

## **Committee on Development and Intellectual Property (CDIP)**

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### **INTERFACE BETWEEN EXHAUSTION OF INTELLECTUAL PROPERTY RIGHTS AND COMPETITION LAW**

*prepared by the Secretariat*

1. The Annex to this document contains a revised Study on the Interface between Exhaustion of Intellectual Rights and Competition Law prepared under the Project on Intellectual Property and Competition Policy (CDIP/4/4/Rev) taking into account inputs received from Member States, as it was decided during the last session of the Committee.

2. *The CDIP is invited to take note of the information contained in the Annex to this document.*

[Annex follows]

1. The present document was prepared as an integral component of the Thematic Project on Intellectual Property and Competition Policy, as revised and approved at the fourth session of the Committee on Development and Intellectual Property (CDIP), which was held in Geneva, on November 16 to 20, 2009.

2. The component in question is phrased as follows:

“Studies on IP and Competition in Selected Countries and Regions: A series of studies on recent developments concerning the interface between intellectual property rights and competition policy will be undertaken. The focus will be primarily on the collection and analysis of Member States’ experiences, such as legal developments, jurisprudence and legal remedies in this respect in different countries and regions. The studies will also analyze the interaction of agencies dealing with the two legal areas – IP and competition law – in different countries.”

3. The attached study, on the interface between exhaustion of intellectual rights and competition law, addresses in particular one of the three recommendations covered by the Project mentioned above. It is Recommendation 7, which reads:

“Promote measures that will help countries deal with intellectual property related anti-competitive practices, by providing technical cooperation to developing countries, especially Least Developed Countries (LDCs), at their request, in order to better understand the interface between Intellectual Property Rights (IPRs) and competition policies.”

4. The study that follows has also a close connection with Recommendation 14, as far as exhaustion of intellectual property (IP) rights can be viewed as a flexibility available under both the Paris Convention and the TRIPS Agreement.

5. The objective of the study that follows is not to cover all the complex legal and economic issues that the interface between exhaustion and competition law entails, but rather to detect for national experiences in dealing with that matter and attempt to identify some possible ways in which the laws of WIPO Member States can use exhaustion as a tool to address anti-competitive uses of IP rights.

6. The Secretariat is grateful for the inputs it has received from Brazil, Japan and the United States. However, it should be understood that the fact that Brazil, Japan and the United States have kindly provided comments to the Study does not mean that they endorse it in its entirety.

Table	Paragraphs
<b>(I) THE NOTION OF EXHAUSTION</b>	<b>1-4</b>
<b>(II) EXHAUSTION, IP, TERRITORIALITY AND THE FREE CIRCULATION OF GOODS</b>	<b>5-6</b>
<b>(III) EXHAUSTION IN MULTILATERAL AGREEMENTS</b>	<b>7-15</b>
<b>(IV) USING EXHAUSTION AS A TOOL TO ADDRESS ANTI-COMPETITIVE ABUSES OF IP RIGHTS</b>	<b>16</b>
(a) Examples extracted from national statutes	17-24
(b) Examples extracted from case law	25
(i) <u>Exhaustion as a tool to define the limits of the legal scope of IP rights</u>	27-38
(ii) <u>Exhaustion as a tool to prevent the segmentation of markets</u>	39-40
- <u>Exhaustion and (national) market segmentation (United States)</u>	41-43
- <u>Exhaustion and (regional) market segmentation (European Union (EU))</u>	44-57
(iii) <u>The Japanese Supreme Court cases related to the exhaustion of patent rights</u>	58-62
<b>(V) CONCLUSION</b>	<b>63-67</b>

## I. THE NOTION OF EXHAUSTION<sup>1</sup>

1. Exhaustion means the consumption of rights in intellectual property subject matter as a consequence of the legitimate transfer of the title in the tangible article that incorporates or bears the intellectual property asset in question. Exhaustion, therefore, is a natural consequence of the intangible nature of the assets covered by intellectual property, such as expressions, knowledge, reputation, quality, origin. Because of their intangible nature, they do not follow the tangible article with which they are associated.

2. As United States Appellate Federal Judge Posner said, in the absence of exhaustion, if every time a car owner wished to resell his/her used car needed to request a license from the car maker that would lead to an absurd situation of implying automatic compulsory licenses.<sup>2</sup> The legal solution is to assume that when that owner purchased the car, the right to use the trademark for commercial operations was consumed.

