sharing the Burden of Proof in Parallel Importation Cases: A Proposal for a Synthesis of United States and European Union Trademark Law,” *J. High Tech. L.* 1 (2002): 121-122.

¹⁹⁸ McCarthy, §29:51.75.

¹⁹⁹ *Ibid.*

materially difference. Consumers want to buy a trademarked product that has the same quality and nature with product that they have history of using in the past. Consumers not only purchase a product because of its characters but also due the goodwill of the owner whom the trademark belongs. When goods imported as gray market products are not genuine, the goodwill of the trademark owner in that local is unprotected.

Furthermore, the Lanham Act does not block the re-importation and sale of genuine goods under their real trademarks. However, this principle does not apply in cases where the domestic and foreign products are materially different. The sale of gray market imported products into the United States under domestic trademarks will create a potential to mislead or confuse consumers about the nature or quality of the product they are buying; they will assume it to be the same as the normal domestic product and be disappointed.²⁰⁰ Therefore, the district court in the *R.J. Reynolds Tobacco Co. v. Cigarettes Cheaper!* (2006)²⁰¹ ruled that “if the products designed for domestic and foreign markets are materially different, then sale of the re-imported product under a mark that consumers associate with the domestic product could be confusing and hence unlawful.”²⁰²

Consumers do not receive what they expect or believe to have when the gray market goods are of “material difference” compared to the domestic products and both are sold in the U.S domestic market. Also, buyers do not obtain the authentic product that they have known from the domestic or from the advertisements of the authorized importers. In this situation, the use of similar trademarks of the parallel importer in such a way creates likelihood of confusion, mistake and deception, thereby triggering a violation of the Lanham Act.²⁰³ Therefore, from the concept of protecting consumers from

²⁰⁰ *R.J. Reynolds Tobacco Co. v. Cigarettes Cheaper!* 462 F.3d 690 C.A.7 (Ill.), 2006.

²⁰¹ *Ibid.*,

²⁰² *Ibid.*,

²⁰³ *McCarthy*, § 29:51.75 (4th ed. 2005).

confusion, the provision on prohibiting gray market goods, the U.S law is justified when the products are of different quality than the normal goods sold in the domestic market.²⁰⁴

Thus, the premise of the rule on “material difference” is that the consumer does not receive what they expect and does not obtain a “genuine” product when they buy such gray market products because the products that they have in mind certain advertisements by the authorized U.S trademark owner, or authorized distributors. A violation of the Lanham Act is triggered when the gray market goods are unauthorized imported by a third party using the trademark in such a way as to create a likelihood of confusion, mistake and deception.²⁰⁵

As a result, the test for material difference is the tool that trademark owner use against the parallel imports. The owner rests on two fundamental grounds (1) to protect their goodwill and (2) to protect consumers from confusion as to the nature and quality of the imported products. By protecting the consumers from confusion, the goodwill achieved by the U.S trademark holder’s business is prevented from erosion.

Once the products are deemed as not “genuine” then such parallel imports of those products thereby should be barred because the products would be seen as non-exhausted products. As regard to non-exhaustion products the further commercial exploitation without the consent of the trademark owner is considered as trademark infringement. A trademark owner in such a case can oppose the parallel importation of the trademarked products into the U.S. market.

In fact, some products are formulated for distinct markets. The products in different markets are different because of the local market demands, market standards, and tastes as well as tradition of that nation. For example, a kind of chocolate (A) formulated for the market of country X, and then a third party imported X into the United States market under the same brand with the chocolate A that

²⁰⁴ Merges and Lemley, Intellectual property in the new technological age, 818.

²⁰⁵ McCarthy § 29:51.75 (4th ed. 2005).

designed for the U.S. market. The imports by the parallel importer (defendant) constituted a trademark infringement, supposing that the test for material difference is met.²⁰⁶

In the *Societe Des Produits Nestle, S.A. v. Casa Helvetia* (1992)²⁰⁷ (the *Perugina* chocolate case), the First Circuit granted an injunction to the owner of the United States trademark for Italian-made Perugina chocolates against the parallel importation of Venezuelan-made Perugina chocolates.²⁰⁸ The court pointed out the differences in quality control, composition, configuration, and price between the authorized Italian imported "Perugina" chocolates and grey the market "Perugina" chocolates from Venezuela without the authorization of the U.S. distributor. The court then held that the differences were likely the result in consumer confusion, and that the trademark owner was entitled to injunctive relief.²⁰⁹

The U.S. courts have found situations in which the goods considered as materially different from which the trademark owners used in order to prevent importing gray market goods. The trademark owners have argued that gray market goods are materially different from authorized U.S. goods because they have material or physical differences in five areas namely (1) Quality control; (2) Composition; (3) Configuration; (4) Packaging; and (5) Price.²¹⁰ The U.S. courts sometimes accept these arguments. Therefore, these five areas are considered as fundamental standards because no mechanical way exists to determine the point at which a difference becomes material for this reason, and the courts determine this on a case-by-case basis.

c. Burden of proof

²⁰⁶ Ibid., § 29:46.

²⁰⁷ *Societe Des Produits Nestle, S.A. v. Casa Helvetia, Inc.*, (1st Cir.1992).

²⁰⁸ Ibid.

²⁰⁹ Ibid.

²¹⁰ McCarthy, § 29:51.75.

Under the Lanham Act, the burden of proof is on the plaintiff to prove that the goods are not “genuine” and thus likely to cause consumer confusion.²¹¹ A U.S trademark owner can stop the importation of gray market goods that are materially or physically different from those marketed America with the mark of owner’s consent. In order to prevent the parallel importation of trademarked goods into the U.S domestic market, one of the popular methods that companies usually use to diversify the products intended for the domestic market and for foreign markets. By diversification, the products that are planned for the non-U.S market have less chance to be re-imported to the domestic market. Of course, this method costs a lot to the manufacturers therefore not so many companies are willing to manufacture the differentiate products for different markets, only brand companies could afford the expense.

3. Repackaging and relabeling

The repackaging and relabeling of gray market goods must follow the trademark provisions in order to be accepted into the domestic U.S market. If the repackaging or relabeling is not strictly conducted, then the difference material could be concluded. As mentioned above, products bearing different materials from the ones sold in the U.S market are not considered as genuine products. In such a situation, trademark owners could oppose the parallel imports of gray market goods into the U.S domestic market.

The violation in repackaging and relabeling are varies in form, which could be due to the lack of information of ingredients of the products, or the labels show up in foreign-language when they have to show up in the English-language, or the imported products not bearing the proper warning

²¹¹ The Lanham Act of 1946, 15 U.S.C. § 1114(a) (1994) “use in commerce any reproduction, counterfeit, copy, or colorable imitation of a registered mark in connection with the sale, offering for sale, distribution, or advertising of any goods or services on or in connection with which such use is likely to cause confusion, or to cause mistake, or to deceive”.

labels. For example, in the *Kubota* tractors case (1999)²¹² the imported tractors had Japanese-language warning labels or no labels at the time of importation was considered as materially different from the authorized U.S. tractors bearing English-language warning labels.²¹³ Similarly, an infringement of trademark right occurred when Mexican Pepsi-Cola company used bottles written in Spanish and did not contain a list of the ingredients.²¹⁴ Nonetheless, concerning the issues of repackaging and relabeling of gray market goods according to the U.S. regulations, the Lever-rule protection²¹⁵ is worth mentioning because it has been marked by a significant change of the U.S. Custom provisions.

a. The *Lever Brothers* case (1989)²¹⁶

An American company known as the Lever Brothers Company (Lever US), and its British affiliate the Lever Brothers Limited (Lever U.K) both manufactured deodorant soap under the "Shield" trademark and hand dishwashing liquid under the "Sunlight" trademark. The trademarks were

²¹² *Gamut Trading v. U.S. International Trading Commission* 200 F.3d 775 (Fed. Cir. 1999).

²¹³ Lynda J. Zadra-Symes & Joseph J. Basista, "Using U.S. Intellectual Property Rights to Prevent Parallel Imports," 20 *European Intell. Prop. Rev.* 219, 225 (1998).

²¹⁴ *PepsiCo, Inc. v. Nostalgia Products Corp.*, 18 U.S.P.Q.2d 1404 (N.D. Ill. 1990).

²¹⁵ Patricia B. Cunningham and David E. Weslow, "Addressing Parallel Imports of Goods under U.S. Law", Reprinted with permission from: INTA Bulletin, Vol. 62, No. 12 – July 1, 2007 "...[S]o called 'Lever Rule' parallel import protection stems from a 1993 decision from the U.S. Court of Appeals for the District of Columbia, which found that parallel import products that are materially different from products authorized for sale in the United States do violate the U.S. trademark owner's rights even if the products originated from an affiliate of the U.S. trademark owner. *Lever Bros. Co. v. United States*, 981 F.2d 1330" (D.C. Cir. 1993)."

²¹⁶ *Lever Brothers Company v. United States*, 981 F. 2d 1330-1331.

registered in each country. The products evidently were formulated differently to suit local tastes and circumstances; for example, only the U.S “Shield” deodorant used materials certified by the Food and Drug Administration (FDA). As to hand dishwashing liquid, the British "Sunlight" dishwashing soap produced less suds. The American “Sunlight” was formulated to work best in the "soft water" available in many American cities, whereas the British version is designed for "hard water" common in Britain.²¹⁷

Furthermore, the packaging of the products manufactured in the U.S. and U.K. was also different. The British "Shield" logo was written in script form, packaged in foil wrapping and contained a wave motif, whereas the American "Shield" logo was written in block form, did not come in foil wrapping and contained a grid pattern. The place indicating where they were manufactured was print on the packages. In addition, the British "Sunlight" came in a cylindrical bottle labeled "Sunlight Washing Up Liquid." The American "Sunlight" came in a yellow, hour-glass-shaped bottle labeled "Sunlight Dishwashing Liquid."²¹⁸

A third party directly or indirectly acquired the British “Shield” and “Sunlight” products and imported them to America over the objection of Lever United States.²¹⁹ The American branch asserted that the unauthorized importation of these foreign products created substantial consumer confusion and deception in the United States about the nature and origin of this merchandise, and that it had received numerous consumer complaints from American consumers who unknowingly bought the British products and were disappointed.²²⁰ As a third party imported the British “Shield” and “Sunlight” without the authorization of either branch, the Lever U.S requested the Customs Service to halt the importation by of the product the third party.

²¹⁷ Ibid.,1332.

²¹⁸ Ibid.,1333.

²¹⁹ Dinwoodie, International Intellectual Property Law and Policy, 1086.

²²⁰ Lever Brothers Company v. United States, 981 F. 2d 1330, 1334.

Lever US argued that the importation of the British products was in violation of the Lanham Act § 42, and claimed that Customs was bound to seize such products. In its reasoning, Lever US contended that although the affiliated domestic and foreign company manufactured products bearing the same trademark, as a matter of fact these products were different in physical content. In other words, the overseas made products violated the Lanham Act § 42 when by “copy or stimulate” the domestic trademarked products. Consequently, the importation of the British products by a third party to the American market infringed upon Lever US. Thus, the parallel imports should be prohibited, regardless of the fact of affiliation.²²¹

However, the U.S. Customs Service reasoned that because the trademarks were used abroad by an affiliate of Lever U.S. the agency would not halt the importation.²²² The U.S Customs Service grounded a regulation what is so called as a general matter for seizure of foreign-made article bearing a trademark identical with the trademark that owned by a U.S corporation.²²³ According to the Code of Federal Regulation 19 §133.21(b) (1988), there are a number of exceptions:

(c) Restrictions not applicable. The restrictions set forth in paragraphs (a) and (b) of this section do not apply to imported articles when:

- (1) Both the foreign and the U.S. trademark or trade name are owned by the same person or business entity;
- (2) The foreign and domestic trademark or trade name owners are parent and subsidiary companies or are otherwise subject to common ownership or control; and
- (3) The articles of foreign manufacture bear a recorded trademark or trade name applied under

²²¹ Dinwoodie, *International Intellectual Property Law and Policy*, 1087.

²²² *Ibid.*

²²³ *Ibid.*

authorization of the U.S. owner.²²⁴

This regulation also was called the “affiliate exception.” From the U.S. Customs Service perspective, the importation of the Lever U.K products of the third parties to the U.S. was not considered as an infringement. The imported goods were genuine, not counterfeit products and thus neither copied nor simulated Lever US trademarked products.²²⁵ The gray market products bearing the trademark that was valid in the America and in fact the Lever U.K was affiliated with the Lever United States. As a result, based on the existence of the affiliation between producers, the U.S. Customs Service permitted the parallel imports of the third parties to the U.S.

b. Lever-rule protection

In 1999 the U.S. Customs Service changed its regulations to reflect its interpretation in the *Lever* case. As mentioned above, the Lanham Act was only used to protect consumers against deception or confusion concerning a product’s origin or sponsorship by restricting the importation of the trademarked products that manufactured outside of the U.S trademark owner’s control. Therefore, the Lanham Act §42 was not applied to solve cases of parallel imports when a product bearing identical trademark and produced oversea by a U.S trademark owner, parent or subsidiary of the U.S owner, or between the U.S mark owner and the oversea party there is a legal or economic relationship. According to this new change by the U.S Customs Service, gray market goods that physically and

²²⁴ *Lever Brothers Co., Appellant, v. United States of America, Et Al.*, 877 F.2d 101 (D.C. Cir. 1989). Federal Circuits (June 1989) Id. v Lex: VLEX-37263367 <http://vlex.com/vid/37263367>

²²⁵ Dinwoodie, *International Intellectual Property Law and Policy*, 1088.

materially are different can be imported into the U.S. when they are properly labeled. This was known as the “affiliate exception” which used to bar gray goods importation.²²⁶

The Lever-rule reflects a different view of the concerning parties in permitting parallel imports of gray market goods. First, for U.S. trademark owners, in order to secure Lever-rule protection, they can submit their oppose requirements to Customs by reasoning that the gray market products are physically and materially different from the products which were designed and produced for the domestic market. When a trademark owner has applied for and received Lever-rule protection, the gray market goods will be detained. The burden of proof is on the shoulder of the parallel importer whether the parallel importations of gray market goods are: (a) identical with those sold in the domestic market; or (b) the gray market products are properly labeled. In such a situation, the parallel importer has to prove either the gray market goods are not physically or materially different with the domestic products or the gray market labels are inconsistent with the Lever-rule provision. Thus, when gray market goods are seized by the U.S. Customs under a *Lever*-rule exclusion order, the imports can be released and entered to the U.S. market by the use of a label in compliance with the regulation.

Second, from the view point of U.S. Customs, the tool to give consumers the notice that the gray market products are not authorized by the U.S. trademark owner when bearing the announcement states that “This product is not a product authorized by the United States trademark owner for importation and is physically and materially different from the authorized product.”²²⁷ The information should appear on the label of the imported product or on the package or container of the products so that consumers therefore cannot be misled or confused about the origin or the sponsorship of the products. Furthermore, related information designed to dispel consumer confusion (if any) may be added onto the label. Under the Lever-rule regulation, gray market products may enter the U.S. only when they are labeled properly as required. When the requirements of the labeling are met there

²²⁶ McCarthy, § 29:50.

²²⁷ 19 CFR §133.23 (b) (1987).

is no consumer confusion and there is no potential damage it might cause to the goodwill of the U.S. trademark owner. Thus, the parallel imports of gray market goods are permitted.

Third, from the viewpoint of parallel importers, the label requirement in Lever-rule is opening a new door of policy for parallel importers bring in physically and materially different gray goods in the U.S domestic market. Prior to the *Lever* case, the parallel importer had to prove that the gray market products are identical with the products that are manufactured by the U.S trademark owner for selling in America. Under the new regulations, the chances for parallel importers are widely open and somehow simpler to perform when following the requirements on labeling.

Fourth, when the Lever-rule is accepted, the potential of misleading consumers could be reduced when they having full awareness for what they are going buy with the information on the label of the products especially when the information that the packing bearing is conspicuous and legible label designed to remain on the product until the first point of sale to a retail consumer in the United States.²²⁸ Thus, the consumers feel more comfortable to choose between the foreign made products and products that made by the U.S owners, and consumers have good opportunities to purchase identical products in lower price than that of those made domestically by the U.S. owners.

Lever-rule regulations can be seen as bringing about a turning point favorable to the parallel importers as well as gray market products in the U.S. market. Lever-rule regulations have changed the situation of parallel imports and also have marked a change in the view of the U.S. Customs Service. Thus, parallel imports with respect to gray market goods into the U.S are not as strict at present. Nevertheless, *Lever-rule* also receives criticism from the owners. The *Lever-rule*, from the trademark owners' point of view, will not eliminate consumer confusion and the labeling provision violates the Lanham Act.²²⁹ Furthermore, in order to apply the Lever-rule protection trademark owners must apply

²²⁸ Ibid.

²²⁹ Geoffrey M Goldale, "New Customs Gray Market Regulations: Boon or Bust for U.S. Trademark Owners, The," *AIPLA Quarterly Journal* 28 (2000): 336.

an application to Customs whereby describing any differences that the imported products may have materially or physically comparing with authorized products. In case the parallel imported goods do not bear proper information on a label and parallel importers cannot prove that the imported products have the same material with the genuine ones, then Lever-rule cannot be applied to protect the legality of the trademarked products. Nevertheless, for some special products, trademark owners may not be so keen in applying this rule because of the potential risks they may have in case they would be forced to disclosure confidential formulas of their products.²³⁰

In addition, the Lever-rule also received many criticizes from the INTA, who argued that this rule should be eliminated in order to reduce the risks caused by materially different gray imports. The INTA does not believe the label per se could prevent consumers from being misled.²³¹ In a letter sent to the commissioner of the U.S. Customs and Border Protection, the president of the INTA pointed out the disadvantages of the Lever-rule and its impacts to trademark owners. From this, the INTA has proposed changes to the Lever-rule by eliminating of the label provision. The INTA also encourages the U.S. Customs to focus more on enforcement to increase effectiveness of the detention of physically and materially different gray market products.²³² In relation to the parallel imports, the INTA advocates for national (regional) exhaustion of trademark rights. Furthermore, the INTA only supports the international exhaustion principle only when there are clear proof that trademark owner expressly consent to such importation.²³³ It is understandable why the INTA strongly opposes the Lever-rule because it was founded “to protect trademark owners.”²³⁴ Thus, the Level-rule, up to now,

²³⁰ Dennis, “Exhausted and Gray, but Still Going Strong: A Comparative View of Parallel Imports from the Trademark Perspective - Contents,” 26.

²³¹ www.inta.org/Advocacy/Documents/October172006.pdf.

²³² www.inta.org/Advocacy/Documents/October172006.pdf.

²³³ <http://www.inta.org/Advocacy/Pages/ParallelImportsGrayMarket.aspx>.

²³⁴ <http://www.inta.org/About/Pages/Overview.aspx>.

is still under a debate with regards to parallel importation of trademarked products from overseas market into the U.S. domestic market.

4. Contractual restriction

As to gray market goods, the language of the contract could affect their genuine status or in other words, the distribution of the goods must follow when there is contractual restriction. In such a situation, the burden of proof is on the side of the plaintiff by proving that the products in question were designed or intended for sale in a non-U.S market or for a different class and that the resale of those products on the domestic market causes confusion among customers. Consequently, if the products were made with the trademark holder's "intent to restrict resale is clear," then the importation by the parallel importer may be held liable for infringement regardless of his or her awareness of the existence of the restriction.²³⁵ With the proof of the existence of the contractual restriction as well as the material differences, the trademark owner can stop parallel imports on the grounds that such imported products are not genuine.

Trademark owners use license restriction to limit the sale or distribution of products bearing their mark when these products were manufactured abroad. Accordingly, the license restriction defines the territory in which the trademarked products could be manufactured, sold or distributed. The importation or sale of the products manufactured abroad under a license restrictive of the U.S trademark owner into domestic market infringes on the owner's trademark who is granted a permanent injunction against the importer and distributor of the products.

In the *Original Appalachian Artworks v. Granada Electronics (1987)* case,²³⁶ the district court found that the U.S trademark holder had contractually restricted the sale of its products in the

²³⁵ Brassler, "Sharing the Burden of Proof in Parallel Importation Cases," 122-125.

²³⁶ *Rigina Appalachian Artworks Inc v. Granada Electronic Inc*, 816 F.2D68.

territory of Spain. For the existence of contractual restriction, the importation and selling of dolls in the U.S domestic market was a trademark infringement because the dolls manufactured in Spain bearing the Spanish-language birth certification (as part of fantasy) was different language from those distributed and sold in the U.S domestic market with an English language birth certification. Consequently, the imported dolls were materially different and were not genuine dolls. More importantly, the Spanish dolls were not intended to be sold in the United States market; therefore the unauthorized distribution of the imported dolls was not accepted.

Furthermore, § 32 (1)(a) of the Lanham Act prohibits the unauthorized sale of goods bearing a registered trademark where there is a likelihood of confusion, mistake, or deception of purchasers thus confusing the consumers. In this doll case, the sale in the U.S. domestic market of the Spanish-language dolls with the prominent English-language trademark caused the consumers to confuse or mistake the Spanish dolls for the American dolls that they expected to be for sale.²³⁷ The material difference was the main reason that creates the confusion over the source of origin of the products and results in a loss of the trademark owner's goodwill. Therefore, even if the Spanish-made dolls bearing the valid trademark and manufactured under the license with the U.S trademark owner they were still considered as not genuine and from the contractual restriction as they were not authorized for sale in the United States.

5. Quality control

Quality control is one of the elements in which the court determines whether gray market goods are manufactured of the identical or different material with the product intended for selling in

²³⁷ United States Court of Appeals, Second Circuit. 816 F.2d 68, 8 ITRD 2361, 1987-1 Trade Cases 67,523, 2 U.S.P.Q.2d 1343 (to be corrected). 6.

the U.S domestic market. Under the Lanham Act a trademark holder has “the right to control the quality of the goods manufactured and sold under the ... trademark.”²³⁸ The trademark owner can therefore claim that the quality of gray products bearing the same trademark is different from that of the genuine goods.

In the *El Greco* (1986) case²³⁹ the U.S. owner of the *Candie’s* trademark shoes manufactured large amounts of the products in Brazil. Accordingly, the shoes were made under the trademark owner specifications of quality standards. There were two lots of shoes that did not obtain the quality certification from the agent. The shoes were sold to the defendant thereafter in turn were imported and sold in the U.S. market.

When the *El Greco* case was brought to the first court, the district court held that the goods the defendant sold to consumers in the U.S market were genuine and therefore the sell did not infringe on El Greco’s trademark. The reasoning of the district court was that the product had been produced under the plaintiff’s specifications and there was no likelihood of confusion among potential buyers. Nevertheless, the second circuit court on appeal did not agree this opinion by the district court. The second circuit court emphasized that the trademark owner was entitled to maintain the control of the quality as to the products bearing that trademark²⁴⁰ because the owner has the right to control the quality of the goods manufactured and sold under the holder’s trademarks. Even the two lots of shoes were manufactured under the same procedure of the other lots of shoes so they could have the same quality with other lots of shoes. However, in fact the shoes in these two lots did not obtain the quality certification that was indispensable part of the procedure from the agent. Therefore, the shoes that

²³⁸ The Lanham Act of 1946, 15 U.S.C. §1051 (1994).

²³⁹ *El Greco Leather Products Company Inc v. Shoe World Inc* - 806 F. 2d 392.

²⁴⁰ Goldale, “New Customs Gray Market Regulations.”

were imported and sold by the defendant were not genuine and as a result of this the selling of the trademarked shoes infringed on the plaintiff's trademark.²⁴¹

In the *El Greco* case even when there was no difference in the products which were produced with the quality control certification and those are not, still there was possibility of confusing happen to consumers or potential consumers. In fact, consumers relied on the U.S trademark to buy the products because they want to receive what they had intended to buy (i.e. the same or unity quality products). The court focused on the trademark's quality assurance function of the products in order to solve the problem. Also, the debate over the genuineness of the imported products was also based on the trademark's quality assurance function element than element of source function of the trademarked products. The imported shoes were manufactured with the same process and the facts indicated that the shoes were not inferior imitations produced by defendant or an entity independent of the trademark owner, the defendant did not attempt to deceive purchasers.²⁴² Therefore, the quality assurance function of trademark should be considered over the source function when there was no confusion to the consumers since the sales of the defendant caused no damage or bad affected to the trademark's quality guarantee function.

However, the court confirmed the ability of the U.S domestic trademark owner to control the importation of products bearing its marks regardless of whether or not there was consumer confusion. The source function of the trademark in this case was attached to special consideration when the court interpreted that consumers relied on the trademark to purchase the products rather than pay attention as to where the products were manufactured. From this point of view, once again the goodwill of the trademark was emphasized which is especially important when the mark was not famous or well-known.

²⁴¹ Hiebert, *Parallel Importation in U.S. Trademark Law*, 107.

²⁴² *Ibid.*, 108.

Quality control in trademark licensing also is a point that should be noted when discussing about quality control issue. The licensor's right to control quality measures, however, may be abandoned when the licensor has not previously enforced such quality control procedures to the licensee.²⁴³ When the trademark is licensed the goodwill associated with the mark is also transferred; therefore, the trademark owner (licensor) must maintain the quality control over the mark in order to ensure that the products manufactured by the licensee contain the same quality with the ones produced by the holder. Quality control not only plays a role as a tool to protect the goodwill of the trademark owner but also protects the quality of the products under which such goods bearing the same trademark have the same quality no matter who really manufactured (licensor or licensee). Consumer expectation when buying trademarked products has also been met when quality control is strictly done between the licensor and licensee.

The trademark licensing agreement without the provisions on quality control is called a "naked license." If there is no quality control clause in a licensing agreement, it could be assumed that the trademark holder has abandoned their trademark rights. A trademark licensing agreement should provide some means of regulating the nature and quality of the goods associated with the trademark that manufactured by the licensee.²⁴⁴ By failing to adequately enforce quality control measures the trademark holder has consented or waived his right to protest further resale by implication.²⁴⁵ An owner may have direct or indirect control to the products that manufactured under a licensing agreement.²⁴⁶

²⁴³ Brassler, "Sharing the Burden of Proof in Parallel Importation Cases," 121-125.

²⁴⁴ Richard Stim, *Intellectual Property: Patents, Trademarks, and Copyrights* (West/Thomson Learning, 2001), 379.

²⁴⁵ Brassler, "Sharing the Burden of Proof in Parallel Importation Cases," 120-125.

²⁴⁶ Richard Raysman et al., *Intellectual Property Licensing: Forms and Analysis* (Law Journal Press, 1999), 4-26; 4-27.

a. Direct control

Direct control is the most common form of quality control carried out by the licensor. In order to exercise direct control, the licensor may, among other things: (a) supply products or ingredients to the licensee or require the licensee to obtain the products or ingredients from approved source. Also, the direct method of services require that the goods and or services meet licensor or industry approved standards or specifications; (b) periodically inspect the facilities, products, and packaging supplied by the trademark licensee and the equipment and services provided by the service mark licensee; and (c) inspect advertising and promotional material prepared by the licensee.²⁴⁷

b. Indirect control

Indirect control can be performed by a delegation from a third party or reliance on licensee to control the quality. The delegation from third party occurs in some situations, when the licensor may delegate quality control task to a third party that monitors the activities of the licensee to ensure that the licensee is compliance with the required standards. Meanwhile, the reliance on licensee to control the quality occurs in some circumstances, when the trademark owner cannot directly perform his/her quality control task, other than delegating a third party, the licensor could reliance on licensee to control the quality of the products. In this way, the licensor may appoint licensee as its agent for purpose of controlling the quality. However, when using this method of quality control, there are some points that the licensor must take into consideration such as the licensor has known the quality of the products that manufactured by the licensee and provision on maintaining the identical quality of products must be stipulated in the licensing agreement.²⁴⁸ Reliance on licensee to control the quality occurs when the relationship between licensor and licensee has lasted for long time. Also, they have a

²⁴⁷ Ibid., 4-26.

²⁴⁸ Ibid., 4-27.

history of doing business together before in which the connection between them could be partners as long-standing business or corporate affiliation relationship.²⁴⁹

D. Summary

U.S law regarding international exhaustion of trademark right is based on §526 of the Tariff Act, especially grounded on the interpretation of the Supreme Court in the *Kmart* (1998) case. Accordingly, when the trademarked products were put on the foreign markets by the entities under the common control with the U.S domestic trademark holder then the parallel importation of those products will not be blocked. Also, the same treatment was applied to the importation of trademarked products that previously launched to the oversea markets by the authorized licensees of U.S domestic trademark owner.²⁵⁰ The court also affirmed the common control exception with regards to parallel importation products, which means that when the products were manufactured by common controlled enterprises then the U.S trademark owner could not prevent the parallel imports of those products.

Section 42 of the Lanham Act prohibits the importation of products that “copy or simulate” a registered U.S. trademark. Accordingly, if the imported products are physically or materially different foreign goods having a trademark identical to a registered U.S. trademark, regardless of the affiliation relationship between the U.S. domestic trademark owner and foreign manufacturer, then the Lanham Act bars importation of such products.²⁵¹ In order to launch the foreign-made products on the U.S domestic market when these imported products bearing the same trademark with a valid mark in the U.S., a material difference test must be followed to determine the substantially same quality between

²⁴⁹ Ibid.

²⁵⁰ Abbott, Cottier, and Gurry, *International Intellectual Property in an Integrated World Economy*, 342.

²⁵¹ Ibid., 356.

them. If a difference does exist, then the Customs will stop the parallel importation of trademarked products.

As for the U.S position on parallel imports of trademarked products, it is not be a problem to prevent parallel imports under the regulation of the U.S Custom Services. The U.S provisions on parallel imports of trademarked goods tend to protect the American domestic trademark holders from such imports of gray market products; therefore, the issue of physical and material difference seems too wide in scope. In the U.S there appears to be no problem when the trademarked goods have been properly labeled. When the Lever-rule is applied, the existence of the material difference does not meet the trademark owner's expectation of preventing parallel importation. Moreover, the U.S. trademark law takes the principle of territory as its dominant rule, and any parallel imports of gray market products, which causes confusion as to the source of origin to consumer as well as has a bad effect upon the goodwill of the trademark owner, will not be allowed.

II. Parallel imports and trademark rights in the European Union

World trade recently has developed rapidly which has a strong impact on countries; one of the impacts is parallel importation of trademarked products. Parallel importation has put many developed countries into a difficult position. On the one hand, large industrial producers usually place their products in developed and developing markets at different prices in order to satisfy consumer demands with different incomes. By differentiating the prices, producers want to sell as much as possible. On the other hand, different prices for products bearing the same trademark may cause a suspicion for consumers in higher priced markets, especially when they can buy the cheaper priced product. Besides

the possibility of reducing of the goodwill with respect to that trademark, the trademark owner also has to face with the high potential of parallel imports.²⁵²

Under the impacts of parallel imports, the EU is also affected as much as other developed countries. The issue of parallel imports in the European Union is of significant importance to trade mark proprietors and particularly for those in the luxury goods and the pharmaceutical sector. There are many case laws on the issue and recent developments have shown that despite the provisions of the Roma Treaty (EC Treaty), Trade Mark Directive (TMD), the guidance of the European Court of Justice (ECJ) or national courts there are still many arguments made by the parallel importers.

Two scenarios exist regarding parallel imports in Europe: first, the parallel imports of trademarked products between countries within the Europe Economic Area (EEA); and second, the parallel imports between countries with other countries outside of the EEA. Thus far, many courts and scholars have explained and interpreted this phenomenon as well as used various theories such as the theory of free movement of goods, the theory of implied consent, or the property right theory. In fact, courts and scholars have employed many theories in order to solve a case.

However, adopting any of these theories will affect the scope of the trademark exhaustion in the EU whereby the interests of parties concerned as well as the consumers' interests will also be changed. As a result, parallel imports are also affected. For example, if courts adopt the implied consent theory then this will allow the parallel importers to prevent the effects of trademark exhaustion by contractual means and to seek an enforcement of rights under the trademark law. Consequently, the legitimate interests as well as the goodwill of the trademark holders is affected when parallel importers reasoned that they have the implied consent for parallel imports from the trademark owner. Also, the interests of the purchasers may suffer when the risk of being confused or misled about the origin of products increases.

²⁵² William Cornish, David Llewelyn, and Tanya Aplin, *Intellectual Property: Patents, Copyrights, Trademarks and Allied Rights* (Sweet & Maxwell, Limited, 2010), 839.

This section thus, will briefly discuss the provisions on parallel imports and trademark rights in the Europe Union in order to give a clearer look on the legislation and on the principle of exhaustion to trademarks used in the union. This chapter will explore the difference in treatment with respect to trademarked products that are first sold in the EEA territory from those goods first sold in the non-EEA market.

A. Introduction to European Union statutory provisions on parallel imports

1. Overview on trademark law in European Union

First, if the trademark owners desire to protect their trademarks they have to register their trademarks as European Union applies the “first to file” principle.²⁵³ In the past, trademark owners in Europe Union could choose to register their national marks for each of the member-states. However with the EC-wide frame for the registration, subject to harmonized EC rule, a trademark owner may gain a Community Trade Mark Registration (CMTR). As a matter of fact, the registration of trademark rights in the EU can be easily be conducted by the Community Trade Mark Registration. The trademark proprietors have their trademarks enforced across the entire internal market by one proceeding that could be done through the Office of Harmonization for the Internal Market (OHIM)²⁵⁴ and from then on have their trademark protected for all the member states of the European Union.

Second, the trademark owners have exclusive rights to use their marks for commercial purposes and any use of the mark without owner’s permission is considered as an infringement. With exclusive rights the trademark owner could partition national markets and thereby create a dominant

²⁵³ “First to file” principle: Rule establishing that rights in a mark belong to the party that first files an application to register the mark in a trademark office, accessed November 23, 2010, http://www.inta.org/index.php?option=com_glossary&func=display&letter=F&Itemid=127&catid=45&page=1&getcontent=1.

²⁵⁴ Cornish, Intellectual Property, 77.

position in the markets. In order to avoid market partition from occurring, the owners could exercise their rights by putting products labeled with the mark on the market for the first time. Thereafter, trademark owners cannot interfere into the further circulation of the products on the market since their trademark rights have already been exhausted.²⁵⁵ Among the trademark rights, the right to distribute and right to import are the most important rights of the owners in the context of parallel trade.²⁵⁶ With the exclusive right to distribution, the trademark owner could prevent the subsequent sale of the product conducted by other parties.

Similarly, the exclusive right to import could be applied to prevent any trade of the trademarked products no matter who manufactured or conducted the importation, as well as where the products previously were put into the market.²⁵⁷ In such a situation, the trademark owner could have the support from the Custom Office, normally with the provisional measure as seizure of the goods upon import. However, the provisional measure is only applied to the products that are distributed or imported by the unconnected third person also known as counterfeit products. In parallel trade the scenario is different as the goods bearing the trademark are not counterfeit and in fact are genuine products. Therefore, the products bearing the trademark are excluded from such kind of action performed by the Custom Office.²⁵⁸

The Trade Mark Directive of 1989 was the first main legal tool used when any trademark infringement case occurred in the European Union. Article 5 of Trade Mark Directive established the exclusive right conferred upon trademark owner by Member States of the European Union.²⁵⁹ Article 5 entitled the “Rights conferred by a trademark” was worded as follows:

²⁵⁵ Paul Torremans, Holyoak and Torremans Intellectual Property Law, 5th ed. (OUP Oxford, 2008), 437.

²⁵⁶ Stothers, Parallel trade in Europe, 40.

²⁵⁷ Ibid.

²⁵⁸ Ibid.

²⁵⁹ William J Littman, “Case of the Reappearing Spectacles--The Future Is Not So Bright for International Parallel Importers in the ECJ after Silhouette International Schmied GmbH & Co. KG v. Hartlauer

1. The registered trademark shall confer on the proprietor exclusive rights therein. The proprietor shall be entitled to prevent all third parties not having his consent from using in the course of trade: (a) any sign which is identical with the trade mark in relation to goods or services which are identical with those for which the trademark is registered;

3. The following, *inter alia*, may be prohibited [under paragraph 1]: ... (c) importing or exporting the goods under the sign.²⁶⁰

Accordingly, Article 5 gives the trademark proprietor exclusive rights to prevent third parties from (amongst other things) importing, placing goods on the market and selling goods under the trademark. However, the trademark proprietor loses these rights where the goods have been put on the market in the EEA by the proprietor or with his or her consent.²⁶¹ In other words, the trademark rights of a product are exhausted after it has been put on the market by or with the consent of the owner. The trademark owner, therefore, cannot prevent the further commercial exploitation of the product because his or her trademark rights are exhausted as to this product.

The position of parallel imports under European law is different from provisions under the United States and Japanese legal system. The difference depends upon whether the trademarked products have been put first inside the EEA market or previously placed outside and then re-entered into the EEA market. In other words, identifying the jurisdiction whereby the trademarked products were marketed first is the main concern under the EU Law.

Handelsgesellschaft MbH,” *Tulane Journal of International and Comparative Law* 7 (1999): 483. “passed on December 21, 1988, the Trade Mark Directive served to codify the Court’s case law regarding exhaustion of Community right.”

²⁶⁰ Trade Mark Directive, Art. 5.

²⁶¹ *Ibid.*, Art. 7.

2. Parallel imports of trademarked products in the EU

The European Union applies the principle of regional exhaustion in all fields of intellectual property for goods cross the border of Member States in the sense of encouraging the free movement of goods within the Community, but this principle excludes parallel imports of goods coming from outside EEA market.²⁶² The concept of the ECJ on free circulation of goods over intellectual property rights within the market of EEA has upheld this view under the Treaty of Rome.²⁶³ This principle legally creates a good opportunity for promoting unrestricted movement of goods cross borders between Member States and also creates arbitrage extends to products sold in different markets of different countries due to varying price controls, or other different policies such as trade policy, public-health policy (in case the products in question are pharmaceutical products).

Though parallel imports occur when there is a difference in price of the same products in the various markets inside the Community, national governments within the EU cannot use differential price mandates to justify restrictions on parallel imports because there are other elements in association with this issue. Therefore, a thoroughly analyze on parallel imports in the EU starts from the legal provisions on parallel imports in the EU, and introduced in the following part. A complete analysis of laws and practices in the US is necessary because the treatment of parallel imports in the EU is different from the U.S or Japan.

2.1. EC Treaty: Articles 28 and 30

A provision related to the principle of exhaustion of trademark rights was adopted in the scenario when the applicable trademark laws of the Member States contain disparities, which not only

²⁶² Mattias Ganslandt and Keith E. Maskus, “Chapter 8 Intellectual Property Rights, Parallel Imports and Strategic Behavior,” in *Frontiers of Economics and Globalization*, vol. 2 (Bingley: Emerald (MCB UP), 2008), 263-288, <http://www.emeraldinsight.com/books.htm?chapterid=1797193&show=abstract>.

²⁶³ Ganslandt and Maskus, “Intellectual Property Rights, Parallel Imports and Strategic Behavior.”

may impede the free movement of goods in the Member States' markets but also may distort competition within the Community market. Therefore, it is necessary for members in view of the establishment and functioning of the internal market, to approximate the laws of countries about the exhaustion of trademark rights.²⁶⁴ Moreover, the formation of the principle of exhaustion of rights originated from a wider principle of competition law and freedom of goods which are stated in the European Economic Community Treaty (EC Treaty)²⁶⁵.

Articles 28 and 30 of the EC Treaty prohibit the prevention of the free movement of goods in the European Economic Area.²⁶⁶ In other words, these two articles established a principle of Community wide exhaustion, according to that the sale anywhere in the regional markets with or by the consent of the trademark rights owner exhausts the right throughout the Community. If the trademark owner uses exclusive rights to prevent the importation of goods that were previously put outside of the EEA market, then the provisions of these articles cannot be employed because they are irrelevant. Since Articles 28 and 30 of the EC Treaty regulate the Community exhaustion, they in fact do not impose an international exhaustion.²⁶⁷

Article 28 of the EC Treaty prohibits quantitative restrictions on imports between Member States of the European Union. Therefore, there is a European Union regional exhaustion of trademark rights in their goods once their trademarked products are placed on the market for the first time anywhere within the union with the consent of the owner. This provision has extended the former

²⁶⁴ See European Council, Directive 89/104/EEC of December 21,1988 to approximate the laws of the Member States relating to trade marks, accessed January 5, 2010, <http://oami.europa.eu/en/mark/aspects/direc/direc.htm>.

²⁶⁵ EEC Treaty is one of the Treaties of Rome signed on 25 March 1957 and came in to force on 1 January 1958. This treaty was renamed Treaty establishing the European Community (the EC Treaty) in 1993 upon the entry into force of the Treaty of Maastricht (Treaty on European Union; TEU) in, and in 2009 renamed Treaty on the functioning of the European Union (TFEU).

²⁶⁶ Keeling, Free Movement and Competition Law, 129. “[W]e have also noted that the EEA Agreement widened that principle into one of EEA-wide exhaustion”.

²⁶⁷ Ibid.

system of national exhaustion of rights that each individual country applied for their intellectual property system.²⁶⁸

Article 30 of the EC Treaty provides an exception to regional exhaustion where the imposed restriction is in relation to the protection of industrial (intellectual) property. This article provides that the restriction is not a means of arbitrary discrimination or a disguised restriction on trade between Member States. Therefore, within the European Union right holders can rely on their rights to prevent the free further movement of these products within the EU provided that they have legitimate reasons.²⁶⁹ This concept was affirmed once again in the *Centrafarm v. Sterling & Winthrop* (1974)²⁷⁰ when the ECJ concluded:

Inasmuch as it provides an exception to one of the fundamental principles of the common market, article [30] in fact only admits of derogations from the free movement of goods where such derogations are justified for the purpose of safeguarding rights which constitute the specific subject-matter of this property.

In the relation to trade marks, the owner of that trade mark has the exclusive right to use that trade mark, for the purpose of putting products protected by the trade mark into circulation for the first time, and is therefore intended to protect him against competitors wishing to take advantage of the status and reputation of the trade mark by selling product illegally bearing that trade mark.²⁷¹

The fundamental purpose of the EC Treaty is to harmonize and balance the basic aim of the single markets thereby promoting the economies of the members and create an integrated market that

²⁶⁸ Anna Feros, "Free Movement of Pharmaceuticals within the EU - Should Rights be Exhausted Regionally?" E.I.P.R. 2010, 32(10), 487.

²⁶⁹ Ibid.,

²⁷⁰ *Centrafarm v. Sterling & Winthrop* Case 16/74 [1974] E.C.R 1183; [1974]

²⁷¹ Ibid., paras 7-8.

motivates the free movement of goods in the Community.²⁷²²⁷³ In other words, the EC Treaty sought to unite the national markets into a single market having the characteristics of a domestic market.²⁷⁴

2.2. Article 7 of the Trademark Directive

In order to approximate the laws of Member States relating to trademarks, the principle of Community-wide exhaustion requirement eventually was incorporated into Article 7 Trademark Directive. Prior to the enactment of the Trademark Directive, trademark owners sought protection for their legitimate rights through the provisions of the EC Treaty (particular Article 28 and 30). Although the concept of Community exhaustion was first established and developed under Article 28 and 30 of the EC Treaty, the Community legislation that earlier had harmonized mostly as to intellectual property rights now widely codifies the concept.²⁷⁵ Therefore, Article 7 of the Trademark Directive provides that a trademark owner may rely on his or her granted exclusive rights to prevent free movement of goods in the Community where there is a legitimate reason to do so such actions including change or damage to the goods which bear its mark. The damage that the trademark owner may consider is that whether or not the parallel importing activities impair the purpose or function of the trademark.²⁷⁶ In other words, the mark did not entitle its proprietor to prohibit or oppose the trademark's use in relation to goods which have been put on the market in the Community under that

²⁷² Keeling, *Free Movement and Competition Law*, 5. The treaty lays down four fundamental freedoms: free movement of goods (Arts 23-31), person (Arts 39-48) service (Arts 49-55) and capital (Arts 56-60).

²⁷³ *Ibid.*, 120.

²⁷⁴ *Ibid.*, 121.

²⁷⁵ Stothers, *Parallel Trade in Europe*, 43.

²⁷⁶ Anna Feros, "Free Movement of Pharmaceuticals," 487.

mark by its proprietor or with the owner consent.²⁷⁷

Article 7.1 of the Trademark Directive has been a controversial provision since its conception in the drafting stage. In fact, during the drafting process the text was substantially modified and changed several times.²⁷⁸ The final text of the provision codified the exhaustion doctrine as established by the ECJ and confirmed the principle of Community-wide exhaustion for all members of the EEA (by virtue of the EEA-wide exhaustion since the EEA Agreement entered into force in 1994).

Article 7.1 of the Trademark Directive can be seen as a tool to harmonize and balance the fundamental interest of protecting trademark rights with the free movement of the goods within the common market. Article 7.1 of the Trademark Directive states as follows:

The trademark shall not entitle the proprietor to prohibit its use in relation to goods which have been put on the market in the Community under that trademark by the proprietor or with his consent.²⁷⁹

The core target of this provision is to prevent the trademark holders from using their exclusive rights to partition the markets, as well as to encourage the free movement of goods.²⁸⁰ However, under some circumstances, trademark owners can prevent the parallel importation of trademarked products. Accordingly, the legitimate owner cannot be expected to tolerate “further commercialization” of the trademarked products when that further commercialization” affects the essential functions of the trademark by taking unfair advantage or causing illegitimate damage to the trademark’s goodwill.

²⁷⁷ Littman, “Case of the Reappearing Spectacles--The Future Is Not So Bright for International Parallel Importers in the ECJ after *Silhouette International Schmied GmbH & Co. KG v. Hartlauer Handelsgesellschaft MbH*,” 484.

²⁷⁸ Irene Calboli, “Trademark Exhaustion in the European Union: Community-Wide or International? The Saga Continues,” *SSRN eLibrary*, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=802226.

²⁷⁹ Trade Mark Directive, Art.7.

²⁸⁰ Keeling, *Free Movement and Competition Law*, 78.

The main aim of the principle of exhaustion of rights is to prevent the intellectual property owners from using their exclusive rights to partition the market or control the market. Nonetheless, after years of applying the principle of Community-wide exhaustion, member states are still unclear when the Trademark Directive only represents a minimum standard whereby leave room for Member States to apply the principle wider for instant, principle of international exhaustion of trademark rights. Article 7.1. of the Trademark Directive provides for exhaustion only where the goods have been put on the market in the Community and not for international exhaustion.²⁸¹ The Trademark Directive does not require Member States to provide for international exhaustion. At most, the directive leaves that open as an option for Member States. If the directive had sought to impose international exhaustion, then Article 7.1. would not have referred only to marketing in the Community.²⁸²

The *Silhouette International Schmied v. Hartauer Handelsgesellschaft* (1998)²⁸³ and the *Sebago Inc. et.al. v. GB-Unic SA* (1999) were considered as landmarks in which the ECJ upheld the concept of Community Exhaustion of rights. The ECJ ruled that the Trademark Directive precludes national rules that provide for international exhaustion of trademark rights. Nevertheless, after considering the strong pressures coming from some Member States in favor of international exhaustion, the ECJ suggested that a possible remedy could be “to extend the exhaustion provided for by Article 7 to products put on the market in non-member countries by entering into international agreements in that sphere, as was done in the context of the EEA Agreement.”²⁸⁴ Although archiving pressure and influence on many Member States, this concept of the ECJ also has not changed toward

²⁸¹ *Silhouette International Schmied GmbH & Co. KG v Hartlauer Handelsgesellschaft mbH*, 1998 E.T.M.R. para. 30.

²⁸² *Ibid.*, para. 31.

²⁸³ Case C-355/96, 1998 E.T.M.R. 539, <http://curia.eu.int/jurisp>.

²⁸⁴ *Silhouette*, 1998 E.T.M.R. para.30.

the issue of the international exhaustion of right.²⁸⁵ The similar provision on Community exhaustion has been provided in Article 13 of the CTMR²⁸⁶ as also trademark laws of its Member States.²⁸⁷

Because of the Community-wide exhaustion regime, the EU law on parallel imports consists of two scenarios: (a) the first sale occurs inside of the EEA and/or (b) the first sale occurs outside of EEA. The legal treatment to parallel imports in each scenario is also different. The trademark owners have their own rights to decide where to sell their products for the first time. The first selling is important because it helps the possibility of trademarked products being parallel imported as well as to maintain their positions on the market because the prices of the same products in different nations are not the same.²⁸⁸

For instance, company X has developed a pharmaceutical product in country A and is able to obtain patent protection under the patent law. However, in country B this product is unable to obtain patent protection under the patent law of B. There are many variables in this situation for company X to consider where to sell the pharmaceutical product. For example, the price of this medicine in country A is higher than that of in country B. Without patent protection, medicine would have had to sell at a lower price in country B. Parallel importers will take their chances by purchasing products from country A to sell in country B and benefit from the different prices between country A and

²⁸⁵ Irene Calboli, Trademark exhaustion in the European Union: Community-wide or international, the saga continues, *Marquette intellectual property law review*, Vol 6, 2002, p51 “...[i]n its November 2001 judgment in *Zino Davidoff*, the ECJ has continued to prevent any change towards international exhaustion.”

²⁸⁶ Council Regulation 40/94 of 20 December 1993 on the Community Trademark, Article 13 Exhaustion of the rights conferred by a Community trademark

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

²⁸⁷ See Section 12 of United Kingdom Trademark Law 1994, section 24 of German Trademark Act.

²⁸⁸ Keeling, *Free Movement and Competition Law*, 77-78.

country B. The medicines that were intended for the market of country A will find their way into the market of country B. Therefore, the position of company X in the pharmaceutical market in country A has been narrowed down. In addition to the economic loss that company X accrues from the parallel importation, the goodwill of the company is also affected by such trade. In such a situation, Company X has to reduce the price of the pharmaceutical product in the market of country A in order to stop the parallel importation. When the difference in prices of the two countries is small, the importers will engage in parallel importing because profits no longer exist.

In another scenario, if company X decided to sale the products in country B for a low price (because there is no patent protection) the situation shifts in another direction but the result is almost the same. The advantage of this business strategy is that the market share of this product on the market in country B is larger compared with products of other companies that obtained patent protection. This strategy is suitable in case the population of country B is large as more consumers know about the products of company X. However, a disadvantage in such policy occurs because company X is unable to obtain the patent protection in country B. Therefore the life circle of the products are not so long, and that products could be taken advantage by other companies. Taking into consideration all the variables that might affect the difference level in prices in different Member States it is necessary for trademark owners to make the proper business policies.

a. The first sale inside of the EEA

Article 7 of the Trademark Directive and Article 13 of Community Trademark Regulation show the concept of community-wide exhaustion which the ECJ has been following. With these provisions, there is no restriction on movement of goods within the EEA. However, the parallel imported goods that are mentioning must be genuine goods. When the trademarked products are marketed within the EEA, the owners use Article 7.1 of the Trademark Directive to construe whether or not the conditions are met. In other words, there are three points that the trademark proprietor has to

take into consideration. These points are (1) consent- the trademarked products are put in the market of the EEA with or by the consent of the trademark owners; (2) legitimate reasons; and (3) the possibility of goods changed or impaired (quality) after having been put on the market. These factors are provided in Article 7.2 of Trademark Directive as follows:

Paragraph 1 shall not apply where there exist legitimate reasons for the proprietor to oppose further commercialization of the goods, especially where the condition of the goods is changed or impaired after they have been put on the market.²⁸⁹

(1) Consent of the trademark proprietor

Trademark rights are exhausted once products are placed on the market inside the European Union with or by the consent of the trademark proprietors. Consent of trademark proprietors can be expressly shown. In certain circumstances consent could be implied²⁹⁰ but it cannot inconsistent with consent of the trademark owners.²⁹¹ Consent is the first element that the trademark owners or the courts construe when dealing with a parallel imports case. Therefore, when the sale of the products has been conducted without the consent of the owner, the trademark rights are not exhausted and the parallel importation in such a case constitutes trademark infringement.

The ECJ in its conclusions²⁹² emphasized that where a product is protected by trademark rights and is placed on the market with consent in a member state, then Article 30 of EC Treaty cannot

²⁸⁹ Trademark Directive, Art. 7.2.

²⁹⁰ Anna Feros, “Free Movement of Pharmaceuticals”, 486-497.

²⁹¹ Torremans, Holyoak and Torremans Intellectual Property Law, 437.

²⁹² For example, in case 78/70 Deutsche Grammophon v. Metro-Grossmarkte [1971] E.C.R. 487; [1971] C.M.L.R 631 at paragraph 11, ECJ stated that Article 30 only permits prohibitions or restriction on the free movement of goods in the extent that they are justified for the protection of the rights that form the specific of the industrial or commercial property.

be invoked. The right owner cannot use his exclusive rights to prevent further transactions in the products in the Community.²⁹³ This is also known as the doctrine of consent,²⁹⁴ which has a close relationship with the doctrine of exhaustion. The doctrine of consent is sometimes referred to as the doctrine of exhaustion because the owner of an intellectual property rights exhausted his or her rights when the products are put on the market with or by his consent.²⁹⁵ This principle has been incorporated into harmonizing Community legislation in the field of intellectual property rights. Consequently, there are provisions in the Trade Mark Directive and Community Trade Mark Regulation state that trademark rights are exhausted as products have been put into the market circulation by or with the consent of the proprietors.²⁹⁶

The matter of consent also raises a question as to whether or not the fact of consent has to be proved for the actual products in question or to the similar products bearing the same trademark. This issue of consent was raised in the *Sebago* (1999)²⁹⁷ case. Sebago is a company incorporated in the U.S and the proprietor of two Benelux trademarks with the name “Docksides” as well as three Benelux trademarks with the name “Sebago.” These trademarks are registered *inter alia* for shoes. Maison Dubois is the exclusive distributor of the Benelux of shoes bearing Sebago's trademarks.

From 29 May to 11 June 1996, GB-Unic advertised Docksides-Sebago shoes for sale in its Maxi-GB hypermarkets (Belgium). The products in question were 2,561 pairs of shoes manufactured in El Salvador and purchased from a company incorporated under Belgian law which specializes in parallel importation. The entire stock was sold during the summer of 1996. Sebago and Maison Dubois did not dispute that the shoes sold by GB-Unic were genuine goods. They both claimed, however, that since they had not authorized the sale of these shoes in the Community that GB-Unic had no right to sell them there. The trademark right to goods in question was not exhausted and

²⁹³ Guy Tritton, *Intellectual Property in Europe* (London: Sweet & Maxwell, 2002), 470.

²⁹⁴ *Ibid.*

²⁹⁵ *Ibid.*

²⁹⁶ *Ibid.*, 471.

²⁹⁷ *Sebago* case C-173/98 *Sebago Inc and Ancienne Maison Dubois et Fils SA and GB-Unic SA*.

consequently the owner could prevent parallel importation. Concerning this point of view, the ECJ said that:

...the rights conferred by the trade mark are exhausted only in respect of the individual items of the product which have been put on the market with the proprietor's consent in the territory there defined. The proprietor may continue to prohibit the use of the mark in pursuance of the right conferred on him by the Directive in regard to individual items of that product which have been put on the market in that territory without his consent.²⁹⁸

In concluding this case, the ECJ held that “for there to be consent within the meaning of Article 7.1. of that Directive, such consent must relate to each individual item of the product in respect of which exhaustion is pleaded.”²⁹⁹ In addition, consent must expressed positively and “unequivocally demonstrate” that the trademark proprietor has renounced any intention to enforce his or her exclusive rights.³⁰⁰ Also, consent by the trademark owner for some products does not mean consent for all products.³⁰¹ In other words, the point of consent applies to a specific batch of products only. Therefore, the trademark owner can prevent the imports and sale of other batches of products, which emanated from the same source in the EEA market as the requisite consent must be in respect of each individual item of the product which exhaustion is pled.³⁰²

²⁹⁸ Judgment of the court (fifth chamber), 1 July 1999 in case C-173/98, note 17.

²⁹⁹ *Ibid.*, note 22.

³⁰⁰ *Sebago Inc. and Ancienne Maison Dubois et fils SA v. GB-UNIC SA*, Case C-173/98[1999] ECR I-4103.