3. However, exhaustion is not absolute. Generally, exhaustion concerns the rights that, among all those that form the bundle of IP rights, are of an exclusively commercial nature. These are those that are consumed in any operation that leads to the transfer of title – generally an operation of a commercial nature, but not always.<sup>3</sup> Those rights that concern the manufacturing or physical handling of the article and that are under the exclusivity regime – such as making, reconstructing, repairing and packaging – are not exhausted as a consequence of the first sale. They may be to some extent affected,<sup>4</sup> but they are not entirely exhausted.

4. Exhaustion is a market-driven legal consequence and in that context it has been categorized in accordance with the geographical dimension of its impact. It is commonly said that exhaustion can be national – when it leads to the consumption of rights within the borders of national jurisdictions – or international – when it is generated by the first sale in another country. Exhaustion can also be regional when it affects a single market that extends over the borders of one or more countries associated in a trade region. For all purposes, regional

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<sup>1</sup> Comment added by the United States:

“The doctrine of exhaustion, also known as the ‘first sale’ doctrine, determines the limits of a patent holder's rights after the first sale of the product embodying the patented invention. Patent exhaustion is intended to prevent double-recovery by limiting a patent owner's ability to collect more than a single reward from a patented product. It is important to note this point in Section I and throughout the paper. A use is not anticompetitive simply because the IP rights have been exhausted. Rather, if an IP right is exhausted, the antitrust laws are then applied, as they would be to any other activity, to determine whether the use is anticompetitive.”

<sup>2</sup> “It is one thing to say that a manufacturer of copying machines who requires his customers to buy from him the copying paper that is used in the machines is conditioning the sale of the machines on the customer's purchase of a distinct product; it is quite another to say that General Motors lets you use the name Buick on condition that you buy the car to which the name is attached. That is a fantastical description of the transaction and the cases reject the proposition that a tie-in claim be based on it. [citation omitted] To accept it would be to impose in the name of antitrust a regime of compulsory licesning of trademarks – an absurd project.” *Jack Walters & Sons Corp. v. Morton Building, Inc.*, 737 F.2d 698, 704 (7th Cir. 1984).

<sup>3</sup> For this reason, it is commonly said that exhaustion is caused by the first sale. However, any legitimate transfer of title results in exhaustion of the commercial IP rights. This matter is clarified by Article 6(2) of the WIPO Copyright Treaty (WCT), of 1996 (“the conditions, if any, under which the exhaustion of the right [...] applies after the first sale *or other transfer of ownership* of the original or a copy of the work with the authorization of the author.” – emphasis added) and Articles 8(2) (concerning performers' rights) and 12(2) (concerning phonogram producers' rights) of the WIPO Performances and Phonograms Treaty (WPPT), of 1996. However, it is generally understood that when the transfer has not a commercial nature – a donation, for example – the IP owner can impose downstream restrictions on the use and disposal of the article by the person in whose favor the donation was made. This is however, an exception and must be expressed at the time the donation occurs. Otherwise, exhaustion will operate as usual.

<sup>4</sup> Some sort of repairing has been admitted by courts in various jurisdictions; repackaging – provided the trademark in question is not affected – has also been accepted.

exhaustion operates in the same way as national exhaustion – it is generated by the first sale within the same trade region and it has consequences in the territories of the several countries that form the trade region in question.

## II. EXHAUSTION, IP, TERRITORIALITY AND THE FREE CIRCULATION OF GOODS

5. Some commentators view the territorial effects of intellectual property as a restriction to free trade in itself. The General Agreement on Tariffs and Trade (GATT), of 1947, echoed this approach, to the extent that it said that measures aiming at securing “compliance with laws or regulations which are not inconsistent with the provisions of this Agreement, including those relating to [...] the protection of patents, trade marks and copyrights, and the prevention of deceptive practices,” provided they are “not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade” should not be prevented by the Agreement.” This provision, adopted in Article XX(d) of the GATT 1997, is placed under the heading “General Exceptions.”

6. However, from a public policy perspective, WTO Members (as well as WIPO Member States) may wish to impose limitations on rights so that the notion of “illegitimacy” loses ground. This is when exhaustion can be used to geographically confine the enforceability of IP rights. To what extent countries may decide whether the first sale of an IP protected article in a foreign jurisdiction amounts to a first sale of that IP protected article in its own territory for the purposes of limiting the rights of the owner is a matter that has not attracted consensus, as it will be shown next.

## III. EXHAUSTION IN MULTILATERAL AGREEMENTS

7. At the multilateral level, exhaustion is explicitly covered by provisions found in four treaties, two of which are administered by WIPO: the United Nations Set of Principles and Rules on Competition, of 1980;<sup>5</sup> the Agreement on Trade-Related Aspects of Intellectual Property Rights (the TRIPS Agreement), of 1994;<sup>6</sup> the WCT, of 1996;<sup>7</sup> and the WPPT, of 1996.<sup>8</sup>

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<sup>5</sup> Section D(4)(e) of the UN Set reads: “Enterprises should refrain from the following acts or behavior in a relevant market when, through an abuse or acquisition and abuse of a dominant position of market power, they limit access to markets or otherwise unduly restrain competition, having or being likely to have adverse effects on international trade, particularly that of developing countries, and on the economic development of these countries: [...]”

(e) Restrictions on the importation of goods which have been legitimately marked abroad with a trademark identical with or similar to the trademark protected as to identical or similar goods in the importing country where the trademarks in question are of the same origin, i. e. belong to the same owner or are used by enterprises between which there is economic, organizational, managerial or legal interdependence and where the purpose of such restrictions is to maintain artificially high prices; [...].”

<sup>6</sup> Article 6 of the TRIPS Agreement reads: “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.” Paragraph 4(d) of the Declaration on the TRIPS Agreement and Public Health (WT/MIN(01)/DEC/2, of November 20, 2001), reads: “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, subject to the MFN and national treatment provisions of Articles 3 and 4.”

<sup>7</sup> Article 6 of the WCT, on the Right of Distribution, reads: “(1) Authors of literary and artistic works shall enjoy the exclusive right of authorizing the making available to the public of the original and copies of their works through sale or other transfer of ownership. (2) Nothing in this Treaty shall affect the freedom of Contracting Parties to determine the conditions, if any, under which the exhaustion of the right in paragraph (1) applies after the first sale or other transfer of ownership of the original or a copy of the work with the authorization of the author.”

[Footnote continued on next page]

8. Moreover, the Paris Convention contains two provisions that may be deemed to have an impact on the setting of exhaustion regimes. Those provisions are found in Articles 4bis, on the independence of patents granted in different territories for the same invention and Article 6(3), on the independence of trademarks registered in different countries of the Union.

9. The way these treaties interact is not clear, because, given their different purpose and scope, those provisions may have different meanings. For example, Article 4(bis) of the Paris Convention originally speaks to the issue of procurement and maintenance of patents for the same invention in different territories. Its purpose was not to deal with the enforcement of patent rights in the context of the international trade of patented goods, even if its particular language (“The foregoing provision is to be understood in an unrestricted sense”) may lead to a different conclusion. After all, the original purpose of the Paris Convention in the field of patents was to permit the interoperation of national patent systems, rather than seeking their harmonization. By contrast, Article 6(3), which regards trademarks, naturally has a trade-related concern. However, like Article 4(bis), Article 6(3) was not introduced in the Paris Convention with the purpose of dealing with protection of substantive rights in connection with the international trade of goods, but rather with a more limited purpose of dealing with the issue of national registration and maintenance of trademarks to which “as is protection” is granted (Article 6quinquies). The relationship between Article 6(3) and 6quinquies is a complex one, which stems from the gradual evolution of the treatment of trademarks in the Paris Convention from a simple function of recognizing the origin of trademarked goods to a more modern notion of brands acknowledging reputation – which ultimately led to the de-linking trademarks from the source of designated goods in Article 15.1 of the TRIPS Agreement.

10. Apparently, it could be argued that it results from Articles 4(bis) and 6(3) of the Paris Convention that protection of patents and trademarks is bound by the jurisdictional borders of the territory of each Member State. If it is so, commercial acts taking place in the territory of one country could not affect the rights of the IP holder in another territory under a parallel IP asset. This was the interpretation given by the predecessor of WIPO, the *Bureaux Réunis pour la Protection de la Propriété Intellectuelle* (BIRPI), as explained in comments to the Model Law for Developing Countries on Inventions (1965).<sup>9</sup> Nevertheless, the historical linkage of Articles 4bis and 6(3) with procurement procedures may indicate that the understanding of Paris Convention Contracting Parties was that territoriality should not impact on the dimension of substantive rights.

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[Footnote continued from previous page]

An agreed statement clarifies that this provision refers “exclusively to fixed copies that can be put into circulation as tangible objects.”

<sup>8</sup> Paragraphs (2) of Articles 8 and 12 of the WPPT have the same language as Article 6.2 of the WCT, even if applied to different rights, as already noted above.

<sup>9</sup> Section 23.2 of the Model Law reads:

“The rights under a patent shall not extend to acts in respect of the product covered by the patent after the product has been lawfully sold in the country; [...]” This particular language was the subject of the following commentary: “Sub-section (2) means that, in general, any patented product may be freely used, resold, etc., once it has been lawfully sold in the country. [...] It is equally a matter of indifference whether the product was lawfully manufactured or lawfully sold in another country, because these acts do not affect the patent in the country itself.”