³⁰¹ *Ibid.*

³⁰² *Ibid.*

In the *Zino Davidoff* (1999)³⁰³ case the ECJ held that consent by a trademark proprietor to the marketing of goods within the EEA bearing a mark which had previously been placed outside the EEA market could be implied as well as expressed, with the following guidance:

(1) Consent could be implied by facts and circumstances around the time that the goods were put on the market outside of the EEA, which unequivocally demonstrated that the proprietor had renounced his right to oppose the marketing of the goods inside the EEA;

(2) Implied consent could not be inferred from (a) the failure of the proprietor to communicate to all subsequent purchasers that he did oppose such marketing; (b) the lack of a warning to that effect on the goods; and (c) the lack of appropriate contractual reservations in contracts transferring ownership of the goods; and

(3) It is not relevant to exhaustion of rights that the importer of goods bearing the trade mark is not aware that the proprietor objects to there being placed on the market within the EEA, or that authorized retailers or wholesalers, knowing of the proprietor's opposition, have not imposed contractual reservations on their customers setting out such opposition.³⁰⁴

The obligation and burden of proving consent belong to the party alleges that the trademarked products have been put legally into the market. According to the ECJ, “where it is alleged that a person has consented to the marketing of goods in EEA, the burden lies on the trader and consent must be demonstrated equivocally.”³⁰⁵ The obligation to prove whether consent is expressed or implied belongs to the parallel importers, which is based on the standards of proof with conformity with civil

³⁰³ *Zino Davidoff SA v. A & G Imports Ltd* (C-414/99).

³⁰⁴ *Joined Cases C-414/99 to C-416/99, Zino Davidoff SA v. A & G Imports Ltd* (C-414/99), *Levi Strauss & Co., Levi Strauss (UK) Ltd v. Tesco Stores Ltd, Tesco plc* (C-415/99), *Levi Strauss & Co., Levi Strauss (UK) Ltd v. Costco Wholesale UK Ltd, formerly Costco UK Ltd* (C-416/99).

³⁰⁵ Tritton, *Intellectual Property in Europe*, 476.

litigation (i.e. the balance of probabilities).³⁰⁶ Consent is the most important element that the courts take into consideration a case concerning the legality of parallel imports. However, there are other elements beside consent that require discussion in solving parallel imports cases.

(2). Legitimate reasons to oppose further commercialization

Article 7.1 of the Directive recognizes the regional exhaustion regime, however the Directive allows the trademark owner to protest the parallel importation when legitimate reason exists to oppose further commercial. For example, trademark proprietors can prevent the parallel imports of trademarked goods if after having been put on the market they are changed or impaired in the goods condition. Except for the reason “condition of the goods is changed or impaired after they have been put on the market” which expressly stated in Article 7.2. “legitimate reasons” could be understood as reasons that are not contravene with the general rules. In analyzing Article 7(2), the court upheld that the trademark owner could oppose further efforts by the parallel importers to market repackaged products unless this opposition by the owner would lead to an artificial partitioning of the market.³⁰⁷

While the ECJ affirms the legitimacy of parallel importation of genuine goods within the EEA, it did not exclude the possibility for trademark owners to invoke exclusive rights where the trademarked products at issue were “materially different.” Therefore, the material difference can be considered as a legitimate reason for the trademark owner to oppose the parallel imports even when the trademarked products have been marketed with their consent. In such a situation, the consumers might become confused by source of origin of the goods. Their expectation about the quality of the

³⁰⁶ Torremans, Holyoak and Torremans Intellectual Property Law, 437.

³⁰⁷ William J. Littman, “Recent Developments: The Case of the Reappearing Spectacles - the Future Is Not so Bright for International Parallel Importers in the Ecj After Silhouette International Schmied GmbH & Co. Kg V. Hartlauer Handelsgesellschaft Mbh,” *Tul. J. Int'l & Comp. L.* 7 (Spring 1999): 487.

products also is not met because the products that they purchased are different from the quality of the products that they have a history of using.

In the *Colgate Palmolive v Markwell Finance* (1989) case,³⁰⁸ for instance, the products designed for the Brazilian market and manufactured by Colgate Brazil were found in the market of the United Kingdom. The parallel imported products had different ingredients from the ones sold in the United Kingdom, and they were of inferior quality than the existing goods. In this case, the element of different ingredients was a legitimate reason that allowed the trademark owner to oppose the parallel importation.

Similarly, “legitimate reason” could be applied when the parallel imported products were not labeled in the language of the imported country. The label of a product is a tool from which essential information to consumers is explained such as ingredients, usage instructions, manufacturer/ importer or distributor, and date of expiry. If parallel imported goods are not labeled in a proper manner, consumers might confuse the source of the products and might doubt for the quality of the products as well. Therefore, the functions of trademark become meaningless.

In the *Hackney London Borough* case (1999),³⁰⁹ Coca-Cola cans were imported from the Netherlands to the United Kingdom. However, these cans thereafter were prohibited because the ingredients were listed in Dutch. It is needless to say that Coca-Cola is a famous trademark in the first place. In the second place, the ingredients of this famous beverage are the same all over the world. Thus, the taste of Coca-Cola in the Netherlands is not different from the taste of Coca-Cola sold in the United Kingdom. Nevertheless, the use of Coca-Cola – a world-wide famous trademark- simply was not sufficient to comply with the requirements in labeling foodstuffs to list ingredients according to Food Labeling Regulations 1996 (1996 No 1499), or to exempt the material from the regulations. As a

³⁰⁸ *Colgate Palmolive v. Markwell Finance* [1989] R.P.C. 49 C.A.

³⁰⁹ *Hackney London Borough Council -v- Cedar Trading Ltd*, (1999).

result, the Coca-Cola trademark owner was able to prevent the parallel importing as well as selling the Dutch listed ingredients cans in the United Kingdom.

(3). Goods changed or impaired after having entered the market

One of the legitimate reasons why proprietors can oppose the further commercialization of parallel imported goods is when the goods have changed or are impaired after entering the market. Since the use of the word “*especially*” is used in Article 7.2., this is another of the legitimate reasons that previously mentioned in part (2). The nature of the parallel imports is to exploit the price difference by purchasing a product in a market and selling it in another market for arbitrage. Each market has its own demands, and own characteristics which depend on the tradition, custom, or habit of usage by people in that market. In order to approach a market, parallel importers have to change the goods in order to fit with the conditions of the imported market. Parallel importers not only follow the market requirements to maximize the selling amount but also have to follow the legislation provisions of the imported country in regard with the of the imported products.

In case the same trademark was used in the country of origin and the country of importation, parallel importers may choose to repackage the products to make it saleable in the market of the country of importation. Countries have their own regulations on labeling products. In order to sell products parallel importers have to follow the import conditions of the importing country. Similarly, when different trademarks are used in different countries, the parallel importers need to rebrand or re-label the products with the mark of the country of importation in order to sell the products in the intended market.

b. The first sale outside of the EEA

If the sale occurs within the EEA market, then the principle of exhaustion would apply. Consequently, any economically related affiliate, subsidiary of the trademark owner can give the consent for trademarked products to be put into the market. They cannot prevent any further commercial exploitation with respect to those trademarked products.

On the contrary, if a sale were to take place outside of the Community market, then the issue of whether consent for the resale of the goods within the market has been given could be decided on the terms of that sale. However, the consent of the trademark rights holder should be given by the owner of the applicable trademark rights in the Community, not by some economic affiliate even a subsidiary of the right owner, if operating outside of the market.³¹⁰ Two rules can give consent sufficient to exhaust trademark rights and place products in free circulation within EEA (1) the lower standard, for goods already in the market, where any economic affiliate of the right owner can give consent; and (2) a much higher standard for goods to be imported into the market.³¹¹

Regarding the issue in which the trademarked products marketed in the EEA by persons other than the trademark rights owner, the ECJ focused on the criterion of consent (of the trademark rights holder) than the criterion of independency³¹² as stated in the *Ideal Standard* case as follows:

...application of a national law which would give the trade-mark owner in the importing State the right to oppose the marketing of products which have been put into circulation in the exporting State by him or with his consent is precluded as contrary to Articles 30 and 36. This principle, known as the exhaustion of rights, applies where the owner of the trademark in the importing State and the owner of the trademark in the exporting State are the same or where, even if they are separate persons, they are economically linked. A number of situations are

³¹⁰ Thomas Hays, "The Free Movement (or not) of Trademark Protected Goods in Europe," in *Trademark Law and Theory: A Handbook of Contemporary Research*, ed. Graeme B. Dinwoodie and Mark D. Janis (Edward Elgar Publishing, 2009), 221.

³¹¹ *Ibid.*, 221-222.

³¹² Tritton, *Intellectual Property in Europe*, 477.

covered: products put into circulation by the same undertaking, by a licensee, by a parent company, by a subsidiary of the same group, or by an exclusive distributor.³¹³

Prior to the adoption of Article 7 of the Directive, it was unclear when there was an open question as to whether Articles 28 and 30 (ex article 30 and 36) of the EC Treaty had any application to cases involving the parallel importation of goods first placed on the market outside the EC/EU (later, the EEA) or not. In practice, the approach taken by the Member States at that time were varied when some countries applying a rule of international exhaustion and in the meanwhile others applying a rule of Community exhaustion.³¹⁴ According to the report prepared by the European Union subcommittee on the parallel importation of trademarked goods,³¹⁵ the tendency in parallel imports inside the Community was different between Member States when “there was a north-south split in approach, with the northern European countries tending to follow the principle of international exhaustion and the southern European countries being more restrictive in their approach and thereby favoring brand owners who wanted to prevent parallel imports of their products.”³¹⁶

In many cases the defendant claims to have obtained trademarked products within the community market from sources related to the trademark owner distribution network. When trademarked products are first put outside EEA market by the distribution network, the trademark owners prevent their from being imported in the EEA by clarify that imports are not permitted into EEA to police the terms of their distribution agreements and again to mark invoices and packaging with an import restriction.³¹⁷ When parallel imports of products from outside market occurs, the

³¹³ Case C-9/93 IHT Internationale Heiztechnik GmbH and Uwe Danzinger v Ideal-Standard GmbH and Wabco Standard GmbH, Judgment of the Court of 22 June 1994, para 34.

³¹⁴ Report on Parallel Imports: Summary of EC Law and its Application in the EU Member States, prepared by The EU Subcommittee of the Parallel Imports Committee 2004 – 2005 p 4 available at:

“report_eclaw.pdf,” http://www.inta.org/images/stories/downloads/report_eclaw.pdf.

³¹⁵ Ibid.

³¹⁶ Ibid.

³¹⁷ Morag Peberdy, “Trade marks - parallel imports,” *E.I.P.R.* 2007, 29(6), N84-85.

owners claims their trademarked products were imported from outside the market and that they have not given any consent for such importation.³¹⁸

B. Principle of Community exhaustion of trademark rights

1. Principle of community exhaustion

The European Union follows the principle of regional exhaustion of intellectual property rights (also known as principle of Community-wide exhaustion). The development of the doctrine of Community-wide exhaustion was a compromise between national and international exhaustion. According to the principle of Community-wide exhaustion, once a trademarked product has been put on the market in a particular member nation, then it can no longer rely on national rights to prevent the importation of the product from that country into another member nation.

Since the adoption of the Treaty of Rome (what is so called EC Treaty) issues regarding trademark exhaustion have been at the center of discussion in Europe because of the impact on the control of economic distribution. In the very first years of the European Economic Community (EC), the European Community Commission and the European Court of Justice argued that the exclusive rights granted by national laws to trademark owners could be an obstacle to the creation of a unified internal market, and the result of the debates was the establishment of the Community exhaustion of right. The EC Treaty, as applied by the European Court of Justice (ECJ) and the European Community Commission (Commission), has done much to facilitate parallel importation.³¹⁹

According to the principle of Community exhaustion of trademark rights, the owners exhaust their trademark rights in that jurisdiction with a volitional transaction or purchase. In other words, the

³¹⁸ Hays, "The Free Movement (or not) of Trademark Protected Goods in Europe," 222.

³¹⁹ Catherine Seville (Reviewed), "Parallel Trade in Europe: Intellectual Property, Competition and Regulatory Law, Christopher Stothers," *E.I.P.R.* 2009, 31(12), 636-637,

jurisdiction whereby the product has been purchased volitionally for the first time is the place where the trademark rights towards that product is exhausted. Another issue concerns the exhaustion of trademark rights in EU is that whether or not the principle of international exhaustion exists in European Union. This issue was simply decided following the judgment in the *Silhouette* case where it was ruled that the Trade Mark Directive provides only for EEA-wide exhaustion, rather than providing for international exhaustion.³²⁰ Similarly in the *Sebago* case, even if the shoes were first put into circulation outside the EEA with consent, Sebago could still use its trademark rights to prevent further marketing of shoes within the EEA.³²¹

Whether or not a trademark owner can be deemed to have given consent to the marketing within the EEA of a batch of products imported from outside the EEA on the basis that he had consented to the marketing within the EEA of other batches of identical or similar products. Also, whether Sebago had exhausted its trademark rights in batches of identical or similar goods by consenting to the marketing of one batch of the goods within the EEA. Both the ECJ and the Advocate General stated that the principle of exhaustion of trademarks in the EEA relates only to the individual goods or batches of goods, not to whole product lines. By merely putting a product onto the market a product bearing the trademark, Sebago did not lose the right to protect its trademark on other consignments of identical or similar goods which had not yet been placed on the market within the EEA.³²²

2. The harmonization between national law and community law

The EC Treaty is used to replicate the market of a Member State across the entirety of the Europe community. As certain Member States had applied national exhaustion of rights principle in

³²⁰ Seville, EU Intellectual Property Law and Policy, 361.

³²¹ *Ibid.*, 361-362.

³²² Stothers, Parallel trade in Europe, 59-60.

the past, the provisions of the EC Treaty (particularly, articles 28 and 30) have extended the scope of the national exhaustion of rights principle to the Community-wide exhaustion of rights principle.³²³ Therefore, the exclusive rights that the trademark owners conferred must be harmonized with the principle of free movement of goods in the community market.

After the *Silhouette* case there was change of the national laws of the EU members. According to the ECJ decision in this case there were two main issues that contributed to the process of harmonization between the national laws and Community law in intellectual property rights aspect. First, the ECJ held that national rules providing for exhaustion of trademark rights in respect of goods put on the market outside the EEA under that trademark by the proprietor or with his consent are contrary to art 7.1 of the Trademark Directive. With this issue, the Directive could not be interpreted as leaving open to the Member States to provide in their domestic law for exhaustion of rights conferred by a trademark with respect to products put on the market in non-member countries. In fact, countries understood and applied Article 7.1 differently when some Member States provided for international exhaustion while others provided for community exhaustion only.³²⁴ As a result, differences applied from Article 7.1 would inevitably give rise to barriers to the free movement of goods and the freedom to provide services in the Community market.³²⁵ The ECJ explained that by the establishment of trademark rules through the Community, the Directive did not leave any scope for the Member States to apply a rule of international exhaustion of an individual basis.³²⁶

Second, the ECJ held that subject to the interpretation that made by the national court, in conformity with community law, Article 7.1. of the Trademark Directive could not be interpreted as meaning that the proprietor was entitled, on the basis of that provision alone, to obtain an order restraining a third party from using his trademark for products which have been put on the market

³²³ Tritton, *Intellectual Property in Europe*, 474.

³²⁴ Keeling, *Free Movement and Competition Law*, 133-138.

³²⁵ *Silhouette case*, para 27

³²⁶ Keeling, *Free Movement and Competition Law*, 133-138.

outside the EEA by or with the proprietor consent. Therefore, in order to prevent the parallel imports, the trademark owner could use Article 7.2 as a useful tool to protect their legitimate rights from an infringement.³²⁷

C. Concerned issues in parallel imports of trademarked goods

1. Theory of implied consent

In order to solve a parallel import case in the Europe, the first element the court takes into account is whether the products are market by or with the consent of its owner. Therefore, the central issues are what does consent mean and whether consent has to express, or could it be implied? If it could be implied, in what circumstances could it be implied. An important exception consent is that when products are placed on the market under a compulsory-licensing order, they may not be traded in parallel.³²⁸

Regarding the issue of implied consent, the laws on consent for resale products in other Member States have been interpreted in two different schools.³²⁹ In the United Kingdom consent for resale of trademarked products in the form of an incidental license could be implied from the purchase of trademark-protected goods, unless that license was specifically withheld at the time of sale.

³²⁷ Ibid.

³²⁸ Ganslandt and Maskus, “Chapter 8 Intellectual Property Rights, Parallel Imports and Strategic Behavior.”

³²⁹ Jens Schovsbo, “Exhaustion of Rights and Common Principles of European Intellectual Property Law”, SSRN-http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1549526. “Contract” (implied licence). Here “Freedom of Contract” prevails and the law generally leaves it to the parties (and courts) to define the balance, i.e. decide whether the buyer of protected goods is allowed to resell, parallel import etc. the goods. “Principle of Exhaustion”: The legislator defines the balance. “Exhaustion” is a statutory limitation to the (statutory) “distribution right”. According to the rule the right holder automatically loses (some of) his distribution rights with the first marketing.

Meanwhile, the national law of Germany represents another approach, where consent for resale of protected goods deemed not to have been given at the time of the first sale of those goods, unless the intellectual property owners expressed the consent. For other Member States, their national provisions on consent for resale are come somewhere between the two interpretations.

From the theoretical point of view, if products previously placed outside of the EEA and later imported back into the market without the consent of owner, then the owner can prevent parallel importer from importing those products into the EEA market. From its rulings, the ECJ has solved the problem case by case with important cases in this area. In the *Davidoff* (1999) case, for instance, the ECJ setup one of the most important requirements of implied consent. In *Davidoff*, the ECJ said:

...consent must be so expressed positively and the factors taken into consideration in finding consent must unequivocally demonstrate that the trade mark owner has renounced any intention to enforce his exclusive rights.³³⁰

From this decision consent can be interpreted as only being implied when the seller's intention to give consent is "unequivocally demonstrated." Accordingly, implied consent cannot be inferred in the following situations:

First, implied consent cannot be inferred from the fact that the trademark proprietor has not communicated to all subsequent purchasers of the goods placed on the market outside the European Economic Area his opposition to marketing within the European Economic Area; second, implied consent cannot be inferred from the fact that the goods carry no warning of a prohibition of their being placed on the market within the EEA; third, implied consent cannot be inferred from the fact that the trademark proprietor has transferred the ownership of the products bearing the trade mark without imposing any contractual reservations and that, according to the law governing the contract, the property right transferred includes, in the

³³⁰ Zino Davidoff v. A&G imports 45.

absence of such reservations, an unlimited right of resale or, at the very least, a right to market the goods subsequently within the European Economic Area.³³¹

In the litigation between *Honda Motor Co Ltd v Nesham and others* (Honda case) (2008),³³² the trademark rights of Honda in the United Kingdom are held to be exhausted by sales made by Honda Australia. Also in this case, the court followed the interpretations in the Davidoff case on the issue of the implied consent.

The main concern of this case related to the sale of Honda motorbikes through Honda Australia to Lime Exports which in turn imported the bikes to the UK and resold to the consumers by KJM. The judge held that when Honda Australia sold large quantities of new motorcycles to Lime Exports without any conditions as to the identity or location of onward purchasers, this was consistent only with its consenting to the bikes being resold to any purchaser outside Australia. There was no reason for distinguishing between purchasers based in the EEA and purchasers based anywhere else in the world. If Honda Australia gave consent for the bikes to be resold anywhere in the world except in Australia, then this included consent to their being resold anywhere in the EEA including in the United Kingdom.

For a long time a business relationship existed between Honda Australia and Lime Exports, and during that time, there was no restriction on sales from Honda Australia. The judge held that sales made without restriction to a dealer that sold bikes to the trader was, by its very nature, an act implying consent to further sale within the EEA market and to customers in the UK.³³³ In other words, Honda in this case has recognized of the long time existence of the trade but has made no restriction on that trading of Lime Exports. Indirectly, an implied consent has been made from the silent of Honda Australia side.

³³¹ Joined cases C-414/99 to C-416/99.

³³² *Honda Motor Co Ltd v Nesham and others* [2008] EWHC 338 (Ch), February 28, 2008.

³³³ Rachel Montagnon and Owen Richards, "Honda's UK trade mark rights exhausted by sales made by Honda Australia," *Journal of Intellectual Property Law & Practice* 3, no. 7 (July 1, 2008): 429,430.

According to the ECJ the consent of the trademark holder needs to be “unequivocal demonstrated” for there to be exhaustion similar to the earlier case - Davidoff. However, implied consent could be unequivocal since “a proved act which is consistent with consent and inconsistent with the absence of consent establishes unequivocal consent.”³³⁴

2. Contractual restrictions

The place where the products were first put into circulation with or by the consent of the trademark owner is important in determining whether or not trademark rights have been exhausted. Contract restriction is not the proper method to avoid the exhaust status of trademarked product unless a contract means that the products were not put on the market (i.e. when the products manufactured by the licensee) or were not manufactured by or with the consent of the owner.³³⁵

In the *Coty* case (2010)³³⁶, the trademark owner found that his trademarked tester products were sold on the EEA market, particularly on sale in a German retail chain. This retail chain was not an authorized retailer and had acquired the tester perfume bottles from a Swiss company called Simex. This Swiss company in turn appeared to have sourced trademarked products from Singapore, where Coty had originally sent them to an authorized retailer.

The case was brought to a court in Germany for trademark infringement against Simex. As the defendant, Simex argued that Coty consented to the tester perfume bottles being marketed within the EU. Sharing the same point of view, the German court held that Coty had already provided the same types of tester perfumes to its authorized retailers in the EU. Therefore it had consented to such products entering into the EU market, even where the tester bottles in question came from outside of

³³⁴ *Zino Davidoff SA v. A & G Imports Ltd* (C-414/99).

³³⁵ *Stothers*, Parallel trade in Europe, 70.

³³⁶ *Coty Prestige Lancaster Group GmbH v. Simex Trading AG*, C-127/09

EU. Based on that, the German court held that the trademark rights of Coty had been exhausted according to Article 13.1 of the Community Trademark Regulation and Article 7.1 of the Trademark Directive.

Coty, however, did not agree with the conclusion that made by the lower court and appealed the case where the appellate court doubted the lower court's findings and referred to the ECJ for guidance. From the guidance of the ECJ the exhaustion status of trademarked products cannot be applied for the whole product but rather in individual items or particular batches. As such, it was not right to regard Coty's rights in the tester perfume bottles in Singapore authorized retailers as having been exhausted mainly because other testers which bore the same brand were already being provided to authorized retailers in the EU. In this case, the testers in question were imported from Singapore (outside the EU market) and were put on the market in the EU by Simex. As a result, the consent issue became clear when Coty consented to Simex to put the tester perfume bottles which were imported from Singapore into the EU market.

The ECJ had pointed out that there had been no implicit consent of the trademark owner. In this case, as to the tester perfume bottles, Coty had its contractual restrictions when explicitly showed with the clearly marked "Not for Sale" on the package of these tester bottles. This means that the tester products were not for sale and by the clearly marked Coty has already been precluded a finding that its trademark rights had been exhausted. In other words, the markings on the tester packaging clearly indicated that Coty did not consent to the sale of the testers in the EU or elsewhere. Therefore any further commercial exploitation on the tester products was considered as trademark infringement.³³⁷

3. Packaging

Selling products in a specific market that is different from that for which they were originally

³³⁷ Ibid.

designed and marketed usually requires a change in the packaging of the products. When products are imported from the country of origin to country of importation, in order to make the products saleable, parallel importers have to change the packaging of the products. Depending on different situations, the parallel importers can choose the relevant method that fits the most practical condition. In other words, repackaging is the method in which a parallel importer acquires a product placed in the market, replaces the container in which the products were sold in export country, and reaffixes the trade mark before marketing in the market of importing country. The legal terminology of packaging used for general falling into the following categories: repackaging, re-labelling, re-boxing, over-stickering, and de-branding.³³⁸ These are defined in the following ways:

1. Re-labelling is the method which according to that a parallel importer replaces the outer packaging of the products and reaffixes another trade mark, under which the very product is sold in the Member State where it is going to be marketed;
2. Re-boxing is when a parallel importer retains the original internal packaging of the products but adds a new exterior carton printed in the language of the Member State of importation in order to put the products into the market of the importing country.
3. Over-stickering is a method in which a parallel importer keeps the original internal and external packaging of the products but adds an additional external label printed in the language of the Member State of importation; and
4. De-branding is conducted when a parallel importer sells the goods after their original trademarks have been removed and not replaced.³³⁹

In order to sell goods in a market from that originally planned, parallel importers often change the packaging of the products. As to pharmaceutical products for instance, warnings and related

³³⁸ Anna Feros, "Free movement of pharmaceuticals," 489-490.

³³⁹ Ibid.

information leaflets in addition to the packaging must be changed in order to comply with specific regulatory requirements, local healthcare product provisions, and they should also have these translated into the local language. These requirements may also be controlled by what the market tendencies are in the jurisdiction in terms of consumer preference and history of using the products.³⁴⁰ In fact, situation when certain drugs are sold in different packing formats in different country member is quite popular. In many instances the trademark proprietors opposed the importation when the importers repackaging the trademarked products.³⁴¹

For example medicinal product M is packaged with 50-100 tablets for sale in country A. However, in country B people are familiar with this product being packaged in smaller amounts, for example, 10-20 tablets. In this case the repackaging by a parallel importer involves a change in packet size of the products. If a parallel trader buys the medicine from country A to resale it in country B, the parallel import trader is required to repackage the medicine in the standards of country B. During the repackage process, if the requirements of the package are not strictly followed then quality of the products would be damaged. Therefore, not only is consumer expectation unsatisfied but also their health is not protected by the use of these repackaged products. The goodwill of the trademark can be damaged by the failure of repackaging. In such a situation, parallel importation should be stopped because a trademark owner has a legitimate reason to oppose the further commercialization of the products in the country of importation.³⁴²

In dealing with parallel imports related cases, the courts always base on the basic functions of trademarks. On the one hand, the quality function of trademark is a guarantee to the consumers that the quality of the products as they have expected when going to purchase the products, which also says about the identity of the trademarked products origin. Therefore, consumers can distinguish without any risk or potential of being confused or misled from a different origin.

³⁴⁰ Ibid., 489.

³⁴¹ Stothers, Parallel trade in Europe, 86-93.

³⁴² Ibid., 86-87.

On the other hand, the origin function of a trademark guarantees to the consumers that the products they buy are genuine and legally placed in the market. Moreover, the products that are offered to consumers are guaranteed in quality not any products that are previously unauthorized interference by any third person in such an inappropriate manner that affect to their original conditions.³⁴³ Therefore, based on the granted exclusive rights of the trademark, the owner can oppose further commercialization or any use of the product which is liable to impair the origin function of the trademark.

In *Hoffmann-La Roche v. Centrafarm* (1978),³⁴⁴ Hoffmann brought an action for infringement of its German trademark when the company Centrafarm obtained drugs in the UK which it then repackaged (to comply with German packing requirements) before selling the products in the German market with Hoffmann's trademark. Hoffmann argued that the repackaging interfered with the essential function of the trademark, namely the indication of the origin and guarantee of the quality of the trademarked products.³⁴⁵ The ECJ held that the trademark owner could not impede the repackaging of the product without artificially partitioning the market.³⁴⁶ However, the repackaging activity should have been done in a way that users were not confused and that the original conditions of the product are not affected negatively. In particular the parallel importer should have indicated on the box that the goods were repackaged and by whom. Also, the importer should notify the trademark owner of its intention to repack. Absent of these conditions, the trademark owner was entitled to oppose repackaging.³⁴⁷

In some situations, repackaging of the products is unavoidable for parallel importers,

³⁴³ Dinwoodie, *International Intellectual Property Law and Policy*.

³⁴⁴ *Hoffman-La Roche v Centrafarm* [1978] ECR 1139.

³⁴⁵ Catherine Colston and Jonathan Galloway, *Modern Intellectual Property Law* (Taylor & Francis, 2010), 705.

³⁴⁶ Yuka Aoyagi, *Free Movement Rules and Competition Law: Regulating the Restriction on Parallel Importation of Trade Marked Goods*, *IP Bulletin* 2007, 4.