See *Model Law for Developing Countries on Inventions*, at 45-46 (4th reprint, BIRPI, Geneva, 1968). However, some participants in the Model Law Committee expressed the view that securing an exclusive right of importation “may, in connection with the rights related to sale and use, lead to unsatisfactory results in a developing country.” *Id.* at 44. But the Committee noted, however, “that the system of compulsory licenses [...] can take care of this question and safeguard the interests of developing countries.” *Id.* In fact, this is not possible. Exhaustion and compulsory licenses are different concepts. Exhaustion is a limitation to rights, to the extent it means that rights cease to exist under particular circumstances. Compulsory licenses are exceptions to rights: these do not cease to exist and can still be enforced against those who do not benefit from the license. Moreover, most compulsory licenses are subject to remuneration, whereas exhaustion, in view of the fact that it means that the right has been consumed, never leads to remuneration.

11. The TRIPS Agreement has taken a different avenue. Its Article 6 does not impose on WTO Members one special geographical category of exhaustion. WTO Members are free to adopt national (and regional) or international exhaustion, provided they comply with Articles 3 and 4 of the Agreement. Because Article 6 of the TRIPS Agreement refers explicitly to “dispute settlement under this Agreement,” issues as regards exhaustion could eventually be raised in dispute settlement under other Agreements, such as the GATT, but this discussion would be beyond this document. Moreover, it seems that paragraph 4(d) of the Doha Declaration may have, in the particular field of pharmaceuticals, extended the impact of Article 6 to dispute settlement under other Agreements as well, in the sense that it has not confined the freedom of WTO Members to “dispute settlement under this Agreement.” However, this matter is also beyond the scope of this document.

12. The language of Article 6(2) of the WCT and of Articles 8. and 12.2 of the WPPT appears to have drawn inspiration from Article 6 of the TRIPS Agreement. The basic proposal for the Treaty that would become the WCT offered two alternatives.<sup>10</sup> Under the first alternative (Article 8, Alternative A), the exclusive right comprised the right to import. The only exclusion would apply to importation effected by a person solely for his/her personal and non-commercial use as part of his/her personal luggage. The second alternative (Article 8, Alternative B) omitted the right of importation, which would leave open for domestic law to adopt international exhaustion.

13. The relationship of the WCT and WPPT provisions on exhaustion and the Berne Convention is not clear. The Berne Convention does not make any reference to exhaustion nor, because of the informal protection of copyright (Article 5(2)), to matters of independence in the context of procurement procedures. Article 5(2) provides that the enjoyment and the exercise of copyright shall be independent of the existence of protection in the country of origin of the work, but this seems to be related to the (non) applicability of the law of the country of origin.<sup>11</sup> Moreover, because exhaustion is a limitation to rights conferred, and, even if it has affinity with exceptions, is of a different nature, as mentioned above, it does not fall automatically under Article 9(2) of the Berne Convention. It is for this reason that the TRIPS Agreement deals with exhaustion (as a limitation) and exceptions in different provisions. Indeed, there is no need to say that exhaustion should not unreasonably prejudice the legitimate interests of the patent owner because, once exhaustion occurs, the patent owner has no rights left, let alone interests.

14. Finally, the UN Set is clear in its recommendation on the adoption of international exhaustion of trademarks, with a number of caveats, namely that the market segmentation or discrimination resulting from the use of international brands:

- (a) constitutes an abuse of a dominant position or a means to acquire and abuse of a dominant position;
- (b) has or is likely to have adverse effects on international trade; and
- (c) has or is likely to have adverse effects on the economic development of developing countries; (d) has the purpose to maintain artificially high prices.

15. As a preliminary conclusion, it can be submitted that current international law does not provide guidance as to how WIPO Member States could use exhaustion to address anti-competitive practices in the field of IP. The only treaty that makes that connection explicitly is the UN Set, but the value of its recommendation is very limited to the extent it is linked to an

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<sup>10</sup> See CRNR/DC/4, of August 30, 1996, at 34-37.

<sup>11</sup> In this sense, see Mihály Ficsor, *Guide to the Copyright and Related Rights Treaties Administered by WIPO and Glossary of Copyright and Related Rights Terms*, at 42 (WIPO, Geneva, 2003).

issue of international pricing and suggests the application of a number of restrictive caveats, as noted above.

#### **IV. USING EXHAUSTION AS A TOOL TO ADDRESS ANTI-COMPETITIVE ABUSES OF IP RIGHTS**

16. As noted above, the purpose of this brief study is to identify the most relevant experiences of WIPO Member States in using exhaustion as a tool to address anti-competitive practices involving the use of IP rights. Those experiences can be detected in national statutes as well as in case law of a number of Member States.