³⁴⁷ *Hoffman-La Roche v Centrafarm* [1978] ECR 1139.

especially when the products are pharmaceutical products. Because of the importance of the products to human health, the ECJ in a pharmaceutical parallel imports, holding that pharmaceutical trademark owners could restrain the further marketing of their products which have been repackaged, unless the parallel importers have to meet the basic requirements of repackaging.³⁴⁸ These requirements are stated as followed:

- (1) The use of the trademark right by the owner, having regard to the marketing system which he has adopted, will contribute to the artificial partitioning of the market between Member States;
- (2) Such repackaging is necessary to gain effective access to the market;
- (3) There is clear identification of the manufacturer and importer on the pack;
- (4) The repackaging cannot adversely affect the original condition of the product;
- (5) The presentation is not liable to damage the reputation of the trademark owner; and
- (6) The trade mark owner has been given prior notice.³⁴⁹

With regards to the repackage issue, the parallel importer bears the burden of proving compliance with conditions. The parallel importer has to make sure that the presentation of the repackaged products must not be such as to be liable to damage the reputation or the goodwill of the trademark proprietor. The main sticking point is to which extent it is “necessity” to repackage. In fact, these conditions are applied and construed case by case by the ECJ. In the field of pharmaceuticals, the issue raised in parallel trading extended to allow for the unauthorized relabeling of branded drugs,

³⁴⁸ Bristol-Myers Squibb and Others v Paranova A/S [1996] ECR I-3457, Joined Cases C427/93, C429/93 and C436/93; Eurim-Pharm v Beiersdorf and Others; Case C232/94 MPA Pharma v Rhone Poulenc [1996] ECR I-3603, Joined Cases C71/94, C72/94 and C73/94.

³⁴⁹ A/S--C429/93, C429/93 and C436/93 [1996] E.C.R. 3457.

and to unauthorized repackaging and rebranding of pharmaceuticals where necessary to effectuate the free movement of the goods in question.³⁵⁰

Repackaging could cause damage to imported products because during the repackaging process, the importers do not follow the technical requirements or procedures. When the repackaging is not carefully conducted, the consumer could be misled about the source or the origin of the trademarked products. Therefore, repackaging could damage the quality of the products. Furthermore, damage to the trademark the repackaging may give consumers the impression that there is a commercial connection between the importer and the manufacturer, or that the importer is part of the official distribution chain.³⁵¹ In such a situation, the goodwill of the trademark holder could be decreased.

There is high potential risk that problems can occur during the repackaging of products, especially when these are pharmaceuticals which in nature has a close effect on human health. Recognizing that repackaging is an important issue; however, Member States cannot prohibit the repackaging of the products or allow the trademark owner to prevent its occurrence. If so, Member States are going against the principle of free movement of goods in the common market. In order to ensure the repackaging of the parallel importers, Member States have their national law or regulations to deal with the issue. In order to sell or put the products into a state market the distributors have to follows these provisions.

³⁵⁰ Dinwoodie and Janis, *supra* note ___ at 221-222.

³⁵¹ Claudia Desogous, *Competition and Innovation in the EU Regulation of Pharmaceuticals: The Case of Parallel Trade*.

4. Quality control

A trademark cannot perform its fundamental functions unless it is under the control of a single undertaking in a specific territory.³⁵² In fact, there are situations when the trademarked products are manufactured and put into circulation by a licensee, a parent company, a subsidiary of the same group, or an exclusive distributor.³⁵³ When trademarked products enter the market by the other person but not by trademark owner and if they are economical linked, then it is be considered that the products are put into the commercial with the trademark owner's consent.³⁵⁴ The consent of the trademark proprietor can be seen as an approved action manifesting with the further commercialization of the products bearing the trademark.

According to Article 7 of the Directive, the trademark holder can oppose the further commercialization of the trademarked products when the products were put into the market without his or her consent. The owner can rely on the facts that the products bearing the trademark were manufactured out of his or her control or the manufacturing was not obey the specifications which required by the owner or with its legitimate authorized person to prevent parallel importation. In such a situation, the trademark's source function as well as trademark's quality assurance function of the products was placed under a high pressure of being infringed.

In addition, in considering the trademark functions, the products bearing the same trademark probably having same quality. Therefore, if the trademark bearing products of a producer differs in quality between one market and another, then trademark proprietors can use their exclusive rights to prevent such a importation. The reason that trademark owner base on is different in quality of the products can confuse consumers. On the contrary, trademark owners cannot exercise their rights to

³⁵² Keeling, *Free Movement and Competition Law*, 89.

³⁵³ Case C-2/93 IHT Internationale Heiztechnik GmbH v Ideal-Standard GmbH [1994] ECR I-2789, para 34.

³⁵⁴ *Ibid.*, para 34

oppose parallel imports when the goods are not different and trademark functions are sufficiently fulfilled.

The control of the trademark owner over the quality of goods is not always directly performed. In fact, sometimes the owner does not have the actual exercise of that control. When there is a license between the trademark owner and licensee the control of the owner is not directly but by the terms and conditions in the license agreement. As a result, the licensor can control the quality of the licensee's products by including in the contract clause a requirement the licensee to comply with his instructions and giving him the possibility of verifying such compliance.³⁵⁵ According to the national legal provisions, a licensor is allowed to oppose importation of the licensee's products on grounds of poor quality.

The responsibility for quality control of the licensors is required when they tolerate the production of poor quality goods. In such a situation the question arises as to whether or not the principle of exhaustion applies to the licensee's goods that do not comply with the quality standards stipulated in the licensing agreement. The answer to this question is most likely negative. In the first place, the trademark owner will not agree or give consent to the marketing of inferior quality products manufactured by the licensee because the inferior quality products would damage the goodwill of the trademark. In the second place, the expectations of the consumer as to trademark that the poor quality products bearing had fail. The legitimate benefit of the consumer, therefore, is not guaranteed when the inferior products are put into the market under the trademark. The essential functions of a trademark are impaired in this situation.³⁵⁶

The trademark rights constitute an essential factor in the system of unfair competition which is the target of the legal provisions. Under this system, the trademark owners attract and keep

³⁵⁵ CASE C-9/93 Judgment of The Court 22 June 1994 IHT Internationale Heiztechnik GmbH, Uwe Danziger and Ideal-Standard GmbH, Wabco Standard GmbH, para 37.

³⁵⁶ Keeling, Free Movement and Competition Law, 91.

customer by the quality of their trademarked products, which also help consumers identify and distinguished products or service supplied by this undertaking from others in the same market. Basic functions of trademarks are the source of origin and quality guaranteed, which constitute a guarantee that all the products that bear that trademark are produced under the control of a single producer to which responsibility for their quality may be attributed use.³⁵⁷

The primary function of trademark is to indicate commercial origin of the trademarked products and to prevent any confusion of the public or consumer. Accordingly, when goods have been manufactured and marketed independently they would have no common origin if there were no quality control for them. When there is no quality control between the goods that are produced by licensor and the one manufactured by licensee then it is possible to invoke trademark rights to prevent the importation of products bearing identical or similar trademarks that might create consumer confusion.³⁵⁸ As such, the E.U. provision on quality control not only protects the goodwill of the trademark proprietor but also protect consumers from being misled or confused or from purchasing non-genuine products.

D. Summary

In general, the EU applies the principle of regional exhaustion of trademark rights, under which parallel importation of trademarked goods which have been placed into circulation within the EEA market, is allowed. However, the proprietors have their right to prevent parallel imports of their goods even when the imported products are genuine with respect to the products which have been for sale outside of the EEA. In cases of parallel imports within the EEA market, the parallel importers have to follow many regulations and guidelines in practice of the EU in trademark field in order to avoid legal actions that may be carried out by the proprietors. Nonetheless, even parallel imports

³⁵⁷ Dinwoodie, *International Intellectual Property Law and Policy*, 11.

³⁵⁸ Calboli, "Trademark Exhaustion in the European Union."

between the Member States of the EU may be prevented or detained when parallel importers do not follow the requirements or violate the legitimate reasons which are depend on case by case basis. Furthermore, in order to prevent trademark proprietors and distributors restricting the sale of products, the agreement between members must pass the test of non-restriction of competition within the EEA market.

The consent of the trademark proprietor for the further commercial exploitation of trademarked products is necessary in parallel imports cases. However, consent for some product does not mean consent for all products. It means that, the consent of trademark owner to one batch of goods necessarily implies with respect to all like batches of goods. Also, the implied consent theory is used sometimes in cases when the products were first placed outside the EEA market and then any third party want to import those trademarked products to the Community market. According to ECJ's decision, in such a situation, the consent must be expressed. If parallel importers refer the consent as a implied one, then he or she has to prove consent was implied through the trademark owner's action.

III. Parallel imports and trademark law in Japan

Compared to the United States and European Union, the cases in Japan related to parallel imports are relatively less in number.³⁵⁹ With respect to parallel imports of trademarked goods, there have been cases that refer in which direction the Japanese courts now want to lead and how they solve the issues related to parallel importation. While parallel imports occurred in the United States and the

³⁵⁹ Darren E Donnelly, "Parallel Trade and International Harmonization of the Exhaustion of Rights Doctrine," *Santa Clara Computer and High-Technology Law Journal* 13 (1997): 484.

European Union long time ago, the history of parallel importation of trademarked goods in Japan occurred in the 1960s, when the courts held infringement in a number of cases.³⁶⁰

A. Introduction to Japanese statutory provisions on parallel imports

1. Introduction to the Japanese Trademark Act

Japan follows the “first to file” principle on trademark which is also known as the “registration principle”.³⁶¹ The Japanese Trademark Act (JTA) does not grant an exclusive right to a trademark application until that trademark is registered with the Japan Patent Office. A trademark right is granted when a mark is registered at the patent office. The registration allows the trademark owner to use the mark continuously.³⁶² Therefore the trademark owner has the right to prohibit the use of a similar mark registered for similar goods or service. Furthermore, the registration of the trademark allows the holder to request for compensation or to sue a third person for intentionally infringing on the rights of the owner.³⁶³

According to Article 25 of the (JTA), the trademark holder shall have an exclusive right to use the registered trademark in connection with the designated goods.³⁶⁴ Acts of “use” of the holder of a trademark right with respect to a trademark as defined in Article 2(3) of the JTA are acts of applying the trademark on products or packaging of products, displaying or distributing trademarked products,

³⁶⁰ Christopher Heath, *The interface between competition law and intellectual property in Japan* in Hays, *Parallel Importation Under European Union Law*, 292.

³⁶¹ Ono, *Overview of Japanese Trademark Law*, chap. 7.

³⁶² *Ibid.*, chap. 3.

³⁶³ *Ibid.*

³⁶⁴ Japanese Trademark Act, Art. 25: Effects of trademark right, accessed October 4, 2010, <http://www.japaneselawtranslation.go.jp/law/detail/?id=45&vm=04&re=02>,

advertising.³⁶⁵ Meanwhile, acts of trademark infringements are provided under Article 37 of the JTA. This article also provides that import goods that bear any marks confusingly similar to registered trademarks constitute a trademark infringement.³⁶⁶

Under the JTA, there are no provisions explicitly dealing with parallel imports.³⁶⁷ Neither Article 25 nor Article 37 of the JTA could be applied to the act of importation of parallel importers and such an act does not violate any rules. All the decisions so far which relate to parallel imports of trademarked products have been made by the courts. This is also a different point in jurisprudence with respect to parallel imports and exhaustion of rights between the U.S, the E.U and Japan.

2. Courts decisions in parallel imports

a. The Parker decision

In Japan, the parallel importation of genuine products was considered as legal and through case law the courts and administration have already paved the way for such goods to be legitimately imported into Japan by importers.³⁶⁸ The ruling in the *Parker* case (1970)³⁶⁹ created a turning point in dealing with parallel imports of trademarked products into Japan.³⁷⁰

In this case, Shriko was the sole import distributor of Parker Fountain Pens in Japan. The plaintiff company was NMC which had obtained original pens from Hong Kong and imported them

³⁶⁵ Ibid., Art.2.3.

³⁶⁶ Ibid., Art. 37.

³⁶⁷ Christopher Heath, “Exhaustion and Parallel Imports in Japan,” in *Parallel Imports in Asia*, ed. Christopher Heath (Kluwer Law Intl, 2003), 65-66.

³⁶⁸ Fujino Jinzo, “Parallel Import into Japan Carry a Duty of Care,” <http://www.ngb.co.jp/en/news/200312.html>.

³⁶⁹ Osaka District Court, 27 February 1970, IIC 325, *Parker*.

³⁷⁰ Ono, *Overview of Japanese Trademark Law*, chap. 7.

into Japan. Shriho asked the Customs Office to stop that importation. The case after that was brought to the Osaka District Court.

The Court in the *Parker* case based on the basic function of trademark in determining whether an act was deemed to infringe on a trademark right. The JTA is designed to guarantee the source of origin and the goods quality as well. Furthermore, the purpose of the law is to protect the goodwill of the trademark owner. At the same time, the trading pattern is sought to be maintained so that customers can make a purchasing decision accurately based on the source of products, thus protect the interests of the consumers. After examining how parallel importation of Parker pens affected the interest of related parties and considering the trademark functions in this case, the Osaka District court concluded that the JTA was intended to guarantee the source of origin and the quality of good as well as protect the goodwill of the trademark owner.³⁷¹ The act of importation by the importer did not violate the provisions in the trademark law system. In this decision, the Osaka District Court concentrated upon two major functions that a trademark contains, namely the "function of indicating origin and ownership" and the "guarantee function." The Court stated:

...these functions are the subject of protection and protection is not only for the benefit of the trademark owner but also for the benefit of the public at large. It can be said, therefore, that trademark law as compared with other areas of industrial property protection is characterized by its very strong and common interest aspect. The scope of protection is also limited by public policy considerations within the framework of the principle of registration, even though basically a trademark can be characterized as a private property right...³⁷²

In its decision, the court based on the main purposes of trademark law, which stated in Article 1 of JTA that the law protected the goodwill of the owner and the benefits of the consumer, for its

³⁷¹ Christopher Heath, "Decision of The Intellectual Property High Court, 27 April 2010, Itochu v. Royal," IIC Vol 42, 240-242.

³⁷² Osaka District Court, 27 Feb.1970, 2 ICC 325-326 (1971).

decision.³⁷³ First, the goodwill of the trademark owner is created after a long progress by the usage of the trademark. Moreover, goodwill of the trademark is also a tool to which consumers are able to distinguish products manufactured by the actual producer from others. Second, the Trademark Act of Japan aims to prevent consumers from being misled or confused when showing that the source of goods is not identical. Thus, the goods available on the market achieve a certain level of quality, and consumers can more easily purchase a desired product.

Also, the court took the position that parallel imports were permissible as long as such functions of the trademarks were not impaired. From this position, the act of importing and distributing the genuine Parker pens was seen as substantially legitimate from the perspective of trademark law's view of the essential meaning of trademark protection. It was found that, the functions for indicating the origin and guaranteeing the quality of the trademarked Parker pen was maintained.³⁷⁴ Therefore, the act of parallel importer did not constitute infringement.³⁷⁵ The Osaka District Court held that the sole agency of Parker in Japan (plaintiff) had no right to block the parallel importation of authentic Parker Fountain Pens into Japan based on the Japan Trademark Act.³⁷⁶

The rulings of the Osaka District Court opened a trend for the parallel importation of trademarked goods.³⁷⁷ This case also introduced the theory called the "trademark function doctrine" for parallel imports of genuine trademarked products. After this decision, the Japanese Courts have applied the trademark function doctrine from the Osaka District Court decision in treating parallel imports of goods bearing trademarks.

³⁷³ Japanese Trademark Act, Art., 1.

³⁷⁴ Mitsuo, "Issues Regarding Parallel Importation of Trademarked and Patented Products and Competition Policy in Japan," in *Intellectual Property: Trade, Competition, and Sustainable Development*, ed. Thomas Cottier and Petros C. Mavroidis (University of Michigan Press, 2003), 190.

³⁷⁵ Ono, *Overview of Japanese Trademark Law*, chap. 7.

³⁷⁶ Mitsuo, "Issues Regarding Parallel Importation of Trademarked and Patented Products and Competition Policy in Japan," 190.

³⁷⁷ Christopher Heath, "Decision of The Intellectual Property High Court," 242.

b. The Fred Perry decision

The decision of the court in the *Parker* case³⁷⁸ focused on the trademark functions in determining the legality of the parallel imports genuine goods. The *Fred Perry* case (2003)³⁷⁹ marked an important turning point in respect to parallel imports with the decision of the Supreme Court. This is considered as the most authoritative Japanese ruling on trademark exhaustion because it is the first decision s given by the Supreme Court on that issue.³⁸⁰

In this case, the Supreme Court of Japan developed an interesting conclusion concerning the parallel importation of genuine trademarked products. In the ruling, the Supreme Court confirmed the concept of parallel importation of genuine trademarked products, by stating that importers of such products would not be liable for trademark infringement when the following requirements were satisfied:

- 1) The foreign trademarks were legitimately placed by a licensee who was granted a license under a trademark agreement with the owner of the licensed trademarks or its exclusive licensee;
- 2) The foreign trademarks indicate the same source as that of the registered trademarks in Japan; such fact can be presumed by the fact that the owner of the foreign trademarks is the same as the owner of the registered trademarks in Japan or otherwise he or she can be regarded as the identical person as the trademark owner in Japan legally or economically; and

³⁷⁸ Supreme Court, Feb. 27, 2003 (1817 Hanreijho 33, 1117 Hanrei Taimuzu 216).

³⁷⁹ Ibid.

³⁸⁰ Fhima, “The Functions of Trade Marks and Their Role in Infringement Cases - What Can the EU and Japan Learn from Each Others’ Experiences,” 5.

3) The trademark owner in Japan is in a position to directly or indirectly manage the quality of goods bearing the foreign trademarks.³⁸¹

In other words, the parallel importation of trademarked products was not substantially illegal when it satisfied the above-mentioned conditions. From this decision, the Supreme Court of Japan followed the trademark function doctrine in the *Parker* decision. Accordingly, the Osaka District Court applied this doctrine where the function of a trademark was not considered to be damaged by a parallel importer's action when: (a) the parallel imports product was a genuine product with a genuine trademark; (b) the trademark owner in a foreign country was identical to the trademark owner in Japan; and (c) the quality of the imported products was equal to that of the Japanese products.³⁸²

However, the situation in the *Fred Perry* case differed from the *Parker* case. The products in question in the *Fred Perry* case were manufactured by a contractor with the licensee out of the license agreement. The main problem in this case concerned whether the Japanese trademark owner could stop the importation of licensed products that were manufactured under a license granted outside Japan by a trademark licensee outside the scope of the license agreement territory without the consent of the trademark owner. This also led to another issue when the products in question had a licensed trademark fixed and appeared to have been manufactured by an authorized licensee.

The Supreme Court followed the trademark function doctrine, and held that an imported product which had been manufactured by a licensee in violation of a trademark licensing agreement would not be considered to be genuine. When a third party imports products bearing the same trademark with the registered trademark in Japan without the consent of the mark owner, then that act is deemed trademark infringement. In other words, if the products are subcontracted by the licensee and manufactured outside the agreement territory without the consent of the trademark owner, then the

³⁸¹ Supreme Court, Feb. 27, 2003.

³⁸² Kazuaki Okimoto, "Parallel Import of Non-genuine Product Constitutes Trademark Infringement in Japan," *L.E.S Issue* No.21, September 2003.

importation of such products is illegal. Therefore the act of parallel importing is considered as a trademark infringement.

The Supreme Court reasoned that the source of the imported products was misrepresented and did not meet the source function requirement. Moreover, the imported products were manufactured outside of the quality control of the trademark owner. Therefore, these goods did not meet the third requirement. In addition, the Supreme Court supported such findings concerning the lower courts finding that importers had a duty of care to ascertain whether prospective imported goods were qualified as genuine goods. Indeed, according to the decision of the Japan Supreme Court:

...in the case of so-called parallel import of genuine goods which satisfies each of the above conditions, there is no substantive illegality and no impairment of the functions of the trademark, which are to indicate the goods' origin, guarantee the good's quality, and to protect the business reputation of persons using trademarks as well as the interests of consumers.³⁸³

Recently, the debate over parallel importation focuses on the extent to which a trademark owner should be allowed to maintain control over its own brands. By using its trademark rights in a country (or group of countries that can be defined "national") trademark owner restricts the importation of goods into that country after the goods have been put on the market somewhere else by or with the mark owner consent. Consent of the trademark holder is an issue which should be considered carefully because it decides the legality of the first sale of products. Whether it is implied consumption consent or must be expressed consent the parallel importers have to be proven in some circumstances.

Consumers usually purchase genuine products with their expectation that the goods are sold or distributed through authorized distribution channels overseen by the trademark owners or their

³⁸³ Supreme Court, Feb. 27 2003.

licensees. Unwary consumers are surprised that their "genuine" products do not carry the warranties and service guarantees that accompany typical authorized sales, or that rebates offered to purchasers of authorized products will not be extended for their "genuine" purchases. More importantly, the problem of public health and safety concern occur in these similar cases. In fact, many pharmaceutical companies have prevented the parallel imports of medicinal products. The standard of the products designed for different markets are usually not the same. In many cases goods which are sold in this country do not comply with the safety standards and quality criteria of another country may harm unwitting purchasers. Improper handling, packaging, or storage by unauthorized distributors may lead to spoilage or damage because the quality standards are not controlled.

3. Guidelines concerning distribution systems and business practices

In 1991, the Japan Fair Trade Commission (JFTC) enacted the Guidelines concerning distribution systems and business practice in Japan under the Anti-Monopoly Act. These guidelines again confirmed that importation of genuine products do not infringe upon any trademark right.³⁸⁴ These guidelines do not apply for non-genuine products. If the imported products being sold in the domestic market were counterfeit products, the trademark owner could request Customs to stop the violator from selling such trademarked products on the ground of trademark infringement.³⁸⁵

The guidelines also prohibit acts that considered as unreasonable obstruction of parallel imports. Accordingly, these acts are prohibited: (1) preventing any parallel importer from purchasing genuine products in overseas markets; (2) restriction on distributors' handling of parallel imports goods; (3) restriction on wholesalers of selling the product covered by the contract to retailers handling parallel import goods; (4) interference with marketing of parallel import goods by alleging them as counterfeit except a direct supplier to an exclusive distributor, (5) obstructing transaction of

³⁸⁴ JFTC Guideline, chapter 3.1.1.

³⁸⁵ Ibid., Chapter 3.1.2.

parallel import goods; (6) refusal to conduct repairs or the like on parallel import goods; or (7) obstruction of advertising activities for parallel import goods.³⁸⁶

B. Principle of exhaustion of rights under Japanese trademark law

In the context of trademark rights, the United States, the European Union and Japan follow different regime of exhaustion. The European Union follows the principle of regional exhaustion. The U.S. applies the principle of international exhaustion. Japan, has no explicitly provision on exhaustion of trademark rights, but from the case law, follows the principle of international exhaustion. In its jurisdiction, Japan is driven by the trademark function doctrine, which determines the shape of its general exhaustion rule.³⁸⁷ In the *BBS* case (1995)³⁸⁸, the court ruled that international exhaustion applies in the field of trademarks, unless, through licences, is otherwise agreed.

Japan had already applied the concept of international exhaustion in the *Parker* case. The Osaka District Court recognized that the parallel importation of genuine Parker pens into Japan was lawful. The court held that, “although parallel imports may constitute a literal infringement of the trademark law, parallel imports do not affect the function of a trademark under Japanese law, namely, to guarantee the source and quality of the goods, they do not harm the business reputation of the trademark owner and they do not generally mislead consumers.”³⁸⁹

³⁸⁶ Ibid., Chapter 3.2.

³⁸⁷ Fhima, “The Functions of Trade Marks and Their Role in Infringement Cases - What Can the EU and Japan Learn from Each Others’ Experiences.” 5.

³⁸⁸ *BBS Kraftverzeug Technik AG - v - Racimax Japan KK& Jap Auto Products KK* (Heisei (1995) (o) N°.1988 (July 1, 1995).

³⁸⁹ *Parker* case, Osaka District Court, decision of February 27, 1971, 2-1 Mutaishu 71.

The Japanese Supreme Court provided a reasoned approach in supporting an international exhaustion interpretation.³⁹⁰ The Supreme Court stated that:

- (1) Protection of inventions and public interest must be balanced;
- (2) Sale of goods is based on the premise that the purchaser of goods acquires everything the seller has in the goods, and free movement of goods will be hampered if the patent owner's license is required every time the patented products are resold; and
- (3) The patent owner is compensated for the public disclosure of his invention when he first sells the patented products and he should not be allowed to make a double profit from the patented products once they are sold by him.³⁹¹

C. Concerned issues in parallel imports of trademarked goods

Parallel importation of goods has the same characteristic no matter where it takes place. Japan also has to face with the similar problems as the U.S., the EU in resolving parallel import cases, such as genuine, repackaging, and quality control. Nonetheless, the approach of the Japanese courts is slightly different in which a three-part-test³⁹¹ applied in order to determine when parallel imports are legal or not. In general, this test has some similarities with the provisions in the law of the U.S or the EU concerning parallel imports of trademarked products. However, this three-part test in Japan still has some points are unclear and need to be considered carefully.

³⁹⁰ Brendan Cheong, "Doctrine of Exhaustion as Applied to Patent Rights,"

<http://www.harakenzo.com/en/column/article/20050812.html>, last visited on November 20, 2010

³⁹¹ Jap Auto Products, K. K. and Another v. BBS Kraftfahrzeug Technik AG, No. 3272 of 1994, March 23, 1995.

1. The three-part test

The three-part test was developed by the lower courts in order to help the judicial system in determining whether certain parallel import cases are legitimate. This test had been authorized by the Supreme Court after the *Fred Perry* case. Under the three-part test the court decision added additional duties of care on parallel importers.³⁹² In other words, the onus of proving the imported products are genuine or counterfeit is on the shoulder of the importers. Consequently, this test helps to limit the amount of parallel importation goods.³⁹³ When considering these conditions, the Supreme Court of Japan sought to direct activities of the parallel imports of trademarked products into Japan in a proper way in order to balance the interests of related parties. The trademark owner or authorized distributor cannot rely on their exclusive rights to dominant or partition the domestic market.

a. Legality of the Licensed Trademark

If the trademark licensing agreement is valid, then the imported products that are manufactured under the license are also considered to have the same source of origin to those of owner. In the *Fred Perry* case, the licensee breached the trademark licensing agreement by violating the two points: (1) they subcontract to a third party; and (2) manufacture the product outside the agreement territory without the consent of the licensor. In order to avoid these situations the imported products have to bear a trademark which:

... is legally licensed by either a person holding the trademark right in a country other than Japan or by a person who is licensed to use the trademark by the trademark owner...³⁹⁴

³⁹² Jinzo, "Parallel Import into Japan Carry a Duty of Care."

³⁹³ Ibid.

³⁹⁴ Supreme Court, Feb. 27 2003.

The requirement concerning the legality of trademark licensing agreement is important for trademark licensing practitioners because it directly affects a determination of whether a Japanese trademark owner can stop a product manufactured under the subcontract outside of the license agreement. When this requirement is not satisfied, the examination on trademark functions such as source of origin or quality function is not necessary.

b. Identity of source

Identifying of source of imported products is determining the relationship between domestic trademark owners and oversea manufacturers. This could be a legally identical relationship which can be understood that between them exist the relationship like parent and subsidiary; or between them exist the relationship in which one of them is the agency of the other. Beside that, the relationship also could be an economical identical relationship in which that one of them is a part of the other. In the *Fred Perry* case, the meaning of identity of source of parallel importation trademarked products is stated as follows:

...the source of the trademark represents the same source of the registered trademark in Japan because the trademark owner in a country other than Japan is the same party as the trademark owner in Japan, or they have a relationship under which they are legally or economically regarded as the same party...³⁹⁵

In this condition, there are some similarities between this rule in the decision of the Japanese Supreme Court and the U.S regulation on “affiliate exception.” When the Supreme Court of Japan regulated “same person” or “be in a relationship where they can be viewed as legally or economically the same person”. It could be same person when between the oversea manufacturer and the Japan trademark owner have parents-subsidiary relationship or between them existing a trademark licensing

³⁹⁵ Ibid.

agreement, they belong to the same affiliated group.³⁹⁶ The main purpose of this condition is to assure the source of origin of the products. The courts can use this condition to determine whether the goods are genuine or not. If the imported products are manufactured by a party neither has economical nor legal relationship with the trademark owner in Japan, then these products are not from the same source with the genuine ones. This condition also is used to identify if the imported products bearing the same quality with the products were made for the Japan market. The identity of source is important for consumers when they are aware of what they want to buy and from whom it is manufactured and in which extent it meet consumers expectation about the product. Also, the identity of the source is important to trademark owners when base on that consumers could distinguish which products are made by a specific trademark owner and which are not.

The *Converse* case (2010)³⁹⁷ was one of the most recent cases that the Intellectual Property High Court dealt with concerning parallel imports. In this case, the Converse Company assigned the trademark rights in Japan to *Itochu*, a Japanese company (plaintiff). Converse entered into a marketing agreement with the plaintiff. The IP High Court grounded on the conditions that the Supreme Court ruled on the Fred Perry case to solve the problem in this case. The requirement on identity of source was not met as there was no economic link between Converse and the plaintiff. The court concluded that the products that Converse Company imported with the logo Converse constituted a trademark infringement.

...where products are sold or distributed using a similar or the same trademark as a registered trademark in Japan, parallel imports of the products formally constitutes infringement of the trademark rights in Japan. However, where the entity that affixed the trademark to the products in the foreign country is the same as the owner of the trademark in Japan or can be

³⁹⁶ Ono, Overview of Japanese Trademark Law, chap. 7.

³⁹⁷ Converse case, IP High Court; April 27, 2010.

considered to be the same on the account that they have legal or economic ties, the parallel imports do not constitute infringement of trademark rights.³⁹⁸

In this case, the requirement on identity of source concerns the identity of foreign and Japan trademark ownership. However, this requirement cannot satisfy when there is no such a legally or economical identical relationship existing between plaintiff and Converse. Particularly, there is no relationship as a parent and subsidiary, and they are not related by an agency relationship, therefore, they cannot be considered as legally identical.

c. Substantially same quality

One of the problems concerning the quality of the products is how to make sure that the products are the same quality while they were produced in different territories. If products bearing the same trademark then they suppose to be produced under the control of single undertaking which is accountable for their quality. In fact, different countries have different conditions on economic, labor cost, material or ingredients cost, taste of public and consumers. . It is common when products bearing the same trademark but designed for different market were manufactured in materially or physically different way. However, the condition on substantially same quality requires the products for Japanese domestic market and those manufactured oversea by a licensee have substantially same quality. In order to obtain the same quality it requires:

...the holder of trademark rights in Japan is able to directly or indirectly control the quality of the goods so that the imported goods are considered to have no substantive difference in quality to the registered trademarked goods in Japan.³⁹⁹

³⁹⁸ Ibid.

³⁹⁹ Supreme Court, Feb.27, 2003.

The requirement according to the quality of the imported goods is not different from the authorized goods. If there are no substantial differences in quality between the authentic products and imported products, then the products in question can be regarded as genuine goods. According to the JTA, the importation of genuine products is not deemed as an infringement because such imports do not cause any harm under the trademark function doctrine, namely the source identification and quality guarantee function.

However, in the *Fred Perry* case, there were different ways of understanding the requirement on quality of the parallel imported products. On the one hand, the Tokyo District Court and the Tokyo High Court found that a breach of the licensing agreement did not make the parallel imports of trademarked goods counterfeit.⁴⁰⁰ On the other hand, the Osaka District Court and the Osaka High Court found that there was an infringement.⁴⁰¹ The Supreme Court of Japan, however, agreed with the Osaka Court when it found the trademark infringement in this case stating:

... the source function of the trademark is harmed by the importation of the disputed goods... restrictions in the licensing agreement that relate to the country of origin and issues of subcontracting are also of great importance for controlling the quality of the goods and ensuring the quality function by the holder of the trademark. The disputed goods, having been manufactured and marked in break of such restrictions, may harm the quality function of the trademark, since they could be out of the trademark owner's quality control and thus be different in the quality as would be guaranteed by the latter for all goods to which the registered trademark is attached and that are put onto the market by the defendant.⁴⁰²

⁴⁰⁰ Christopher Heath, *Converse II*, IIC Vol.42, 244.

⁴⁰¹ *Ibid.*, 244

⁴⁰² Supreme Court, 27 February 2003, 35 ICC 216 (2004)-Fred Perry III.

The Intellectual Property High Court had confirmed the requirement of quality of trademarked products in the *Converse* case. In this case, there was a marketing agreement between the Converse Company and the plaintiff. However, the products manufactured by the Converse Company and those of the plaintiff were not governed by the same quality control policy although the agreement included the obligation of cooperation in regards to the promotion of sales. The plaintiff in this case was not able to control the quality of the products that manufactured by the Converse Company. Because controlling was not able to conduct then the quality of the plaintiff products is differ from the imported shoes of the Converse Company. as a result of that, the importation of those products was considered as constituted as infringement of trademark rights of the plaintiff.⁴⁰³

Nonetheless, the issue on the quality of the parallel imported products will not come to a conclusion because the Supreme Court's explanations remain unclear. Therefore, many debates are continuing on in this issue. In the *Fred Perry* case, imported products were made in China, in addition, they were made out of the consent of trademark owner. When products are made without the consent of trademark owner, then trademark owner can base on that to stop the parallel imports. A lack of consent means that trademark owners in fact cannot exercise their ability to supervise during manufacturing of the products in order to ensure that the products pass the quality standards. In other words, if products were manufactured out of the supervision of trademark owners, the quality of the products may not be guaranteed, and the owners can claim to revoke the imported products.⁴⁰⁴

According to the Supreme Court in the *Fred Perry* case, consent is the possibility of supervision.⁴⁰⁵ When a trademarked product has already been placed on the market lawfully it means that that product is put into the market by or with consent of the trademark owner. The EU's provisions provided in Article 7.1 of the Trademark Directive that if the products are placed on the

⁴⁰³ Christopher Heath, *Converse II*, IIC Vol.42, 244.

⁴⁰⁴ *Ibid.*,245-246.

⁴⁰⁵ *Ibid.*, 246.

market without the consent of trademark proprietors then the further distribution of trademarked products is considered as trademark infringement. Meanwhile, both of the national legislations of the U.S and Japan do not mention directly on the issue of trademark owners' consent.

Trademark owners in order to satisfy market requirements usually design different lines of products to suitable with consumers demand and to satisfy market requirements. For instance, a Japanese trademark owner can have his or her products made and marketed in a developing country and these products contain different quality than those for sold in domestic market. In this case, there would some material differences in products because trademark owner wants his products fit with the needs of consumers in that developing market. As a result, products manufactured overseas and those domestically produced can have different quality even though they bear the same trademark..When a trademark owner is totally aware of the inferior products but still chooses to import or produce them then he or she cannot base on the difference in quality of the products to prevent the parallel importation. He or she cannot claim the importation of inferior trademarked products undermine the function of origin. He or she cannot oppose or prevent other individuals from doing the same. In such cases, the quality of the imported products is not the main element to identify whether or not trademarked products are genuine ones. The requirement of substantially same quality therefore seems still controversial .

2. Genuine products

The genuineness of imported products had previously queried by trademark owners or their sole distribution as a legal reason to stop of parallel importation. If the parallel importation of the products does not contravene any of the trademark's functions and does not impede the goodwill of the owner and does not cause any likelihood of confusion for consumers then parallel importation is not unlawful. There are many ways of understanding the genuineness of trademarked products in parallel imports cases such as follows:

...genuine (or original) goods illegally distributed by a contractor of the trademark right owner or the owner of the right of exclusive use. If the quality of the illegally distributed goods is identical to the original goods, it makes no difference.⁴⁰⁶

The genuine status of imported products is the most significant element in a parallel imports case. If the imported products were counterfeit or non-genuine then the importation of these products is regarded as constituting trademark infringement in Japan. When foreign made products imported into Japan are genuine then the trademark rights have already been exhausted, and the trademark owner cannot control the further distribution of the products as Japan applies the principle of international exhaustion of trademark rights. Since the 1970 decision in the *Parker* case in Japan, parallel imports of genuine trademark goods have been considered free from trademark infringement.⁴⁰⁷

Under the JTA, there is no provision on parallel imports as well as no definition as to what is a genuine product. However, after the *Fred Perry* decision, Japanese courts have based on the trademark function doctrine in order to determine whether imported goods were genuine by the three-part test. When this test is met, imported products are considered as genuine products.

3. Repackaging and relabeling

Where the imported goods have different qualities to those which are sold in the home market, the quality guarantee function of the trademark would suggest that there should be no exhaustion applied for those imported products. Compared to the U.S. and the EU, Japan has less cases dealing with problem of repackaging. Nonetheless, such cases in Japan suggest that repackaging of the imported products without the consent of the trademark owner may not prevent the rights on these

⁴⁰⁶ Ono, Overview of Japanese Trademark Law, chap. 7.

⁴⁰⁷ Jinzo, "Parallel Import into Japan Carry a Duty of Care."

products from being exhausted. When the trademarked products are non-exhausted the trademark owner can prevent such importation.

In Japan, trademark infringement occurs when the repackaging leads to a change in the condition of the goods because it means that such a change is a breach of the quality guarantee function of that trademark. However, even if the repackaging does not change the quality of the goods, then it also considered that the act of repackaging constitutes trademark infringement.⁴⁰⁸ The scope of protection with regard to repackaging of trademarked products extends beyond the trademark functions. Thus, with regard to repackaging, Japanese protection appears to go further than what is needed to protect the trademark functions.⁴⁰⁹ The Osaka District Court solved the first case concerning the repackaging in Japan.⁴¹⁰ The subject of the repackaged products was the U.S. produced garden fertilizer.⁴¹¹

In this case the trademark owner had put in the mentioned fertilizers to market circulation and distribution. Thereafter this fertilizer was divided into smaller units which were different than the original format of products. Also these products were attached the trademark that identical or similar to the registered trademark without the consent of the trademark owner. After all, the small units with the trademark were put into further commercialization. The splitting into smaller units of the imported product and marketing them had the negative affects to the exclusive right of use of the trademark owner, therefore damaged the trademark owner's interests by impeding faith in the quality of goods.⁴¹²

First, the Osaka District Court relied on the right of exclusive use of a trademark owner to explain the exclusive right of use over a registered trademark. From the exclusive rights the trademark

⁴⁰⁸ Tokyo District Court, 26 March 2002, 16 Law and Technology 95- "Viagra".

⁴⁰⁹ Fhima, "The Functions of Trade Marks and Their Role in Infringement Cases - What Can the EU and Japan Learn from Each Others' Experiences," 8.

⁴¹⁰ Osaka District Court, 24 February 1994, 1522 Hanrei Jihô 139- "Mag Amp".

⁴¹¹ Heath, "Exhaustion and Parallel Imports in Japan," 65.

⁴¹² Osaka District Court, 24 February 1994, 1522 Hanrei Jihô 139- "Mag Amp".

owner has the right to prohibit any third party from using indication similar to his registered trademark. These rights are granted to the owner and protected by the trademark law. The trademark performs the function as an indicator of origin or guarantee, and the quality of the product in some extent allow consumers distinguish that trademarked products from those of produced by others.

Second, if a third party uses a registered mark, then could damage the goodwill of the trademark owner. Therefore, the registration procedure of a trademark becomes meaningless. Trademark law, as a result will no longer be a legal tool that owners want to reference to in order to protect their goodwill. With respect to a registered trademark, an owner can exercise their rights in the sense of using their rights and preventing others from selling products The use of a trademark by any third party which is relied on as an infringement must be a use upon trademarked products which are not genuine products. Nonetheless, the owner of a registered trademark cannot exercise their rights to control the further exploitation or distribution of their products after products are legally marketed on the background that their goodwill is likely damaged unless they have evidences.

In cases where parallel imported goods bearing a registered trademark are repackaged in smaller packages with smaller quantities, the Japanese courts have ruled that such imports were an infringement, without considering whether or not the goods were genuine. This conclusion was once again confirmed by the Tokyo District Court in the *Viagra* case (2002).⁴¹³

In the *Viagra* case, the defendant purchased and imported the Viagra drugs into Japan for resell. The importer repackaged the drugs into smaller quantities for selling to individual consumers based on their buying orders. The Tokyo District Court held that the import and marketing of repackaged Viagra that was manufactured by Pfizer and subsequently repackaged into smaller quantities could not be recognized as a parallel import of genuine goods because the repackaging was conducted without the trademark owners consent. Therefore, the use of the trademark Viagra with

⁴¹³ Tokyo District Court, 26 March 2002, 16 Law and Technology 95- “Viagra”.

respect to repackaging of this imported drug constituted an infringement of the trademark right.⁴¹⁴

Regarding parallel imports of pharmaceutical products, even if the importer could prove that the three requirements of Fred Perry case are satisfied, he or she still has not yet been allowed to market the products in the market. Under the Pharmaceutical Affairs Law, a license for marketing must be obtained in order to import drugs commercially for the purpose of marketing the products. Any importation without the license would be considered as a violation of the law, and this also applies for import agencies on the Internet.

Although parallel importers may not alter or modify the trademarked imported goods, issues concerning the genuine nature of trademarked goods also arise in the context of genuine goods that are repackaged, relabeled or rebranded especially in the pharmaceutical area.⁴¹⁵ The points worth mentioning from case law on repackaging issues in Japan compare with provision and case law on repackaging issue in the U.S. and the EU. Originating from the different ways of approach from these jurisprudences, the treatments of repackaging of Japan, the U.S, and the EU are slightly different.

According to the U.S law the parallel importers have to strictly follow the requirements on repackaging in order to be allowed by the U.S Customs Service. The domestic trademark owners in the U.S could use the “material differences” to oppose the parallel imports. With respect to the issue of repackaging in the EU, the parallel importers have to satisfy the conditions according to Article 7.2. of the Trademark Directive and established in the *Bristol-Myers Squibb v. Paranova* case. When repackaging requirements are not performed properly, the trademark owner could prevent the further

⁴¹⁴ Hays, Parallel Importation Under European Union Law, 65.

⁴¹⁵ Dennis S. Pahl, Exhausted And Gray, But Still Going Strong: A Comparative View Of Parallel Imports From The Trademark Perspective, Intellectual Property Owners Association 2001 Annual Meeting November 4-6, 2001, New York, 10

commercialization of the imported products. Meanwhile, the courts of Japan have applied the trademark function doctrine in ruling the case concern with repackaging issue.

4. Quality control

The issue of quality control is one of the most important problems related to parallel import of genuine products. In order to obtain a permission of parallel importation, both imported and domestic goods sold in Japan are required to be identical in quality.⁴¹⁶ Consumers expect to purchase the same quality product with respect to parallel imported goods, and their expectation cannot be met when there is a difference in quality between the genuine products and imported products.

The difference in quality is common when products were designed for selling in different markets. Whether or not the quality difference is negligible depends on consumer preferences. When there is a difference in the quality of products between parallel imported products and domestic products then the importation would not be permitted. In order to prove that products bearing the same trademark have identical quality, the obligation of parallel importer is to prove that these products are manufactured under the directly or indirectly control on quality of the trademark owners.

The specific imported goods in the *Fred Perry* case were produced by a contractor of a foreign trademark licensee outside of the territorial restriction of the trademark licensing agreement first negotiated by the parties. At this point, quality control has become important for determining the legality of the products that were manufactured outside of the territorial restriction of the agreement. The quality control requirement is not applied to trademarked products that are manufactured by a licensee or contractor of a foreign trademark licensee outside of the territorial restriction of the agreement. In such a situation, whether or not the trademark owner can stop the parallel imports of goods that are produced the out of scope of agreement is a question that must be answered. The

⁴¹⁶ Ono, Overview of Japanese Trademark Law, chap. 7.

quality control of the trademark owner is the key solution to answer for this question. The control on quality of products is necessary in protecting the consumer benefit from not buying inferior or low quality products. Moreover, the goodwill of the trademark owner is protected when the products bearing the same trademark have the same quality.

By applying the trademark function doctrine from the *Parker* case, and the three-part-test, the Supreme Court concluded that goods manufactured in breach of the license agreement lacked in qualification to meet requirements as genuine goods. Therefore, the Japanese trademark owner could stop the importation of licensed products that were manufactured out of the scope of the license agreement because these products were produced out of the control of the owner. The importation constitutes a trademark infringement according to Japan trademark law when a product manufactured without the quality control of the trademark owner so that the product cannot be regarded as genuine.

5. Contractual restriction

When there is an agreement between the related parties, the terms of the contract must be respected and abided by in order to assure the legal status of the products that manufactured under that agreement. In the *Fred Perry* case, the court made it clear that imported goods would not be considered genuine goods unless they were subject to the terms and conditions of the license agreement. The court clarified the legality of parallel imports is assured only when the imported goods are genuine goods manufactured by the trademark owner or its licensee to the extent that they meet lawful requirements.

One of the ways that trademark owners use to make sure that their products have the same quality is to clarify some limitations or restrictions in the agreements. Limitations of manufacturing territories and outsourcing arrangements under the license agreement are very significant for the trademark owner to make sure that the quality of the licensed products fulfills the quality guarantee

function of the trademark. When the imported goods are manufactured in violation of the limitations that the parties have negotiated, then the trademark owner can counteract the importation of such products.

The territorial restriction in the *Fred Perry* case is a good illustration of the impacts of contractual restriction to the genuine status of parallel imports products. In this case, between the licensee and licensor there was a trademark license agreement in which the licensee can manufacture, sell, distribute contracted products and use the trademarks for the goods within the contracted territories. Besides, the licensee agreed not to enter into any arrangement with any third party without the prior written consent trademark owner. However, contractual restriction was violated when the licensee subcontracted to a contractor to manufacture the licensed trademarked product out of the agreement territory without the consent of the trademark owner. The Supreme Court held that imports of products, which are manufactured under an unauthorized sublicense overseas, could not be recognized as parallel imports of genuine products because the products were manufactured beyond the scope of a license stipulated by the licensing provisions to which the trademark was applied.⁴¹⁷ Thus, the trademark owner cannot perform control or maintain quality of the products, and therefore, the imported goods cannot be considered as genuine. Any further circulation of these products in the market is unlawful because they are made without the consent of the trademark owner. Such an import would harm the function for indicating the source of the trademark.⁴¹⁸

When the products exceed the quantity restriction the trademark licensor is entitled to prevent the importation of the licensed trademark products on the grounds that the exceeding products were manufactured beyond the scope of the trademark licensing agreement. Therefore these products cannot be recognized as genuine products because the trademark licensor cannot control the quality of the products. The importation of the non-genuine products will be regarded as trademark infringement. The difference in the amount does not matter in this situation.

⁴¹⁷ Supreme Court, Feb. 27, 2003.

⁴¹⁸ Ganea, Exhaustion of IP Rights.

Another point worth mentioning in the contractual restriction issue is that even concerned parties can freely negotiate the content of the agreement as well as establish contractual restrictions. However, if the restrictions impair free trade, then the validity of these restrictions cannot be considered as legal. The JFTC Guidelines prevents contractual provisions that serve to inhibit parallel imports.⁴¹⁹

D. Summary

In contrast to the US and the EU, Japan does not provide any clear rules in its law on exhaustion of rights or parallel imports of trademarked products. Therefore the role of the courts is more important. The approach of the Japanese courts in dealing with parallel importation issue has many similarities with the jurisprudence in the U.S., namely on affiliated exception or quality control.

The Japanese courts attempt to protect the domestic trademark owners by focusing on the quality of the genuine products behind the application of the three-part-test. On this issue, there is a similar point between the U.S law on material or physical difference and the Japanese rule on the quality of the imported products. Since there is no clear rule provided on parallel imports, the court of Japan has more room in dealing with cases regarding parallel importation of trademarked goods.

IV. Conclusion

⁴¹⁹ JFTC Guidelines concerning distribution systems and business practices, chapter 3.2.

By analyzing the laws and practices on parallel importation of the U.S, the EU and Japan, there are similarities and different points of each national legislature. First of all, both the U.S and Japan have the regulations on “affiliate exception.” Accordingly, if there is economic or legal relationship between the foreign manufacturer and the domestic trademark owner then they are regarded as having an affiliated relationship. In such a situation, the importation of foreign manufactured products bearing an identical mark with products made in the domestic market is accepted because the imported products are made under the common control of the owner. Common control therefore is an important point in determining the legality of the parallel imported products. When the imported products are produced under the common control, then the quality of the products is assured and causes no confusion to consumers.

Second, both the U.S and Japan have requirements for the quality of the parallel importation of trademarked products. However, the approaches of these two nations are different, as results there are some different issues between them. The U.S courts use the material difference test to identify whether the overseas made products are qualified to import or not. The vagueness of this test shows when differences in post-sale service may be considered as material difference and hence a justified reason to block parallel imports.⁴²⁰ The U.S brand owners seem overuse the material difference test when employ so often in their fighting with gray market products.⁴²¹ On the one hand, regulation on “physical or material differences” ensures that the products are made by one source, no matter where the products are manufactured, as there is no substantial difference between imported products or authentic products because they are both genuine products. As a result, the goodwill of the trademark owner as well as the interest of consumers is protected when the trademark source of origin function and quality guarantee function are satisfied. On the other hand, the “material difference test” could be an extravagant rule that creates unreasonable barriers for free trade. The reasons that consumers could

⁴²⁰ SKF USA Inc., Appellant, v. International Trade Commission, United States Court of Appeals, Federal Circuit. - 423 F.3d 1307.

⁴²¹ See Chapter 4.

confuse from the material difference of imported goods sometimes are not convinced because of the subjectively grounds that trademark owners using.

On the issue of quality of trademarked products, Japan does not have material difference test like the U.S. Therefore, the issue of quality of trademarked products is still vague in Japan. As this point, the requirement of parallel importation of trademarked products in the *Fred Perry* case has a similar purpose compared to the provision of “physical or material differences test” in the U.S law. The purpose of the quality requirement is to serve the quality function of trademark when require that the imported products were manufactured under the control in quality of the trademark owner.

The biggest difference between the U.S and Japan in solving case with regard to issue of quality of products is that the U.S Courts base on material difference test, meanwhile Japanese courts base on the fundamental trademark’s functions. These approaches, however, have their own pros and cons. The U.S material difference test, for instance, seems too vague and wide in scope of applying of which create barriers for parallel importation. However, when considering quality control as a measure to assure the standards of the imported product then the scope of this requirement is narrower than “material difference test” applied in the U.S Courts because such control is considered as one of the measures to determine the material difference in order to protect the domestic trademark owner.⁴²²

In order to import trademarked products into the U.S market when the products do not meet the “material difference test,” parallel importers can use the Lever-rule exclusion whereby clearly state the difference between the domestic products and parallel importation products. Consumers can make their final decision based on the available information on the label of trademarked products. Japan and the European Union have no such regulations.

The courts of the U.S and Japan mainly focus on protecting consumers from being mislead when buying parallel imported products especially when there is different quality between genuine

⁴²² See chapter 4.

products and parallel imported products. The ECJ determines the legality of the imported products by considering if the trademarked products are launched into EEA market by or with the consent by the trademark owners. Therefore, consent of the trademark proprietors is a significant element that the courts examine when dealing with parallel imports cases. With respect to the parallel importation of trademarked products, unless there is a consent or conduct unequivocally indicating such consent, then no trademarked products can be imported into the EEA market without the trademark proprietor's consent.⁴²³ The theory of implied consent therefore is a different point between the EU, the U.S. and Japan.

Regarding the issue of repackaging of parallel importation of trademarked products there is a similarity between the U.S. and Japan in that two national courts base on the ground of protecting the goodwill of the trademark owners as well as preventing consumers from being confused. The ECJ, on the other hand, prevents the trademark owners from artificial partitioning the Community market by exercising trademark rights against parallel importers and when the repackaging would affect the original condition of the trademarked products. The parallel importers can prove the necessity of repackaging of the trademarked products, especially when the trademark owner could restrain the further circulation of trademarked products which have been repackaged whereby hindering the free trade between member countries. Also, parallel importers have to prove that the repackaging could not directly or indirectly affect to the original conditions of trademarked products.

The European Union applies regional exhaustion of trademark rights that originally started through decisional law on the free movement of products theory which prevents trademark owner from further distribution of genuine goods which would distort trade among the Member States. Under this exhaustion regime it will be limited to trademarked products which are first placed within the Community market with or by the consent of the owner. Consequently, the trademark rights under the regional exhaustion regime are not considered to be exhausted, with regard to products that are firstly

⁴²³ Jacob Robin, "One size fits all?," in *Intellectual Property Rights*, ed. David Vaver, 1st ed. (Routledge, 2006), 64-65.

launched outside the Community market and then imported back into the Community market. As a result, it is important to identify the first place where trademarked products are first market, when determining the legitimate of the parallel imported products in the European Union. When trademarked products are first put into the Community market with or by consent of trademark owner, then trademark rights are exhausted, and the owner cannot prevent the further distribution of these products. With regards to trademark rights both the U.S and Japan apply the international exhaustion regime, regardless the exceptions that they established in solving parallel importation of trademarked products.⁴²⁴ Consequently, the situations of which trademark rights are exhausted and scenarios of the further exploitation of those trademark products are not the same in those territories.

From analyzing the provisions and case laws of these three territories, there are many points that developing countries can learn from in order to apply for their countries. The first point is the principle of international exhaustion of trademark rights. For the importance of the global free trade to the development, developing countries should consider the pros and cons of international exhaustion regime. Second, developing countries should allow parallel imports of trademarked products to solve their domestic demand. However, it is necessary for developing countries to consider advantages and disadvantages of parallel imports. Chapter 5 of this dissertation will further analyze the situation of developing countries and also propose some recommendations.

⁴²⁴ Hays, *Parallel Importation Under European Union Law*, 11.

CHAPTER 5

PARALLEL IMPORTATION AND DEVELOPING COUNTRIES

I. Introduction

The development of world trade lately has had significant impact on developing countries. Compared with developed countries, developing countries have faced with many challenges because of obstacles in economic and legal systems. With the lack in sufficient infrastructure, developing countries have to deal with many issues including social health care and welfare. Furthermore, developing nations are incapable of supplying the domestic demand. Such countries have to depend on imports in various kinds of products, including pharmaceutical products. Importation is a very important channel for developing countries to meet domestic demand. In relation to importation, legal systems of developing countries are far from comprehensive, and they many challenges in theory as well as in practice. As a matter of fact, parallel importation of trademarked products is one of those challenges. To a certain extent, allowing parallel importation is a good choice for many developing countries in dealing with the shortage of their capacity of supplying. Besides the advantages of allowing parallel imports, there are also disadvantages that parallel imports can bring to the importing country. Because of the significant of parallel imports, to what extent a country should allow parallel imports is an issue that developing countries must resolve.

Regarding parallel imports there are different policies applied by different countries depending on each stage of development. Developed countries and regions such as the U.S., the EU and Japan are generally not open to parallel imports. In contrast, for policy makers of developing countries, the most important factor is that the openness to parallel imports creates more opportunities

for consumers to sustain the lowest-priced goods.⁴²⁵ At the same time, many developing countries allow parallel imports because of social need. Securing access to necessary medicines is one example of such social needs which impel developing countries to permit parallel imports. In fact, parallel importation has been one of the main issues at the World Trade Organization in the context of the relationship between public health and trade.⁴²⁶

The issue of parallel imports presents a particularly significant policy challenge for developing countries,⁴²⁷ as it also creates opportunities to import new technological knowledge and equipment. Once the issue of technological aspect is solved, domestic enterprises in developing countries are capable of producing more technologically advanced goods for domestic markets. Developing countries will become more competitive in the market of advanced products.

In fact, large industrial manufacturers usually sell their products in developed and developing markets at differentiated prices. Many products are sold at different prices in various markets for many reasons due to the ingredients, the labor costs, transportation methods, the taxation regime or rate of exchange. In order to gain a benefit from the price differential parallel importers buy the products from low priced markets and sale in the higher priced market. Parallel importation, therefore, creates a flow of products between differently-priced markets. With respect to developing countries, designing national trademark law and parallel imports regime which can most effectively benefit for them in harmony with the framework of international agreements as well as the situation of the world trade is a significant task. From the developing countries' viewpoint, parallel imports of trademarked products are considered as a significant tool to expand their markets. The goods on the markets are more abundant with many suppliers, and the prices of the products become cheaper. In addition to economic effects, parallel imports may contribute to social policies. One good example is the case where parallel

⁴²⁵ Yongmin Chen and Keith E Maskus, "Vertical Price Control and Parallel Imports: Theory and Evidence," *Review of International Economics* 12, no. 4: 1-18.

⁴²⁶ *Ibid.*

⁴²⁷ Kerrin, "Economic Considerations of Parallel Imports," 10.

imports enable access to affordable pharmaceutical products for a large number of consumers because of the cheaper price of such products.

From the fact that many brand products are produced under a license in developing countries the overrun products could occur and gray market products would be circulated in developing countries' markets.⁴²⁸ The problem for developing countries is how they should deal with an overrun issue. Developing economies should use lesson from the legal experience of the developed countries when making their law or regulation on parallel imports.

This chapter first analyzes the economic situation that developing countries presently face, and how national parallel imports regimes are designed to benefit developing countries within the context of international agreements. From the fact that in general the legislation of the developing countries is unperfected then there are some issues have not touched by the current provisions. Furthermore, the obstacles that developing countries deal with have negative effects on their development, for example, the incapacity in making laws and applying these regulations into practice. Second, the recent trends of parallel importation in the developing countries, the Doha Declaration on protection of public health and the free trade agreements, which contain issues on parallel imports, will be introduced and construed.

Part III of this chapter discusses the advantages and disadvantages of permitting parallel importation. Part three analyzes the advantages as well as disadvantages points that developing countries are cope with when allowing parallel importation of trademarked products. Part IV provides proposals on the proper treatment of parallel imports in developing countries. First, developing countries should apply the relevant exhaustion regime on trademark rights so that free trade can easily have an effective impact on the economic as well as social spheres. Second, developing countries should legalize parallel imports as a valid channel of importation of trademarked products. Third, together with allowing parallel importation, developing countries should focus on the regulations of

⁴²⁸ NERA report.

related issues of parallel imports (i.e. quality control, repackaging, relabeling) in order to develop an effective policy in their development process.

The last part of this chapter examines the current situation in Vietnam on parallel imports of trademarked goods as a case study. The second point of this part considers which scenario the law and policy makers of Vietnam should adopt in order to build better regulations on parallel imports in particular and intellectual property in general. The deficiency of the current provisions on parallel imports also will be analyzed. The last point of this part provides recommendations for Vietnam in respect of its law and other relevant measures.

A. Economic situations of the developing countries

1. Dependent on import in goods

In general, developing countries are incapable of manufacturing industrial goods sufficiently for domestic demand, and therefore they are dependent on import in goods. Vietnam, for instance, the trade deficit is \$1.7billion in May 2011,⁴²⁹ and much of the deficit was occurred in the industrial fields such as iron and steel, textile fabric, and gasoline.⁴³⁰ High inflation of the domestic economy is another element that makes developing countries dependent on importation of products. For example, Vietnam's annual inflation rate nears 13.9 percent.⁴³¹ Meanwhile the Vietnamese government is trying to control the inflation rate in 2011 to be below 15 percent.⁴³² When the inflation rate of a nation is high, consumers in that country become more cautious about the price of goods and try to purchase

⁴²⁹ Vu Trong Khanh, "Vietnam Trade Deficit Widens," *wsj.com*, May 25, 2011, sec. Asian Business News, http://online.wsj.com/article/SB10001424052702304520804576344794001587116.html?mod=googlenews_wsj.

⁴³⁰ "Nhập siêu tháng 5 ước đạt 1,7 tỉ USD, cao nhất 17 tháng" (Trade deficit in May 2011 approximately \$1,7 billion, reaches the highest level in 17 months) http://tintuc.vnn.vn/newsdetail/kinh_te/87810/nhap-sieu-thang-5-uoc-17-ty-usd-cao-nhat-17-thang.htm

⁴³¹ "Vietnam inflation rate hits 13.9%," <http://www.bbc.co.uk/news/business-12845809>.

⁴³² "Inflation rate must curb by 15 percent", <http://www.vneconomynews.com/2011/06/inflation-rate-must-curb-by-15-percent.html>.

cheaper products. Imported products that are made by mass-producing industrialized technology tend to be less expensive. In addition, in developing countries imported products from developed countries often appeal to consumers better than domestic products with a better taste or superior functions. Domestic manufacturers encounter a lot of problems in order to survive in domestic markets. For example, with respect to clothing products sold in Vietnam, domestic products are not only 30-50% more expensive than imports on average, but also considered to be less fashionable.⁴³³ The domestic industrialization of developing countries consequently cannot be achieved when importing products filter into their markets. As a matter of fact, not so many manufacturers in developing countries concentrate on producing for selling in domestic market. Instead, they are mainly exporting products that do not require high technological features.⁴³⁴

Furthermore, the R& D activities of domestic enterprises are ineffective because of the lack of technological, capital and human resources. In the meanwhile, developing countries allow foreign firms to drive out domestic competition by obtaining patent protection and to serve the market with imports, rather than domestic manufacture. Taking an example of pharmaceutical products, some developing countries such as India or Brazil are capable in producing generic medicines. But even these countries are incapable of develop new drugs.⁴³⁵ When domestic manufacturers cannot supply the needs of inner markets, importation must be an alternative method.

⁴³³ Hoàng Lan, Lạm phát khiến người Việt càng khó yêu hàng nội, (Vietnam's inflation makes domestic consumers say No to domestic products), accessed June 12, 2011, <http://vnexpress.net/gl/kinh-doanh/2011/06/lam-phat-khien-nguoi-viet-cang-kho-yeu-hang-noi/>.

⁴³⁴ World Trade Organization. Secretariat, Graduate Institute of International Studies (Geneva, and Switzerland), *From GATT to the WTO: The Multilateral Trading System in the New Millennium* (Kluwer Law International, 2000), 22.

⁴³⁵ Krithpaka Boonfueng, "Parallel Imports in Pharmaceuticals."

2. Lower price

When the economic conditions of nations are unequal, the income as well as living standard of people in different economies is also unequal. Generally speaking, prices of products (except for technology-intensive products) are lower in developing markets. This situation can be explained by the existence of many elements, such as cheaper labor costs, cheaper raw materials, and lower technical machines. Also, the quality standard of products sold in developing countries is not as high as products that are sold in developed markets. This result is also a reason that consumers prefer imported products over domestic products.

However, a paradox exists in developing countries in that the prices of certain products are higher than identical products that are available in developed markets. As stated above, many developing countries are incapable of supplying their domestic demand so that they rely on importing products from overseas, and consumers in these markets have to pay higher price for identical products. The higher price in developing markets is one of the conditions in which parallel importation occurs. Moreover, the distribution systems are also underdeveloped in developing countries which explains reason why prices of some drugs tend to be higher in other markets.⁴³⁶ However, where parallel importation is possible, consumers have a chance to buy imported products from overseas at cheaper price.

Such situation where identical products are sold at higher prices in developing countries than in developed countries is occurring in products that are strictly protected by intellectual property rights. As stated before, pharmaceutical products are examples. Another example is software, Microsoft Office sells some softwares at higher price in China than in the United States. This is caused by the intellectual property rights owner's decision to sell in smaller volumes to higher markups in developing markets.⁴³⁷ In developing countries where the protection on intellectual property rights is

⁴³⁶ Maskus, "Parallel imports in pharmaceuticals," 20.

⁴³⁷ *Ibid.*, 33-34.

weak, only foreign enterprises and government offices are willing to use the legitimate copies. Meanwhile, in the United States users may be segmented by underlying demand elasticity, therefore some special users such as students and academic users are offered discounts on the expectation that they will not re-sell or copy the software.⁴³⁸

3. Fewer domestic manufacturers

In developing countries, small and medium enterprises are popular and they struggle in order to survive in developing markets where the competition has become stronger. A lack of capital, together with the absence of technological advancement, makes domestic manufacturers many difficulties in manufacturing, distributing and selling of their products. Furthermore, domestic producers are challenged by large and multinational enterprises that primarily are financed on an international scale.⁴³⁹ When they manufacture the similar products with different scales, the possibilities to sell domestic-made products are generally lower than those made by multinational enterprises.

Some people argue that in order to encourage the development of domestic manufacturers, parallel importation should be regulated through intellectual property. However, such a suggestion does not seem to work, considering the strong dependence on imports in general, and the small share of parallel imports in the whole imports. Namely, if we compare the amount of products from ordinary and parallel importation, the quantity of the products of the former type is much larger. A ban on parallel importation would not create a large impact in such a situation. Furthermore, from the position

⁴³⁸ Ibid.

⁴³⁹ Swimming Against the Tide: How Developing Countries are Coping with the Global Crisis, Background Paper prepared by World Bank Staff for the G20 Finance Ministers and Central Bank Governors Meeting, Horsham, United Kingdom on March 13-14, 2009. 5, www.un.org/ga/president/63/PDFs/WorldBankreport.pdf.

of developing countries, allowing parallel importation can bring more positive effects than negative ones as we will see later.

B. Legal situations of the developing countries

In this section, we will see the characteristics of legal situations in developing countries which should be taken into account in the consideration of appropriate approach to parallel importation.

1. Weaker regulation for consumer protection

Many developed countries have strict regulations on the labeling of products before they are put in the market, and this applies to both to domestically manufactured products and imported products. Consumers have the right to know what is contained in the products. Information from labels allows consumers to decide what they want to have when purchasing a specific product. When a product is imported from an overseas market, consumers may not know what really is inside of the products that they buy because of the language differences. Many problems can occur from a lack of necessary information of imported products. For instance, consumer expectation cannot be met when buying an imported product which bears the trademark that is identical with the one attached to a product they had purchased before. More importantly, when imported products are foods, beverages or cosmetics, consumer health could be seriously affected when buying such imported products. In such a situation, importers are responsible for the lack of information in those imported products. In order to avoid these problems, many countries have strict requirements on imported products. For example, the requirements of importing food products into the United States are as follows:

Under provisions of the U.S. law contained in the U.S. Federal Food, Drug and Cosmetic Act (FD&C Act), importers of food products intended for introduction into U.S. commerce are

responsible for ensuring that the products are safe, sanitary, and labeled according to U.S. requirements. The Food and Drug Administration (FDA) is not authorized under the law to approve, certify, license or otherwise sanction individual food importers, products, labels or shipments.⁴⁴⁰

Furthermore, importing requirements are not the same to all products, depending on the kinds of products. Consequently importers have to follow importing requirements in order to place their products in the U.S. domestic market. When import conditions are not satisfied, the importation of these products will not be allowed in the U.S. market.

Similar with the requirements issued by the FDA of the U.S., the European Union also has importing conditions. For example, concerning the importation conditions of foodstuff, the European Commission works to ensure that Europe's food supply is the safest in the world and that the same standards of food safety apply to all products regardless of origin. As the world's largest importer of foodstuffs, the European Union works closely with international organizations and offers advice as well as assistance to third country trading partners.⁴⁴¹ Consequently, in order to be sold in the E.U. market, imported products have to meet specific requirements, depending on what is the imported product. When the labels of imported products are inappropriate, trademark owners can base on that reason to prevent the parallel importation of those products. This is one of the rights of owners that the trademark law of many countries recognizes as a way to protect consumers from being misled or confused, and to protect the goodwill of trademark owners.⁴⁴²

Regulations for consumer protection are not developed sufficiently in developing countries. Many imported products are sold without any proper information or information only in the original

⁴⁴⁰ Concerning the importation of food products into the U.S. market, see the FDA “Importing Food products into the United States,” accessed June 12, 2011, <http://www.fda.gov/Food/InternationalActivities/Imports/default.htm>.

⁴⁴¹ Food Safety, Import Condition, http://ec.europa.eu/food/international/trade/index_en.htm.

⁴⁴² See Chapter 4.

language which consumers cannot understand. In such a case, the consumers' legitimate interest is ignored, because they have to take all the risk when they buy imports. No one will take any responsibility in such a situation. In other words, consumers in developing countries are not protected as much as in developed countries. Developed countries have a well-developed legal mechanism and strong infrastructure which achieve consumer protection to a comparatively high level. On the other hand, with an imperfect legal system as well as weak infrastructure, developing countries are, on average, far behind developed countries in respect of consumer protection. In the context of protecting consumer health as well as the public interests, regulations on consumer protection in developing countries should focus on fundamental issues. Needless to say, trademark law or other intellectual property law will not solve the problems by themselves.

2. Less awareness or protection of intellectual property

Intellectual property laws in general represent newly adopted law in developing countries compared with developed countries. This difference can be explained due to several reasons. First, the value of intangible property had been respected and coded for centuries.⁴⁴³ The awareness of people in developed countries, which is a necessary condition to protect the intellectual property rights, is probably higher than that in developing countries. Second, the economic and social conditions are more favorable in developed countries than in developing countries for the protection of intellectual property. For instance, annual income per person in Vietnam is approximately \$1,148.⁴⁴⁴ That in Japan is approximately \$42,325.⁴⁴⁵ It is really rare for an ordinary person in Vietnam to buy a PC

⁴⁴³ Tim Phillips, *Knockoff: The Deadly Trade in Counterfeit Goods: The True Story of the World's Fastest Growing Crime Wave* (Kogan Page Publishers, 2007), 48. "In England as early as the Statute of Anne of 1710 the booksellers procured a right to prevent others from making copies of an author's book."

⁴⁴⁴ International Monetary Fund, Vietnam GDP per capita (2010): \$1,148.

⁴⁴⁵ International Monetary Fund, Japan GDP per capita (2010): \$42,325.

software. According to a recent study, 90% of PC software products in Vietnam is pirated. Pirated works become substitute option for a large number of people.⁴⁴⁶

The development of counterfeit products is a “nightmare” for trademark owners as the copied products can be seen almost everywhere flowing from Asia to Europe and to Africa.⁴⁴⁷ Not only is the economy damaged by the break out of counterfeit products but also the human health can seriously be affected when individuals consume counterfeit products.⁴⁴⁸ Counterfeit products can be anything that you can use, eat, drink or consume in your daily life. The list of dangerous counterfeit products that inspectors see increases year after year.⁴⁴⁹ Fighting against counterfeit products is a long-term battle that trademark owners have to deal with throughout the world.⁴⁵⁰

When parallel importation of trademarked products is restricted, genuine products are only distributed by authorized distributors or retailers under the control of the owner, which creates a convenient environment for counterfeit products to develop. On the contrary, when parallel importation of trademarked products is considered as a legal activity, then consumers have more opportunities to access genuine products at a cheaper price. Trademarked products that are imported through parallel imports may stop development of counterfeiting products because the comparative price of authorized products can compete with counterfeited products. Therefore counterfeit product would lose their attractiveness compared to price of parallel importation of trademarked goods. Consequently, trademark owners could increase their sales on the international scale, taking over counterfeit markets, more importantly activities of producing and trading counterfeit products activities could be reduced.

⁴⁴⁶ Koji Domon and Kiyoshi Nakamura, “Unauthorized Copying and Copyright Enforcement in Developing Countries: A Vietnam Case Study,” SSRN eLibrary: 95, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=997195.

⁴⁴⁷ Phillips, Knockoff, 20.

⁴⁴⁸ Ibid., 20-26.

⁴⁴⁹ Ibid., 27.

⁴⁵⁰ Ibid., 57-59.

Allowing for parallel imports could reduce the producing and trading counterfeit products in the markets of developing countries. One of the reasons that counterfeit products exist in developing countries is the lack of the legal framework as well as the enforcement of intellectual property remedies. China, for example, is known as “a lawless state, a Wild West for knockoffs”.⁴⁵¹ This name is not completely accurate because China does have law on intellectual property, nonetheless, as a matter of fact this law does not have enforcement opportunities and practices.⁴⁵² The weak enforcement of intellectual property rights is a common situation that almost every developing country is now facing with although the level of enforcement varies according to countries.

3. Less developed social infrastructure

Developing countries vary widely in their restraints on parallel importation of pharmaceutical products. Many developing countries have permitted parallel imports as an alternative method to secure medicines while social infrastructure in health care is insufficiencies and domestic enterprises are incapable of meeting demand. On the one hand, the TRIPS agreement incorporates strong patent protection, which leads to high prices in patented drugs. Consequently large enterprises are beneficiaries of these provisions. Consumers in developing countries, meanwhile, struggle with high price drugs. Besides, because social welfare is weak and insurance programs do not cover most patients in these countries, patented drugs therefore become harder to access. On the other hand, the TRIPS Agreement provides two possible solutions for increasing access to essential drugs, namely compulsory licensing and parallel imports.

Compulsory licensing can be considered as a useful way to solve the problem of high prices of significant pharmaceutical products as well as for those countries lacking essential drugs. However, the current provisions of TRIPS Agreement have established certain conditions for use of compulsory

⁴⁵¹ Ibid., 60.

⁴⁵² Ibid., 61.

licensing that make it difficult for developing countries. Article 31 of the TRIPS Agreement⁴⁵³ lists a number of conditions which refers to five specific grounds for granting compulsory licenses: refusal to deal, emergency and extreme urgency; anti-competitive practices; non-commercial use; and dependent patents.⁴⁵⁴ After the Doha declaration,⁴⁵⁵ the situation became easier when allowing generic copies made under compulsory licenses to be exported to countries that lack production capacity. Therefore if a country wishes to use compulsory licensing as a method to deal with the domestic issue then that country has to satisfy those conditions before being granted a compulsory license.⁴⁵⁶ With the disadvantages of compulsory licensing as well as the complication to issue one, it might be meaningless because developing countries have limited capacity and capability to manufacture pharmaceutical products.⁴⁵⁷

Although the Doha declaration and the discussion which followed afterwards and lead to the amendment of the TRIPS Agreement⁴⁵⁸ made the use of compulsory licensing more accessible, many developing countries continue to have a problem with this option because most of them lack technological conditions for producing medicines. Therefore parallel importation is a better solution for developing countries in dealing with the insufficiency of drugs. As a result of compulsory licensing in some countries, the price of certain drugs is lower than in other advanced countries. Choosing parallel importation may be the best way for developing countries to obtain drugs from different sources with lower prices.

⁴⁵³ The TRIPS Agreement, Art. 31.

⁴⁵⁴ Correa, Intellectual property rights, the WTO, and developing countries, 89-90.

⁴⁵⁵ Doha Declaration on the TRIPS Agreement and Public Health, adopted by the WTO Ministerial Conference of 2001 in Doha on November 14, 2001, http://www.wto.org/english/thewto_e/minist_e/min01_e/mindecl_e.pdf.

⁴⁵⁶ Krithpaka Boonfueng, "Parallel Imports in Pharmaceuticals."

⁴⁵⁷ Duangrat Laohapakakul, "The United States - Thailand Free Trade Agreement Negotiations: Potential Effects on Pharmaceutical Patent Protection in Thailand," accessed April 20, 2011, <http://leda.law.harvard.edu/leda/data/774/Laohapakakul06.html#fnB115>.

⁴⁵⁸ The World Trade Organization, TRIPS and public health, http://www.wto.org/english/tratop_e/trips_e/pharmpatent_e.htm.

II. Recent trends

A. Actual treatment of parallel imports in developing countries

Parallel importation of genuine trademark products promotes free trade and healthy and transparent competition in developing countries. As to the effects on domestic competition, allowing parallel importation may mitigate the market power of monopolistic entities, many of which are multinational enterprises. India, for instance, adopts a regime of international exhaustion of trademark rights. A number of developing countries, including Argentina, Thailand, and South Africa, recently enacted laws permitting parallel imports of pharmaceutical products.⁴⁵⁹

Parallel importation of trademarked products plays an indispensable role in enabling consumers in developing countries to get access to cheaper products. Recently, developing countries are allowing the parallel importation of not only essential products such as pharmaceuticals but also daily life products such as house appliances, automobile spare parts, perfumes and soft-drinks. In the analysis of the effects of parallel imports on developing countries, the key question has changed from whether or not they should be prohibited or regulated to what the relevant legal provisions are. Developing countries should consider the costs and benefits of allowing parallel imports.

The actual treatment of parallel importation of trademarked goods in developing countries is not the same. Depending on their current practical situations as well as legal situations, the treatment of parallel importation is slightly different between developing nations. For example, in India the Trademark Act 1999 contains provisions on parallel imports. While in Thailand, the Trademark Act 1991 says nothing on this issue. The regulations in the Chinese Trademark Act regarding parallel importation of trademarked products are still ambitious. From a general point of view, parallel importation is allowed in most developing countries under different methods. The following analyzes

⁴⁵⁹ Maskus, "Parallel imports in pharmaceuticals," 6.

the treatment of parallel imports of trademarked products in India, Thailand and China as examples of the actual situation in developing countries.

1. India

Indian law allows parallel importation of genuine products bearing registered trademark provided that such goods have not been materially altered after the products have been put on the market by or with the consent of trademark owner.⁴⁶⁰ Concerning the issue of exhaustion of trademark rights, Indian law adopts the principle of international exhaustion of rights because once these products are launched anywhere in the world then legally the trademark owner cannot assert rights to such goods in India.⁴⁶¹ Section 30.3.b (limits on effect of registered trademark) of the Indian Trademark Act 1999 provides as follows:

Where the goods bearing a registered trade mark are lawfully acquired by a person, the sale of the goods in the market or otherwise dealing in those goods by that person or by a person claiming under or through him is not infringement of a trade mark right by reason only of: (b) the goods having been put on the market under the registered trade mark by the proprietor or with his consent.⁴⁶²

However, this principle of international exhaustion does not apply if the trademarked goods have been changed or impaired after they have been put on the market. This issue is provided in Section 30.4.d of the Indian Trademark Act 1999 as follows:

⁴⁶⁰ Baldia Sonia, "Exhaustion and Parallel Imports in India," in *Parallel Imports in Asia*, ed. Christopher Heath (Kluwer Law Intl, 2003), 169.

⁴⁶¹ *Ibid.*

⁴⁶² Indian Trademark Act 1999, Section 30.3.b.

Sub-section (3) shall not apply where there exists legitimate reasons for the proprietor to oppose further dealings in the goods in particular, where the condition of the goods, has been changed or impaired after they have been put on the market.⁴⁶³

In general, Indian law allows parallel imports of trademarked products when the products are genuine and have been marketed by trademark owner or with his consent. This rule is not applied when the imported products are materially or physically altered without the consent of trademark owner.⁴⁶⁴ At this point, the Indian Trademark Act 1999 seems to be in line with the EU provisions in a sense that conditions of “lack of consent” and “legitimate reasons” are provided as legal grounds for trademark owners to exercise their exclusive rights and prevent parallel importation. When parallel importation of trademarked goods is allowed in India, its population has more choices or opportunities to access cheaper genuine products.

2. Thailand

The issues of exhaustion as well as parallel importation of trademarked goods are not explicitly mentioned in the Trademark Act of Thailand 1991.⁴⁶⁵ The law, thus creates a large room for judicial activism in its interpretation.⁴⁶⁶ Even though there is no regulation concerning to parallel imports in the Thai Trademark Act, in fact its courts have dealt with parallel imports cases by citing the principle of exhaustion.⁴⁶⁷ The Thai Supreme Court applies the principle of international exhaustion of trademark rights when solving in a case that related to this issue. In this case, at first the plaintiff sold the trademarked products in Singapore then later these products were sold to the

⁴⁶³ Indian Trademark Act 1999, Section 30.4.d.

⁴⁶⁴ Sonia, “Exhaustion and Parallel Imports in India,” 169.

⁴⁶⁵ Ariyanunkata Vichai, “Exhaustion and Parallel Imports in Thailand,” in *Parallel Imports in Asia*, ed. Christopher Heath (Kluwer Law Intl, 2003), 95.

⁴⁶⁶ *Ibid.*

⁴⁶⁷ *Ibid.*, 99.

defendant who imported the goods to Thailand. In Decision No. 2817/2543 (2000) the court held that when the producer of the goods who is the trademark owner sells the goods under the mark, he is using his exclusive right over the trademark and thus exhausts the right. He has no further rights to prevent the buyer from using the trademark in the resale of the product.⁴⁶⁸

What is special about Thailand is that it is one of the countries that faced an HIV/AIDS epidemic very early on national scale since 1990s.⁴⁶⁹ In order to face with this epidemic, Thailand used parallel importation and compulsory licensing. With respect to pharmaceutical products, a compulsory license was used to stimulate price-lowering competition in the domestic market and to ensure availability of essential medicines for Thailand. However, with a low capacity in technology, the possibilities in which Thailand could take advantage of compulsory licensing to produce the needed pharmaceutical products are in fact relatively low. In other words, compulsory licensing becomes meaningless when Thailand has limited capacity in manufacturing pharmaceutical products for its HIV patients.⁴⁷⁰ With respect to a developing country with low technological advances such as Thailand, parallel importation is a significant alternative for the access to a cheaper drug supply from other countries in case of a public health crisis such as the one cause by HIV/AIDS.⁴⁷¹

In general parallel importation of trademarked products is upheld in Thailand when many proponents use the benefits to consumers in terms of competitive prices as a justification of practice not only with respect to pharmaceutical products.⁴⁷²

3. China

⁴⁶⁸ Ibid., 98-100. Supreme Court, Decision No. 2817/2543 (2000).

⁴⁶⁹ “HIV and AIDS in Thailand”, <http://www.avert.org/thailand-aids-hiv.htm>.

⁴⁷⁰ Krithpaka Boonfueng, “Parallel Imports in Pharmaceuticals.”

⁴⁷¹ Duangrat Laohapakakul, “The United States- Thailand Free Trade Agreement.”

⁴⁷² Vichai, “Exhaustion and Parallel Imports in Thailand,” 99-100.

Being known as the world's factory with the abundant low cost labor China has been an exporter of goods in international trade for a long time. As to the rules concerning parallel imports there are no clear provisions in the Chinese Trademark Act. But according to the prevailing view, parallel importation is not considered as an act of trademark infringement.⁴⁷³ Thus far, the number of cases related to parallel importation of trademarked products reported from the court of China is very limited.⁴⁷⁴ In the only case that the court has solved so far, the situation on parallel imports of trademarked products is still ambiguous.⁴⁷⁵ The main reason for the small number of cases involving parallel imports is that the prices of goods in the Chinese market are generally too low for parallel importers to get profits. In addition, high tariffs as well as quantitative restrictions also make parallel importation difficult. Thus, parallel importation of trademarked products in China is relatively low.⁴⁷⁶ However, China's market is changing from the one filled with low-priced goods towards the one with high-priced goods in certain areas. China also has to reduce its tariffs and other barriers based on its commitments and obligations as a new member of the WTO. For these reasons, parallel importation of trademarked products is expected to increase in China.

B. Doha declaration and the WTO discussion

This section of the study focuses on the discussion concerning parallel imports of pharmaceutical products as a means to protect the public health of the developing countries. Article 6 of the TRIPS Agreement explicitly states that practices relating to parallel importation cannot be challenged under the WTO dispute settlement system. Thus, developing countries can take advantage

⁴⁷³ Yu Xiang, "Exhaustion and Parallel Imports in China," in *Parallel Imports in Asia*, ed. Christopher Heath (Kluwer Law Intl, 2003), 28.

⁴⁷⁴ *Ibid.*

⁴⁷⁵ *Ibid.*, 30.

⁴⁷⁶ Zhang Hui, "Comparative Study on Parallel Imports in Trade marks", accessed June 11, 2011, <http://www.chinaiprlaw.com/english/forum/forum35.htm>.

of this regulation without pressure from the possibility of challenges by other WTO members, especially the United States. Before and during the WTO Doha Ministerial Conference in 2001, the U.S. government was under pressure from the pharmaceutical industries, which had a high volume of trade and the profits, on the issue related to parallel imports for pharmaceutical products and public health. The U.S. suggested that the TRIPS Agreement should not allow each member to determine its own policy on parallel imports.⁴⁷⁷

The WTO Ministerial Conference in Doha sought to clarify ambiguities between the need for governments to protect public health and the terms of the TRIPS Agreement. Accordingly, developing countries were concerned that patent rules may restrict access to affordable medicines for populations in developing countries in their efforts to control diseases of public health importance, including HIV, tuberculosis and malaria.⁴⁷⁸ As a result, the Doha Declaration which was agreed upon by the Ministers of the WTO Members responded to the concerns of developing countries about the obstacles they dealt with when seeking to implement measures to promote access to affordable medicines in the interest of public health. The price of medicine, the main obstacle that affects the accessibility of consumers in developing countries to better health, reduces when parallel importation of pharmaceutical products becomes lawful.⁴⁷⁹

The Doha Declaration refers to several aspects of TRIPS. However, one of the fundamental points made by the developing countries was that members must be free to use measures such as compulsory licensing and parallel importation to enhance access to medicines, without being subject to threat from developed Members. Two measures were confirmed as means to assist the developing countries in solving the problem in the area of public health: one, the right to grant compulsory

⁴⁷⁷ Abbott, “The Doha Declaration on the TRIPS Agreement and Public Health,” 482.

⁴⁷⁸ “WHO | THE DOHA DECLARATION ON THE TRIPS AGREEMENT AND PUBLIC HEALTH,” http://www.who.int/medicines/areas/policy/doha_declaration/en/index.html.

⁴⁷⁹ Ibid.

licenses, and two, the freedom to establish the regime of exhaustion of intellectual property rights.⁴⁸⁰ However, the scope of this chapter does not allow for an analysis of the impacts of compulsory licensing to developing countries.

Parallel importation of pharmaceutical products is important because it allows the imports to occur without the consent of the trademark owners of trademarked products marketed in another country. When applying the principle of international exhaustion of trademark rights, once the products have been placed into the market legally by the trademark owner or any authorized party, then they cannot prevent or prohibit the further commercial exploitation of these trademarked products, as the trademark rights have been exhausted after their first sale.

Furthermore, the Doha Declaration has confirmed that “the effect of the provisions in the TRIPS Agreement that are relevant to the exhaustion of intellectual property rights is to leave each member free to establish its own regime for such exhaustion without challenge.”⁴⁸¹ This provision of the TRIPS Agreement appears to leave each member with the discretion to determine whether it will recognize the national, regional or international exhaustion of intellectual property rights regime, which can apply the same regime to all kinds of intellectual property like the E.U or different regimes to different subject matter as in the U.S. and Japan.

For the developed countries, the problem of so-called “round back scenario” may happen when allowing parallel imports of pharmaceutical products in developing countries. A round back scenario happens when cheaper priced medicine finds its way to the markets of developed countries or other developing countries after being sold in a certain developing market. Therefore, effective controls on parallel trade are necessary to attain effective differential pricing. Without the necessary measures, low-priced drugs supplied to developing countries markets would be re-imported by operation of arbitrageurs, into high priced markets. When this situation arises, the result is not much

⁴⁸⁰ Ibid.

⁴⁸¹ The Doha Declaration, paragraph 5.d.

different from what occurred before allowing parallel imports, a situation with a lack of pharmaceutical products in the developing countries markets.⁴⁸²

C. Free trade agreements

Free trade agreements (FTAs) are international treaties reached among two or more nations (or regions) to reduce tariff and non-tariff barriers in respect of trade among the signatories for enhancing market access for each other.⁴⁸³ As a result, FTAs have widespread effects on national interests in trade, economic, and social structure as well as the legal framework of developing countries.

The United States is particularly aggressive in seeking to include issues related to parallel imports in the scope of FTAs it concludes. As stated in its Article 6, the TRIPS Agreement is neutral on the permissibility of parallel trade.⁴⁸⁴ At the same time, the obligations under the TRIPS set the minimum standards of protection, and WTO Member are basically free to apply more protective measures than provided in the TRIPS. Such measures are called “TRIPS-plus” measures. The United States is using FTAs to proliferate TRIPS-plus regimes internationally as an efficient tool to obtaining stronger intellectual property rights protection.⁴⁸⁵

For example, in the 2003 U.S-Singapore Free Trade Agreement, the issue of parallel imports on patented products is provided as follows:

...each party shall provide a cause of action to prevent or redress the procurement of a patented pharmaceutical product, without the authorization of the patent owner, by a party

⁴⁸² Atik and Lidgard, “Embracing Price Discrimination,” 1044.

⁴⁸³ Ong Burton, “The Trademark Law Provisions of Bilateral Free Trade Agreement,” in *Trademark Law and Theory: A Handbook of Contemporary Research*, ed. Graeme B. Dinwoodie and Mark D. Janis (Edward Elgar Publishing, 2008), 229.

⁴⁸⁴ Atik and Lidgard, “Embracing Price Discrimination,” 1043-1044.

⁴⁸⁵ Burton, “The Trademark Law Provisions of Bilateral Free Trade Agreement,” 235-236.

who knows or has reason to know that such product is or has been distributed in breach of a contract between the right holder and a licensee, regardless of whether such breach occurs in or outside its territory.⁴⁸⁶

Similarly, the 2005 U.S.-Australia Free Trade Agreement provides on parallel imports of patented products as follows:

...each party shall provide that the exclusive right of the patent owner to prevent importation of a patented product, ... without the consent of the patent owner shall not be limited by the sale or distribution of that product outside its territory, at least where the patentee has placed restrictions on importation by contract or other means.⁴⁸⁷

These FTAs are consistent with Article 1.1 of TRIPS Agreement which allows WTO Members to adopt a stronger intellectual property rights protection. Such an approach taken in the FTAs involving the U.S. however, will affect the issues concerning access to medicines and public health that was regulated by the Doha Declaration and the following negotiations at the WTO.⁴⁸⁸ According to the Doha Declaration and Article 6 of the TRIPS Agreement, countries are free to apply an exhaustion regime that best suits their domestic situation. Based on the consideration on the impacts of allowing parallel imports, many countries have adopted international exhaustion regime.⁴⁸⁹ But these countries may be forced to abandon the regime under the pressure from the United States in the negotiation on FTAs.

The examples of the FTAs shown above regulate parallel importation of patented products, and not that of trademarked products. Can the provisions on parallel imports of patented products in

⁴⁸⁶ The U.S.- Singapore Free Trade Agreement, Art. 16.7.2,
<http://www.cptech.org/ip/health/c/singapore/ussfta-ipr-chapter.html#16-10>.

⁴⁸⁷ The U.S.- Australia Free Trade Agreement, Art. 17.9.4,
<http://www.ustr.gov/trade-agreements/free-trade-agreements/australian-fta/final-text>.

⁴⁸⁸ Bonadio, "Parallel Imports in a Global Market," 158.

⁴⁸⁹ Ibid.

the FTAs be used to regulate parallel imports of trademarked products? Probably not, because at least according to the prevailing views in the United States, the evaluation of parallel importation of trademarked products is different from that of parallel importation of patented goods as discussed in Chapter 4. Therefore, the provisions mentioned above would not be interpreted to influence the treatments of parallel imports on trademarked goods in the signatory states.

III. DISCUSSION

A. Advantages of allowing parallel importation

Developing countries should diversify the source of distribution of trademarked products as a valid source of supplying goods. Up to now, WTO members were free to either permit or prohibit the import and sale of trademarked goods that had been placed into commerce in oversea markets. This also means that trademark owners may or may not be provided with an ancillary right to block the importation and sale of parallel importation of trademarked goods.⁴⁹⁰

By legal regulatory mechanisms, when parallel importers assure the quality of importing products as well as guarantee the source of origin and protect consumers from misleading, the legislation may allow parallel importation as long as the goods are genuine. Because of the advantages that parallel importation of trademark goods bring to the society, the Taiwan Supreme Court reasoned:

The parallel import of genuine goods harms neither the goodwill of the authorized user of the trademark in this country nor the interests of consumers. It prevents the authorized user of the trademark from monopolizing the domestic market and controlling the price of goods. It stimulates price competition and provides consumers with choices among the same goods; provided that the quality is equivalent to that of goods marketed by the authorized user in this

⁴⁹⁰ Atik and Lidgard, "Embracing Price Discrimination," 1044.

country, and no danger of confusion or passing off occurs among consumers. The parallel import does not contravene the purpose of the trademark act and thus does not constitute trademark infringement.⁴⁹¹

From the point of view of developing countries, there are many advantages that have been created when allowing parallel importation of trademarked products. First, the price of the product is cheaper. Parallel importers can import products from different sources; for example, suppose that a Japanese trademark owner licensed to licensees in Vietnam and in Thailand to sell the same trademarked products. If the price of the products in the Vietnamese market is higher than that of other markets, there are two possibilities of importing for parallel importers: 1) they can take advantage of the price difference as a benefit by importing the products from the Thailand market and resale in the Vietnamese market. 2) when the price in Thai market is higher than that of in Japanese market, parallel importers can import products from the Japanese market into Vietnam. In both scenarios, the unauthorized products will lower the price of the authorized distribution products. Therefore, consumers can buy the products at a lower price.

In relation to access to low-priced products, it is important to recognize that some products can be too expensive for ordinary people in developing countries when they are sold through exclusive distribution channel (which means a channel authorized by the trademark owner). In such cases, allowance of parallel imports means not only the availability of goods at low prices, but also access to such products. In other words, it is a matter of access, not just of prices. Pharmaceutical products are good examples. Many developing countries cannot supply to their citizens high-tech medicines by the domestic industries, and imports can be also too expensive for ordinary citizens. Parallel imports, especially those from the countries where high-tech medicines are produced at lower prices (under

⁴⁹¹ Liu Kung-Chung, "Exhaustion and Parallel Imports in Taiwan," in *Parallel Imports in Asia*, ed. Christopher Heath (Kluwer Law Intl, 2003), 39-50. Taiwan Supreme Court, decision No. 24444 of 22 October 1992, a case concerning the famous Japanese candy trademark "Chelsea" owned by the Meiji Kabushiki Kaisha.

compulsory licenses, for example), can be virtually the only channel of supply of the medicines for many people. Therefore, allowing parallel imports can bring more positive impacts especially to developing countries.⁴⁹²

Second, supporters of parallel imports stress that such activity has a positive impact on the trade between countries especially developing countries, strengthens competition in international markets and serves consumer demands. If parallel imports are considered as an infringement of trademark rights, trademark owners can use their rights to prevent the further commercial activities in respect of the goods that they have placed in overseas markets. Exclusive rights of trademark owners would become a magnificent tool for dividing the market and practicing differential pricing. More importantly, they can engage in anti-competition behaviors.⁴⁹³ For example, without parallel imports, companies will raise the price as well as reduce the supplies of the products they put on a certain market. When parallel importation is allowed, it can eliminate the monopoly status of exclusive distributors or manufacturers. The competitiveness of local companies in developing countries' markets will be strengthened.⁴⁹⁴

Third, parallel importation of trademarked products may encourage technology transfer. Domestic manufacturers can learn foreign technology by reverse engineering of imported goods.⁴⁹⁵ Besides, domestic firms can understand the market demands and tendencies from available imported products and use that information to upgrade their own products. By doing research on imported products, domestic producers can improve their products in order to supply the domestic market and their products can compete with imported products. Although the possibility of technology transfer through parallel imports of trademarked products is not high, it can still be considered as an advantage when a developing country allows parallel importation.

⁴⁹² Bonadio, "Parallel Imports in a Global Market," 155.

⁴⁹³ Keeling, *Free Movement and Competition Law*, 75.

⁴⁹⁴ Correa, *Intellectual property rights, the WTO, and developing countries*, 85.

⁴⁹⁵ Maskus, "Parallel imports in pharmaceuticals," 41.

Fourth, in certain product areas such as clothes and fashionable products, trademark owners try to sell different products in different countries. In such a case, parallel importation makes it possible for people in a certain market to get products that are not available in that market through their authorized distribution channel. This might not be a significant advantage from the viewpoint of economic or social public policy, but the expansion of choices for the citizens is more or less meaningful in developing countries.

B. Disadvantages of allowing parallel importation

Permitting parallel importation of trademarked products has both advantages and disadvantages. When developing countries allow parallel importation of trademarked products, they should take into consideration the disadvantages that policy might cause. A thorough analysis of the disadvantages of parallel importation of trademarked products is necessary before developing countries can adopt the relevant regime of exhaustion of trademark rights.

First, the lack of after-sales service is a disadvantage that consumers suffer from in respect of parallel imported products. There are some countries that have provisions to govern this problem. In the EU, for example, many trademark owners reduce the value of parallel imported products by restricting guarantees and after-sales service.⁴⁹⁶ However, according to Article 81 of the EC Treaty (which as been transferred to Article 101 on the Treaty on the Functioning of the European Union (TFEU) in 2009) this refusal is an anti-competition behavior.⁴⁹⁷

Japan also provides on the issue of after-sale service of parallel imported products. As mentioned in part III of chapter 4, the Japan Fair Trade Commission (JFTC) states in its guidelines as follows:

⁴⁹⁶ Stothers, *Parallel trade in Europe*, 185-188.

⁴⁹⁷ *Ibid.*

... there may be cases where it is not available for sole distributor to comply with requests for repair of parallel imports goods or to provide the required repair parts. Accordingly, even if the sole distributor refuses to repair parallel imports under the objective circumstances which made the sole distributor unable to comply with the request for repair or make difference in the terms and conditions of repair or the between the goods handed by it and the parallel imports goods, such conduct in itself presents no problem under the Antimonopoly Act.

However, in cases where it is extremely difficult for any party other than a sole distributor or its distributors to repair parallel imports goods or obtain necessary repair parts, and if the sole distributors to refuse such repair work or supply of repair parts, solely on the ground of parallel imports goods, such conduct is illegal and unfair trade practices, if it is employed to maintain price level of the product covered by the contract.⁴⁹⁸

Although the JFTC has provided for the situations concerning a repair of parallel import products that are brought to distributors, in fact, distributors may refuse to undertake such repair work. Consumers in this situation have to prove that “it is extremely difficult” to obtain a repair in another place rather than from the sole distributor. This provision of the JFTC is somehow very ambiguous as no further explanation exists concerning how and when a certain situation can be considered by the JFTC or judges as “extremely difficult.” The burden of proof is put on consumers as they have to prove the situation themselves. In other words, consumers have put themselves into a difficult situation when purchasing parallel imported products. The lack of after-sale service of trademarked products is one of the biggest disadvantages of parallel importation, and this situation will not occur when a transaction is conducted with authorized distribution. Supplying a trustworthy after-sale service is one of competitive advantages that only the sole or authorized distributors can offer to consumers.

⁴⁹⁸ JFTC, Guidelines concerning distribution systems and business practices under antimonopoly act, Part 3 Chapter 3. 6 Refusal to conduct repairs or the like on parallel imports goods.

Consumers are supposed to be aware that parallel import products that they obtain in the market may not be able to get repair or other service. In most cases, parallel importers are concerned only about short time profits, and they do not care about after-sale services. Thus, there is a possibility that consumers are damaged in the trades of parallel imports.⁴⁹⁹

In developed countries national competition authorities have dealt with the anticompetitive or unfair competition practices of trademark owners. Nonetheless, in some cases it is not easy to require the authorized distributor or trademark owner to supply after-sale service to parallel imported products. In developing countries, asking for guarantees or after-sale service for a parallel imported product is almost an impossible mission, because competition law is very weak or even non-existent in developing countries. Perhaps, for the time being the best thing that can be done is self-protection, which means that consumers have to protect their own interests. Dealing with this matter is not an easy task for developing countries since the roots of the problem lay in an imperfect legal framework which do not have sufficient consumer protection law and unfair competition law. Issues concerning after-sale service do not belong to the scope of regulating of parallel importation or intellectual property law. Rather, this issue is regulated and solved by competition law or consumer protection law.

Second, an insufficient amount of information on such imported products may have some negative effects on consumer health and other interests. In developing countries, the imported products range from daily consumer products to soft-drink, and from clothing to cosmetics. As a result, the impacts of these trademarked import products on the daily life of consumers are uncountable in both direct and indirect ways. The lack of necessary information on the parallel imported products is a common phenomenon that occurs in developing countries. When there is no information on the desired products, consumers purchase a product based on their experience of a trademark that they had seen in the past. In this context, buyers cannot exercise one of the most basic rights of consumers: the right to know what they are going to buy. In cases where damage occurs, consumers will find it hard

⁴⁹⁹ Bonadio, "Parallel Imports in a Global Market," 157.

to trace back to the importers, who should take responsibility with their imported products. In such a situation, not only are the legitimate interests of consumers damaged, but also the goodwill of the trademark is also jeopardized. State authorities should consider consumers interests as the top priority when allowing parallel imports.

Third, allowing parallel imports will result in limiting the development of domestic manufacturers in the same industrial area. With lower technology equipment, and a lack of updated technology knowledge, enterprises in developing economies have to face with many difficulties in order to survive in a competitive market. If there is no parallel importation, competition in the market is between imported products supplied by authorized distributors from oversea manufacturers, and domestic products. But once parallel imports are allowed to flow in the market, the competition becomes severe for the domestic products, because parallel imports are generally less expensive than the imports supplied by authorized distributors. Therefore, in comparison with the situation where parallel importation is prohibited, the economic condition of the market where parallel imports are allowed can be unfavorable for domestic manufacturers, and detrimental for the development of domestic industry in developing countries. One caveat is that parallel importation of materials and parts may be beneficial for domestic manufacturers who use such imports. We should take into account such favorable effects, too, when we evaluate the overall effects of parallel imports on domestic industry of developing countries.

C. Recommendations to developing countries

We have seen the advantages as well as the disadvantages of allowing parallel importation from the viewpoint of developing countries. Based on the observation, we now turn to recommendations for developing countries. Here, I present several recommendations for developing countries in general. In the next section, I will discuss more specifically the case of Vietnam.

1. Apply relevant exhaustion of trademark rights regime

As discussed, the principle of exhaustion of trademark rights determines the scope of the rights as to the distribution of a product with the right holder's mark. Under the rules of national or regional exhaustion, trademark owner can prevent parallel imports. When one of these regimes of exhaustion is employed, the question is whether or not and to what extent the government should allow trademark owners to segment their national and regional markets.⁵⁰⁰ When developing countries consider applying one of these types of exhaustion, they also have to foresee the possibility that their markets could be segmented, and this is the least thing that can bring benefit to their development. Parallel importation of trademarked products has almost no chance to occur when the national or regional exhaustion of trademark rights regime is applied because of the enforcement of trademark rights.

A regime of international exhaustion of trademark rights, on the other hand, is generally in favor of parallel imports. As a consequence, under the international exhaustion principle of trademark rights, the price of products on the market would become lower.⁵⁰¹ The application of international exhaustion will avoid the situation in which the trademark holders as well as their authorized distributors exercise their monopoly power on certain brands. In other words, parallel imports would increase what is so called intra-brand competition by reducing the possibility for a trademark owner to exploit his position in that trademark and to set higher prices in certain markets, and by increasing competition market of the product. Parallel imports provide additional competition which reduces the price of products in the market as well as extends the source of distribution channels of the products. Consequently, a large number of consumers can afford to purchase these products. Also, parallel

⁵⁰⁰ Ekaterina Shekhtman and Evgeniy Sesitsky, *Exhaustion and Parallel Importation in The Field of Trademarks*, Working Paper, 9.

⁵⁰¹ Bonadio, "Parallel Imports in a Global Market," 155.

imports reduce the ability of the trademark owners to exploit their positions with respect to particular brands and to set higher prices in certain markets than in others.⁵⁰²

Furthermore, with respect to consumers, parallel imports increase product availability on the market, widen the choice of goods and increase consumption in the domestic market thereby. More importantly, parallel importation attracts more affordable imports of trademarked products in the developing markets, and consumers in such a situation are the one who benefits from allowing parallel imports. Therefore, most of the developing countries consider parallel trade as a magnificent tool to enhance competition in foreign market. Furthermore, parallel imports can prevent the possibility for the trademark owners to exercise their exclusive rights to limit the movement of their products. Also, parallel importation is a good opportunity for economic growth in developing countries.⁵⁰³ According to the NERA report, a vast majority of developing countries are now applying global or international exhaustion of rights principle.⁵⁰⁴

An international exhaustion of trademark rights regime has the potential to promote global trade. Trademark owners cannot interfere in further use or sell or transfer of a trademarked product anywhere in the world after it was sold with or by their consent. In other words, the trademark owner cannot utilize their exclusive rights to divide the market. Therefore trademarked products can enjoy free movement in markets with less barriers. Up to now, many developing countries chose to follow the principle of international exhaustion of trademark rights as well as allow parallel imports as an alternative import. However, there are also many challenges that developing countries can face in order to maximize the benefit of these provisions.

First, if national legislation is not well provided, then some negative effects could occur when allowing parallel imports. For example, if there are no provisions on quality control of the imported

⁵⁰² NERA report.

⁵⁰³ Bonadio, "Parallel Imports in a Global Market," 158.

⁵⁰⁴ NERA report.

products, then the trademark owners could distribute low quality products in developing markets in order to prevent the loss of benefit caused by parallel imports. Consumer deception would take place when they buy those lower-quality products thinking that the products are legitimate versions of higher-quality products.⁵⁰⁵ When a country cannot protect consumers' legitimate interests then allowing parallel imports to that country become meaningless. Parallel imports do not include counterfeit products⁵⁰⁶ but can include inferior quality product as long as they are genuine. The international exhaustion of trademark rights could indeed raise some potential risks with regard to the quality of products sold on the market. This situation could occur in every market when the international exhaustion of trademark rights regime is applied, regardless of the development of a nation.

Second, some types of trademarked products sold on the market bearing the same trademark all over the world can have different characteristics in response to the different needs or requirements in different local markets.⁵⁰⁷ Under the international exhaustion of trademark rights regime, it could lead to a situation that consumers in a specific market buy a parallel imported product with features that are different from the ones they expect based on their experiences. Therefore, there is a risk that the international exhaustion of trademark rights may result in suffering of consumers' interests. Consumers in this situation would be the ones who take disadvantage of this regime of exhaustion.⁵⁰⁸

From these points, international exhaustion of trademark rights regime does not totally contain advantages. As with anything else, this type of exhaustion also contains disadvantages. Nevertheless, with respect to developing countries applying international exhaustion of trademark rights the advantages of this regime outweigh the disadvantages. That conclusion is supported by my observation that the specific advantages I have pointed out so far seem to outweigh the disadvantages

⁵⁰⁵ Maskus, "Parallel imports in pharmaceuticals," 4.

⁵⁰⁶ Bonadio, "Parallel Imports in a Global Market," 156.

⁵⁰⁷ Stothers, *Parallel trade in Europe*, 349.

⁵⁰⁸ *Ibid.*

which I have also touched upon. But more importantly, the international exhaustion regime is more consistent with the economic system of free and fair competition, as well as free trade; the system which developing countries should try to achieve as a basis for future development.

At this point, because both the U.S. and Japan follow international exhaustion of trademark rights, experience from the U.S. and Japan are good reference sources for developing nations. Depending on their own characteristics with legal framework, social structures and economy, developing countries can choose from either of these two developed countries to learn in terms of applying the international exhaustion of trademark rights.

2. Adopt relevant regulations to deal with the disadvantages of parallel importation

When allowing parallel importation of trademarked goods, developing nations still have many things that they have to take into account. Developing countries should regulate concerned issues such as quality control or repackaging or relabeling of imported products. If there is no provisions on these areas of quality control or repackaging and relabeling, then parallel imports become meaningless because the benefits to consumers is not guaranteed when buying those trademarked products. For example, the possibility that inferior quality products could be imported is relatively high when there are no regulations on quality control. Therefore, developing countries should adopt regulations of related issues on quality control and repackaging to the gray market products.

a. Quality control

When developing countries apply an international exhaustion of trademark rights regime, there are possibility that developing countries imported products contains different materials for fitting with local markets' requirements. In order to avoid the parallel importation of inferior quality products,

it is necessary for developing nations to have quality control provisions to ensure the imported products meet the standards to protect the health of consumers as well as the public order. Furthermore, quality control is a useful tool to protect consumers from deception when buying lower-quality parallel import products. In developing countries, when the import conditions are not yet provided, the possibility that the health of consumers can be affected is very high when they buy parallel imported products.

The biggest concerns of a consumer when buying an imported product are price and quality of the products. The price of parallel imported products is cheaper than the price of authorized distributed goods that are on the local market. The quality of a parallel imported product, in addition to its price, can be a reason why a consumer purchases such a product among similar goods on the market. When quality control is conducted, not only the legitimate interests of the consumers are protected but also the goodwill of the trademark owners. Consumer protection law can solve the issues related to the quality of the products. Furthermore, unfair competition law could also be employed to protect the goodwill of the trademark owner from intentional infringement in parallel importation case.

In order to reduce the risks of deception and misconception under the international exhaustion regime, developing countries can learn from developed countries. For example, the provisions on quality control of importing products, or prevent importing low quality products by using the “material or physical test” of the United States are typical examples of what developing countries can learn from the U.S. under the U.S. law, if imported products contain material or physical difference when compared with the U.S. domestically marketed products, the trademark owner can prevent the importation of trademarked products into the U.S. market. In case there is a material difference between the overseas manufactured products and the products that are domestically sold, parallel importers have to use additional labels for imported products as provided in the Lever-rule that the U.S. now applies for parallel imports products.

However, because of the economic, legal and social conditions are very different in developing countries compared with the United States, it is not advisable for them just to copy the U.S laws and regulations. Developing countries can base on their characteristics, their economic conditions to choose the best pattern of quality control to apply. They can issue very fundamental requirements for controlling the quality of the importing products. As a result, developing nations can ensure the quality of the imported products and thereby protect the legitimate interests of consumers.

b. Repackaging/ relabeling

A common phenomenon in developing countries is the lack of regulations on the repackaging or relabeling of trademarked products in parallel importation. The label of an imported product is not only important in supplying the essential information to consumers related to that product but also important in tracking back the responsibility of the parallel importers in necessary circumstances. Such responsibility is especially relevant when the imported products are closely related to human health and involve such items as foods, drinks, cosmetic, or pharmaceutical products. Furthermore, the regulations on repackaging or relabeling also require the responsibility of the parallel importers for imported products. For example, when the imported products are labeled with foreign languages, the essential information of the label has to be translated (accurately) into the language of the importing country to supply the sufficient information for the consumers. In cases where the parallel importers do not follow these requirements, their products cannot be imported into the markets of developing countries. Only by the issuing of requirements on supplying necessary information of imported products, state authorities can thereby control the quality of importing products. Depending on the level of development, the legal framework and social characteristics, the import conditions will vary from country to country.

Regarding the issues of repackaging or relabeling, the trademark owner can prevent the further circulation of the parallel trademarked products when they have legitimate reason to oppose

further commercialization of the products. For example, when the imported products are not repacked or relabeled in a proper way this may cause confusion among the consumers on the source of products.⁵⁰⁹ More importantly, the process of repackaging of original products during shipping, distributing and warehousing might affect the quality of the products.⁵¹⁰ In order to protect the consumers from being misled or confused when purchasing gray market products, legislators in the developing countries should take into account such issues.

Repackaging or relabeling are unavoidable steps that parallel importers have to take so that they can sale products in another market. The ECJ's view on this problem is that "parallel importers are allowed to repackage products where necessary to make them more mobile within the larger EEA market, provided that repackaging does not damage either the quality of the goods or of the brands applied to them."⁵¹¹

Different from the EU, developing countries have not yet regulated repackaging and relabeling of parallel imports. The EU applies community exhaustion of trademark rights and the level of economic development among EU members is not much different from each other. Also, the products that put in the EU market have satisfied certain conditions. Meanwhile the situation of developing countries is totally different. In fact, many countries have not yet taken into account the issue of repackaging and relabeling of parallel imported products. In order to protect consumer health, public order, as well as prevent importation of counterfeit or inferior quality products, it is necessary for developing nations to regulate issues on repackaging and labeling.

According to the ECJ, as long as the quality of imported goods and the trademarks applied to them are not damaged, then parallel importers are allowed to repackage the products. Even if the labels are altered, as long as they are accurate and contain important information, the imported

⁵⁰⁹ Ibid., 188.

⁵¹⁰ Hays, *Parallel Importation Under European Union Law*, 94-95.

⁵¹¹ Ibid., 95.

products can be circulated in importing country.⁵¹² Developing countries can base on the EU regulations to apply for their national legislation, depending on their specific conditions so as to have the most appropriate regulations.

IV. Case Study: Vietnam

A. Situation in Vietnam

As a developing country, Vietnam is facing many socio-economic as well as legal problems. One of the problems Vietnam has to deal with is to improve its legal system, not only to conform with the provisions of the international treaties as a member state but also to deal with domestic issues. The legitimate concerns of consumers must be protected while a good business environment is needed to attract investors. Consequently, the methods to harmonize the interests of the related parties as well as guarantee a transparent and competitive environment for both domestic and foreign investors requires a lot of effort on the part of legislators. For example, how to control the continual price instability situations in the market, is a serious issue when parallel importation is allowed.

1. The current regulations on trademark rights

Vietnam is a developing country which now is in the process of economic transition and attempting to take part in the integration of the regional and world economy. Up to now, Vietnam has joined and become a member of several bilateral as well as regional treaties. For example, Vietnam joined the Association of Southeast of Asian Nations (ASEAN), the Asean Free Trade Area (AFTA),

⁵¹² Ibid., 93.

Asian Pacific Economic Cooperation forum (APEC), and has become a member of the World Trade Organization.

Vietnam decided to apply to the WTO because of the important role and significant of this organization in the development of international global economy as well as the strong influence it has on each individual country. With full awareness of obligations under the WTO Agreements, Vietnam had to comply and commit to upholding the principles of this organization. As a result, Vietnam had to revise its legislative system to fulfill the obligations under the WTO rules. The General Council of the WTO approved Vietnam's membership on November 7, 2006. Thus Vietnam became the WTO's 150th member 30 days after informing the organization that it had ratified the accession package domestically. Vietnam complied with the TRIPS Agreement immediately without any transitional period.⁵¹³

With the participation of Vietnam in the WTO, there already have been positive results in the country's intellectual property system. The Vietnamese government has carried out many significant measures in order to strengthen intellectual property rights through protection as well as enforcement. Especially trademark provisions have already become broadly consistent with those demanded by the WTO as well as other international conventions.

b. Trademark regulations in Vietnam intellectual property law

According to the Vietnamese intellectual property law (VIPL), in order to protect a trademark it has to be registered with the National Office of Intellectual Property of Vietnam (NOIP). According to Article 4 of the VIPL, a mark is any sign used to distinguish goods or services of different

⁵¹³ WTO: 2006 Press Releases, Press/455, 7 November 2006, General Council approves Viet Nam's membership, http://www.wto.org/english/news_e/pres06_e/pr455_e.htm.

organizations or individuals.⁵¹⁴ According to VIPL regulations, trademark rights are awarded on a first-to-file basis. When there are two or more applications for registration of marks identical with or confusingly similar to each other, or for identical or similar goods or services, a protection title may only be granted to the valid application with the earliest priority or filing date amongst all applications.⁵¹⁵ The owner of a trademark is entitled to exclusive rights of use for registered goods and services.⁵¹⁶ A trademark is eligible for protection when it satisfies the conditions stated in Article 72.⁵¹⁷

Trademark owners have exclusive rights in the use of their marks, and any use of the marks without the owners' consent is considered as an infringement. The use of a registered trademark includes: (a) Affixing the protected mark on goods, goods packages, business facilities, means of service provision or transaction documents in business activities; (b) Circulating, offering, advertising for sale or stocking for sale goods bearing the protected mark; and (c) Importing goods or services bearing the protected mark.⁵¹⁸ Trademark owners with their granted exclusive rights can prevent others from using their trademark without consent.⁵¹⁹ However, according to Article 125.2.b. as to the act of circulating, importing or exploiting utilities of trademarked products which were lawfully put on the market (including those put on the overseas markets by the mark owner or their licensees) trademark owners cannot exercise the rights.⁵²⁰

⁵¹⁴ Vietnam Intellectual Property Law, Art. 4.16.

⁵¹⁵ *Ibid.*, Art. 90.1.

⁵¹⁶ *Ibid.*, Art. 123, 125.

⁵¹⁷ *Ibid.*, Art. 72.1 of VIPL: "1. It is a visible sign in the form of letters, words, drawings or images including holograms, or a combination thereof, represented in one or more colors; 2. It is capable of distinguishing goods or services of the mark owner from those of other subjects".

⁵¹⁸ *Ibid.*, Art. 124.5.

⁵¹⁹ *Ibid.*, Art. 125.2.

⁵²⁰ *Ibid.*, Art.125.2.b.

2. Principle of exhaustion of trademark rights in Vietnam

In fact, parallel imports provide an alternative means for improving access to essential products, especially pharmaceutical products because according to Article 6 of the TRIPS Agreement members can decide whether or not such imports are permissible. Moreover, members are free to adopt any regime of exhaustion such as international or national or regional exhaustion depending on the socio-economic as well as legal conditions.⁵²¹ As a new member of the WTO, Vietnam also has to reduce its tariffs and other barriers based on its commitments and obligations as a new member of the WTO.

In the context of trademark rights, Vietnam follows the principle of international exhaustion of rights as stated in Article 125.2.b. of the VIPL. As a developing country, the application of international exhaustion of trademark rights has many advantages as stated before. By adopting this principle, the source of supplying and distributing products for Vietnam's market would be diversified when the products can be imported no matter where they are first marketed. Thus, the monopolistic position of some exclusive or state-owned companies would decline. As a result, Vietnamese consumers have more opportunities in accessing to higher quality products or at least the same quality products at a cheaper price.

B. Legal provisions of parallel imports in Vietnam

In Vietnam, there are direct as well as indirect regulations on parallel importation of trademarked products; however, there is a large gap between theory and practice in terms of the issue. Even when there are provisions in the related areas, the ways that the authorities understand the

⁵²¹ Krithpaka Boonfueng, "Parallel Imports in Pharmaceuticals."

provisions are different leading to relatively different applications of the law. The next section analyzes the provisions of parallel imports of trademarked products in the legal system of Vietnam.

1. The Circular No.825

Circular Number 825 which was issued in 2000 represents the first time Vietnam allowed the parallel importation of trademarked goods.⁵²² In this Circular, parallel imports of trademarked products were stated as follows:

The use of, or carrying out of, commercial activities with respect to products or goods which have been introduced to the market (including an overseas market) by the owner of the industrial property, e.g. parallel import of goods or products containing components which are under industrial property protection from a source supplied by licensees or persons or companies/firms subordinate to mother company in the distribution chain, rather than being supplied by the holder of the industrial property rights, shall not be considered as an infringement of the industrial property rights.⁵²³

According to this Circular, parallel importation of trademarked products is legal when the trademarked products are put into the market with the consent of the owner or by a third party with his permission. The use, transport, distribution or further commercial exploitation of the importation-trademarked products will not be considered as an infringement.

2. The U.S. - Vietnam Bilateral Trade Agreement

⁵²² The Circular No. 825/2000/TT-BKHCNMT of Ministry of Science, Technology and Environment, May 3, 2000.

⁵²³ The Circular No.825, Art 8.1.d.

The U.S-Vietnam Bilateral Trade Agreement (BTA) was concluded in 2001. It is a comprehensive treaty covering trade in goods, protection of intellectual property rights, trade in services, investment protection, business facilitation and transparency. This agreement marked an increase in cooperation between the U.S and Vietnam.⁵²⁴ During the negotiating process, the issue of parallel importation was mentioned as a concern by the U.S. The U.S. side argued that parallel imports must be considered as an illegal activity and should be prohibited by the agreement. However, Vietnamese side rejected this point on the grounds that parallel imports of trademarked products in Vietnam is not an infringement act. With respect to trademarked products, the BTA leaves the issue on parallel importation activity to the national legislations.⁵²⁵ Issues on parallel imports of patented products are provided at Article 7.3 of the BTA.

3. The Decision No. 1906

Although parallel importation has recognized as a legal activity in Vietnam since 2000 according to the Circular 825, parallel imports of pharmaceutical products was not accepted until the middle of 2004.⁵²⁶ The policy change occurred from the recognition of the significance of parallel import pharmaceuticals in the prevention and cure of human diseases.⁵²⁷ By Decision No. 1906 the Ministry of Health (MOH) provides that parallel imports of medicine into Vietnam shall be legalized in order to ensure the sufficiency of medicine for the prevention and cure of diseases. Also, this decision

⁵²⁴ The U.S-Vietnam Bilateral Trade Agreement (BTA) - Resources for Understanding, <http://vietnam.usembassy.gov/econ12.html>, last visited 15/2/2010.

⁵²⁵ Tam Thanh Nguyen, Về pháp luật chống cạnh tranh không lành mạnh và kiểm soát độc quyền liên quan tới quyền sở hữu công nghiệp ở nước ta (Regarding to provisions on unfair competition and controlling on anti monopoly relates to industrial rights in Vietnam), Commercial Journal No 42/2003.

⁵²⁶ Tú Thanh Nguyen, Competition Law, Technology Transfer and the TRIPS Agreement: Implications for Developing Countries (Edward Elgar Publishing, 2010), 237.

⁵²⁷ Decision No. 1906/2004/QĐ-BYT of The Minister of Health promulgating the regulation on parallel import of medicines for prevention and cure of human diseases.

aims to stabilize the pharmaceuticals market. In other words, parallel importation of medicine that is cheaper than those available on the Vietnam market is encouraged by the government to improve the state management on protecting consumer health.

According to Decision Number 1906, its policy parallel imports of medicine will not be applied widely but only to finished drugs which:

have the same specific names, active ingredients, contents and pharmaceutical forms as the medicines which have been granted by the Ministry of Health registration numbers for circulation in Vietnam but the manufactures and distributors do not supply them or supply them insufficiently for the treatment demands or are currently selling them in Vietnam at prices higher than the retail prices of such medicines in the host countries or in the countries where the economic conditions are similar to Vietnam and such medicines are currently in circulation.⁵²⁸

The inconsistency between legal provisions and practice is the main reason of high prices of medicines in Vietnam. The prices of medicines keep increasing regardless of the government attempts to introduce control by legislative measures provided in its legal system.⁵²⁹ Prices for some medicines were up to ten times higher than the original imported prices into Vietnam by the time the medicines reached the customers – patients.⁵³⁰ For instance, Paracetamol was imported by Danang Pharmaceutical and Medical Equipment Joint Stock Company for 9.28 times the original price. As a developing country with a GDP per capita around \$1.000 per year, ordinary consumers are unable to get access to such expensive medicine. In fact there is evidence that the price of some medicines in

⁵²⁸ The Decision No. 1906/2004/QĐ-BYT, Art. 1.

⁵²⁹ Anh Tuan Nguyen et al., “Medicine Pricing Policies: Lessons from Vietnam,” *Southern Med Review* Vol. 3 Issue 2 Oct 2010, 13.

⁵³⁰ *Ibid* 2-3 “For example, prices of locally produced antiretroviral medicines (ARVs), although considerably lower than those of imported ARVs, were still five to seven times higher than current international lowest prices.”

Vietnam market is set by certain pharmaceutical companies.⁵³¹ The retail price of 100 tablets of 150mg ranitidine (Zantac) in Vietnam was higher than that in Australia, New Zealand, and Pakistan. This made medicines even less affordable for the Vietnamese population when the Gross National Product per capita of Vietnam was the lowest among these countries.⁵³² The high price of medicine is a barrier for low-income consumers in obtaining treatment for their diseases. Therefore, Vietnam needs to solve the conflict between the legal provisions and the practical situation. With the current situation of Vietnam, parallel importation of pharmaceutical products is the best solution that the competent authorities can use to increase the sources of distributors.⁵³³ In order to promote this activity in the field of pharmaceutical products, the procedure of parallel importation of drugs must be changed in a less complicated direction so that more distributors or importers can participate in distribution of drugs in Vietnamese market.

4. The Vietnam Intellectual Property Law

In 2005, the Vietnam Intellectual Property Law (“the VIPL”)⁵³⁴ was enacted. It is the greatest landmark in the history of Vietnamese intellectual property law. Regarding parallel imports of trademark products, Article 125.2.b. provided that:

⁵³¹ Anh Tuan Nguyen, et.al., “Medicine Prices, Availability, and Affordability in Vietnam,” *Southern Med Review* Vol 2 Issue 2 Sep 2009. 2-3.

⁵³² Ibid. “For example, prices of locally produced antiretroviral medicines (ARVs), although considerably lower than those of imported ARVs, were still five to seven times higher than current international lowest prices”.

⁵³³ Quốc Túy - Văn Tiên, Quản lý cạnh tranh trong phân phối dược phẩm: Bài học kinh nghiệm (Competition management in the distribution of pharmaceutical products: experience lessons), <http://www.thuocbietduoc.com.vn/tin-tuc-5021-1-2/quan-ly-can-h-tranh-trong-phan-phoi-duoc-pham-bai-hoc-kinh-nghiem.aspx>.

⁵³⁴ The Vietnam Intellectual Property Law 50/2005 was adopted by the National Assembly in Nov. 2005 and took effect on July 1, 2006.

Owners of industrial property objects as well as organizations and individuals granted the right to use...shall not have the right to prevent others from...circulating, importing, exploiting utilities of products which were lawfully put on the market including overseas markets, except for products put on the overseas markets not by the mark owners or their licensees.⁵³⁵

In this provision, parallel importation of trademarked goods does not constitute an infringement of intellectual property rights in Vietnam. When the trademarked goods are lawfully placed on the market by or with the consent of the trademark owners, the parallel importation of the trademarked products is considered as a legal activity no matter where the trademarked products were first placed. The VIPL is the most important legal document that regulates the parallel imports policy, and these provisions are guided by other lower documents such as decrees, decisions and circulars.

5. Decree 89 on labeling of goods

The key legislation regarding labeling is Decree 89/2006/ND-CP on the labeling of goods (Decree 89).⁵³⁶ Decree 89 provides the requirements for the labeling of goods produced in Vietnam for domestic circulation, for export, and of goods produced in foreign countries that are imported for sale in the Vietnamese market.⁵³⁷ In the case of imported goods, the compulsory contents in Vietnamese may be either printed on the original label or presented in a supplementary label attached to the original foreign language label prior to sale or circulation in the Vietnamese market. If labels of goods imported into Vietnam do not contain or fully contain compulsory contents in Vietnamese, they shall be kept together with supplementary labels showing compulsory information in Vietnamese. Contents

⁵³⁵ Vietnam Intellectual Property Law, Art. 125.2.b.

⁵³⁶ On September 30, 2006, the Vietnamese Government issued Decree 89/2006/ND-CP, which became effective on March 13, 2007

⁵³⁷ Decree 89, Art. 2.

in Vietnamese must be similar to those of the original label.⁵³⁸ Responsibilities of labeling of imported products belong to importing organizations and individuals before putting such goods into circulation together with their original labels.⁵³⁹

According to the Decree 89 imported goods must have labels presented under the provisions of this Decree, except for goods which do not require labels.⁵⁴⁰ Compulsory contents which shown on goods labels a) Name of goods; b) Name and address of organization or individual responsible for goods; c) origin of goods. Moreover, depending on each group of goods, contents of labels must meet specific requirements.⁵⁴¹ Decree 89 provides on supplementary labels as follows:

Supplementary label means a label showing compulsory contents of the original label of goods translated from a foreign language into Vietnamese and additional compulsory contents in Vietnamese as required by law which do not yet appear on the original label.⁵⁴²

Although Decree does not explicitly provide for relabeling Article 3.4 can be applied to parallel imported products. Parallel importers must also follow these requirements on labeling of imported goods if they want to sell the products in Vietnam. Provisions on labeling of imported products can be used to parallel imported products as long as all compulsory contents are shown in their labels.

In order to protect consumers from being misled, confused when buying imported products, the following acts constitute violations of the regulations regarding the labeling of goods: circulation of goods without the required labels; labeling goods without including all compulsory contents; failing

⁵³⁸ Ibid., Art. 9.3.

⁵³⁹ Ibid., Art. 10.3.

⁵⁴⁰ Ibid., Art. 5.2.

⁵⁴¹ Ibid., Art. 11.

⁵⁴² Ibid., Art. 3.4.

to meet guidelines for the correct size, position, method of presentation, or languages on labels; replacing labels of goods for the purpose of deceiving consumers;

It is not clear whether trademark owners can use one of those violations as a reason to prevent the parallel importation of trademark products into Vietnam market. Probably yes. With respect to imported products, labels are important to help consumers identify the goods as the basis for purchasers to select, consume and use such goods. Also, labels help manufacturers and importers to advertise their goods; and for functional agencies to conduct inspection and supervision.⁵⁴³ When parallel imported products violate one of those requirements, consumers may be confused or misled. Importers have to fully perform their obligations before putting imported products on market. The situation where the imported products bearing foreign language labels, or even lacking of relevant important information circulate in the market will no longer exist. The goodwill of trademark owners and interests of consumers are protected thereby.

6. The Law on the Quality of Products and Goods

The Law on the Quality of Products and Goods came into effect on 1 July 2008. The Law provides that manufacturers and traders must take responsibility for the quality of the goods or products that they manufacture or trade in order to ensure safety for humans, animals, plants, property and the environment, and to enhance the productivity, quality and competitiveness of Vietnamese goods and products.⁵⁴⁴ Under the Law, products and goods are grouped into two types based up the possibility of causing injury or damage to humans, animals, plants, assets or the environment. Group

⁵⁴³ Hanh Hong Le, et.al., Upgrading Vietnamese Consumer Protection Legislation, Final report, 2009, 22. <http://www.mutrap.org.vn/en/library/MUTRAPIII/Forms/DispForm.aspx?ID=119>.

⁵⁴⁴ Law on the Quality of Products and Goods, Art. 5.2.

1: includes products and goods incapable of causing injury or damage⁵⁴⁵; and group 2: includes products and goods capable of causing injury or damage.⁵⁴⁶

Although this law does not explicitly provide anything on parallel importation, this law does not prohibit this activity.⁵⁴⁷ According to this law parallel importation of trademarked products is allowed. The relevant issues of parallel imports are also provided in this law.

a. Quality control

In order to ensure the quality of imported products, there are some conditions that importers have to follow.⁵⁴⁸ Accordingly, imported goods must have their applicable standards announced as provided at Article 23 of this law. With respect to parallel importation of trademarked products, quality control is a necessary tool to eliminate the disadvantages of parallel imports such as low quality products or lack of after-sales service. If imported goods fail to conform to announced applicable standards or relevant technical regulations of Vietnam, depending on the nature and severity of violations of quality control requirements, competent state agencies shall decide on compulsory re-export, destruction or reprocessing of the goods, and at the same time, notify such to customs agencies for coordinated handling and to importers for implementation.⁵⁴⁹

However, with respect to parallel imports, the products designed for overseas market can be different from the products that circulate in domestic market. Trademark owners or their authorized distributors may base on the applicable standard announced to prevent the parallel imports of overseas products. On this point, we should look at Article 1, which states as follows:

⁵⁴⁵ Ibid., Art 3.3.

⁵⁴⁶ Ibid., Art 3.4.

⁵⁴⁷ Ibid., Art. 8.

⁵⁴⁸ Ibid., Art 34.

⁵⁴⁹ Ibid., Art.36.3.

This law provides for the rights and obligations of organizations and individuals producing or trading in products or goods as well as organizations and individuals conducting activities related to product and goods quality; and the management of product and goods quality.⁵⁵⁰

When the law on quality of products and goods is adopted, it aims not only to protect the legitimate interests of consumers but also to protect the goodwill of trademark owners from being undermined. However, when the law enforcement in general is not so high there is always a gap between law and practice. The question how to harmonize the benefits of trademark owners, parallel importers, consumers and the public remains to be resolved.

b. After-sale service

According to the Law, conducting after-sale service is one of the obligations that the importers have to undertake.⁵⁵¹ After purchasing an imported product consumers can ask to repair the products. In case importers cannot repair, consumers have two other options: 1). they may have their money back, or 2). they may ask for exchange for new goods, and importers have to receive back defective ones returned by consumers. This is an advanced provision when the legitimate interests of consumers are respected. At this point, it is understandable when the law requires importers undertake repair work for products they import. From the theoretical point of view, this is a good provision because it protects the legitimate interests of consumers. This provision, however, is not easy to apply in practice. Importers in this situation can be parallel importers or authorized importers. Can consumers bring the parallel imported products to authorized importers to ask for repair or exchange or have their money back from authorized importers? Probably not, because according to the law, importers take responsibility for the quality of products that they import.⁵⁵² The distributors may

⁵⁵⁰ Ibid., Art.1.

⁵⁵¹ Ibid., Art. 12.8.

⁵⁵² Ibid., Art. 12.2.

refuse to undertake such repair work because they do not import those products. Although Article 12.8 allows consumers exchange new products or take back the money it is really hard to require parallel importers to undertake their obligation in practice in such a case. When the law enforcement in general is not so high there is always a gap between law and practice.

Compensation liability of importers is also provided in this law. Namely, importers shall pay compensation to consumers when their goods cause harms to the consumers due to their failure to ensure the goods' quality.⁵⁵³ Compensation liabilities are applied to importers in general, regardless of their status as distributors or parallel importers. This provision is a necessary because producers and importers are tend to seek for profits, being careless about the quality of import products. How to apply these provisions in reality in order to protect interests of consumers is a challenge to the state authorities of Vietnam.

C. Recommendations

After construing the situation of parallel importation of trademarked products in Vietnam the following part proposes some recommendations in order to improve the legal environment regarding parallel imports. The recommendations presented above for developing countries in general apply to Vietnam. Particularly, Vietnam should pay attention to the disadvantages of allowing parallel importation as it adopts the international exhaustion rules. Here I focus on the points which are specifically related to Vietnam. The recommendations that the government should consider include modifying Article 125.2.b. of the Vietnam intellectual property law, supplementing regulations on concerned issues of parallel imports, and enhancing the role of court system in solving parallel import case.

⁵⁵³ Ibid., Art. 61.1.

1. Modify Article 125.2.b. of the VIPL

In the Vietnam intellectual property law, article 125.2.b states as follows:

Owners of industrial property objects as well as organizations and individuals granted the right to use...shall not have the right to prevent others from...circulating, importing, exploiting utilities of products which were lawfully put on the market including overseas markets, except for *products put on the overseas markets not by the mark owners or their licensees*. (emphasis is added.)

The phrase “products put on the overseas markets not by the mark owners or their licensees” in Article 125.2.b should be modified to “products put on the overseas markets not by the mark owners or with their consent”. In fact, the trademarked products are put on a market by the trademark owners, their licensees, and/or distributors. There is some difference between a licensee and a distributor. A licensee connects to a licensor through a license agreement. For example, in a trademark license, the licensee will be granted full privilege to use the trademark on goods or services provided that the use is in accordance with agreed signage protocols and quality guidelines.⁵⁵⁴ Meanwhile a distributor is not required to obtain a license to distribute a trademark or products. A distributor connects with a producer or manufacturer by a distribution agreement. The distributor may be an exclusive agent selling only those goods belonging to the producer or, as is normally the case, the exclusive agent is the only distributor of a certain producers in the market. The majority of distributorships are non-exclusive.⁵⁵⁵ For the difference between licensees and distributors, the use of phrase “their licensees” is not precise because it does not embrace all the people who can legitimately put trademarked products into market.

⁵⁵⁴ Ian Cockburn, Franchising & Licensing - What are they? and how can you benefit from them? 7, accessed May 15, 2011, <http://www.wipo.int/sme/en/documents/franchising.htm#aut>.

⁵⁵⁵ Ibid.

2. Supplement regulations on concerned issues of parallel imports

a. Repackaging

Vietnam should adopt provision on repackaging parallel imported products. From the judicial practice of developed countries, according to the decision of ECJ for instance, in order to allow the parallel imported products circulate in the market, the products must be repacked in a proper way and have to satisfy certain conditions.⁵⁵⁶ The requirements for repackaging are necessary in order to supply the information for consumers and prevent them from get confused about the source or the producer of the goods.

Furthermore, the packaging procedure must be performed under strict technology conditions because of the importance of specific products to human health, such as pharmaceutical products, foods, beverages or cosmetics. For this reason, if there is no requirement for the repacking of the parallel importation of trademarked products, then this could cause damage to consumers. Regarding this issue, there are many examples from the courts of the developed countries such as the U.S., the E.U and Japan in dealing with cases where the distributors did not follow the repackaging requirements. Vietnam can learn from the laws and practices of these developed countries or region to issue its own provisions on repackaging of imported products that fits with Vietnam situation.

b. Relabeling

Decree 89 so far has regulated many issues related to the relabeling of imported products and parallel imported products. However, this decree has no provision to the situation in which the parallel imported products are materially or physically different from domestic ones. At this point, Vietnam can learn from the United States experiences on adopting the Level rule protection.

⁵⁵⁶ See Chapter 4.

3. Enhancing the role of Court system in solving parallel imports cases

The enhancement of role of the system of court in interpretation and application of the law is an important key for developing countries in order to improve their legal system. In Vietnam, enforcement of intellectual property rights is the responsibility of the People's Supreme Court, lower court and various government authorities. From the theoretical point of view, the courts not only solve disputes between related parties but also give their guidelines from the judicial practice. However, according to the annual report of the Supreme People's Court there has been no case relating to exhaustion of trademark rights or to parallel imports of trademarked products in Vietnam up to date.

The court system in Vietnam has not yet shown its role in solving disputes related to parallel importation. In fact, the role of the court has not been highly evaluated by the related parties involved in disputes brought to the courts in Vietnam. People therefore tend to prefer to use other means to solve their problem rather than to bring a case to court. In order to enhance the role of the judiciary of Vietnam in dealing with parallel imports of trademarked products, there are many lessons from the juridical system of developed countries that Vietnam should learn. One lesson from the court system of Japan is that, even when there is no explicit provision on parallel imports in the law (as the case of the Japanese Trademark Act), the courts can solve many cases related to this issue. The courts in fact have made many rulings on dealing with parallel imports of trademarked goods. The role of the court is crucial and also has changed in a more flexible way. Another example is to use Japanese court system for reference, which introduces a case-based manner to facilitate the interpretation of flexibility in solving a similar case. In such a situation, the courts need qualification of judge, which is a challenge that Vietnam now has to deal with. Also, because the courts have not yet recognized case-based manner in the judicial practice, this is a good lesson for the Vietnam courts to start making certain necessary changes.

Therefore, enhancing the role of the courts in Vietnam judicial system in dealing with parallel import cases is a necessary step that should be taken as soon as possible. Even if new regulations are not realized soon in the form of law and other legal or administrative instruments, the courts can give guidelines in solving cases related to parallel imports. Nonetheless, this process is not a simple task for the courts. On the contrary, this is a tough challenge because of the lack of capacity of the judicial branch. Moreover, the level and capacity of judges in Vietnam are matters of current concern⁵⁵⁷ in respect of not only disputes concerning parallel imports cases but also those in solving disputes in general. In order to fulfill this task, there are many steps that the court system must take, and the most important one is enhancing the qualifications of judge and legal professionals in general.

D. Concluding remarks

Under the rapid change of the international trading system, the development of a country impacts to other countries. Also, the rapidly changing conditions of the world trade have thrown countries into a quandary about the potential of parallel importation.⁵⁵⁸ In dealing with parallel imports, different countries have different treatments. With respect to trademarked goods, industrial countries with the support of statutory provisions, case law, and public policies from a well-made legal framework have already formed their treatment of parallel imports. Furthermore, the court systems with the supports of experienced judges and scholars are a guarantee for developed countries in dealing with parallel imports of trademarked products.

On the contrary, developing countries meet a lot of difficulties in dealing with parallel imports. The insufficiency of provisions on regulating parallel imports shows the shortcomings of

⁵⁵⁷ Thanh Quang, Năng lực của thẩm phán vẫn là vấn đề quan ngại, (Capacity of judges is a matter of concern) accessed April 30, 2011, http://www.rfa.org/vietnamese/in_depth/Incompetence-of-judges-and-law-graduates-in-vietnam-03302010071108.html.

⁵⁵⁸ Cornish, Llewelyn, and Aplin, *Intellectual Property*, 839.

legal framework. Moreover, domestic manufacturers are fewer and incapable to supply for the national needs. Developing markets thus rely on imported products in many fields of products. By analyzing the current conditions of developing countries, it is necessary for these nations to allow parallel importation of trademarked products. As we have seen, there are advantages when parallel imports of trademarked products are possible. From the consumers' point of view, parallel imports help to protect their legitimate interests by increasing the source of supplies and reducing the prices of products. From the markets' point of view, monopolistic position of certain manufacturers will be mitigated and a more competitive market is created thereby. Also, one of the major concerns is counterfeit products in developing markets. The expandability of counterfeit products will be reduced when countries allow parallel importation of trademarked products.

In the context of trademark rights, the treatments of developed countries are quite different. Although, the United State and Japan follow the principle of international exhaustion of trademark rights, their actual application of this principle is slightly different. The EU stays in its own position of applying the principle of Community-wide exhaustion. This paper recommends that developing countries should adopt the international exhaustion regime in order to motivate the free trading in global scale. Developing countries can choose either the U.S. or the Japanese pattern of exhaustion regime to apply, depending on their domestic demands so as to achieve the highest result. Furthermore, developing countries should also take into consideration other specific regulations related to parallel importation of trademarked products such as quality control, repackaging, relabeling so that parallel imports can be able to apply properly and effectively.

There are a lot of problems that developing countries have to solve in their itineraries to development, such as eliminating trade deficits, reducing inflation rates, reforming legal frameworks, and improving social welfare. Developing countries must tackle with all of such problems so as to ensure their development. All of the above problems are significant, but I believe that reforming the legal frameworks is the most fundamental starting point.

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