##### **(A) EXAMPLES EXTRACTED FROM STATUTES**

17. Many national statutes, particularly those that were passed after the entry into force of the TRIPS Agreement, provide for some type of exhaustion. Generally, the trend is that the laws that contain such provisions provide for international exhaustion. Also generally, statutes that are silent on that issue are construed as providing for national exhaustion. The reason is that, given the inherent territoriality of IP rights, in the absence of a provision in a different sense, it may be understood that the inclusion of the right to import (as well as to exclude others from importing) in the bunch of rights accorded to the different assets covered by IP means that exhaustion occurs at the national level only – therefore, IP owners keep the right to prohibit imports even if a legitimate sale has taken place outside the country.<sup>12</sup>

18. However, rare are those statutes that provide for an explicit interoperation of exhaustion with antitrust. One remarkable exception is the industrial property statute of the Sultanate of Oman. Section 11 of the Law on Industrial Property Rights, promulgated by Royal Decree No. 67/2008, reads:

“(4) (a) The rights under the patent<sup>13</sup> shall not extend:

(i) to acts in respect of articles which have been put on the market in Oman by the owner of the patent or with his consent, consequently exhausting the patent owner’s rights; [...]

(5) Without prejudice to the provisions of subsection 4(a) of this Section, the Minister shall have the authority, ex officio or at the request of any interested party, of declaring the patent rights exhausted, and thus of authorizing others to import the patented product or a product manufactured directly or indirectly by means of the patented invention (“the product”) from another territory when that product is not available in the territory of Oman or is available in the territory of Oman with unreasonably low quality standards or in a quantity that is not sufficient to meet the local demand or at prices that the Minister deems abusive or for any other reason of public interest, including anticompetitive practices, provided that:

(i) the product has been put in the channels of commerce in the territory from which it will be imported by the owner of the patent or with his consent; and

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<sup>12</sup> For a general overview of how national statutes deal with the territorial effects of exhaustion in the field of patents, see *Patent related flexibilities in the multilateral legal framework and their legislative implementation at the national and regional levels*, CDIP/5/4, of March 1, 2010, Annex II, at 32 *et seq.*

<sup>13</sup> The Omani statute provides for the same treatment in respect of other industrial property rights (utility models, industrial designs, layout designs, trademarks, and geographical indications).

(ii) a patent claiming the product or the process for its manufacture is in force in the territory from which the product will be imported and is owned by the same person who owns the patent in Oman or by a person under his control.

(a) If the importer fails to fulfill the purpose that justified the Minister's decision to consider the patent rights exhausted, the Minister shall, ex officio, or at the request of the patent owner, cancel the authorization.

(b) If the conditions that gave rise to the Minister's decision to consider the patent exhausted cease to exist, the Minister may, ex officio or at the request of the patent owner, cancel the authorization, provided that the legitimate interests of the importer are taken into account, including but not exclusively that the importer will retain the right to commercialize the products that remain on stock."

19. According to the Omani statute, exhaustion of industrial property rights occurs nationally, but where the IP owner engages in certain practices that are qualified as abusive or that involve the public interest, including anti-competitive practices, the Minister shall have the authority, ex officio or at the request of any interested party, of declaring the rights in question exhausted upon a legitimate first sale made abroad by the owner or with his consent (and where parallel rights are in force).

20. The advantage of the Omani solution – one that we can call *controlled national exhaustion* – is that it provides for national exhaustion as a general rule, for the sake of ensuring effective protection of IP rights and protecting the legitimate interests of foreign direct investors (who, under an international exhaustion regime, may be confronted with products made by themselves in other countries). However, Oman has not been left defenseless in the case the IP owner uses the relative territorial insulation granted by national exhaustion in an anti-competitive (or otherwise abusive) manner: in this event, Oman may resort to international exhaustion.

21. This is a new and creative flexibility that serves both private and public interests and is an expression that effective IP protection can be ensured and yet makes it possible for WIPO Member States to pursue national public policies, such as encouragement of foreign direct investment and prevention of anti-competitive practices and other abuses. This is not about compulsory licenses, however – this is a (new) modality of exhaustion that, like compulsory licenses, is grounded on the public interest, but, unlike those, only occurs upon the legitimate sale of the articles, does not permit their making, and does not entail any sort of remuneration.

22. A second example of the interaction between exhaustion and competition law can be found in Article 37, of the Law on Patents of Invention of the Hashemite Kingdom of Jordan (Law No. 32, of 1999, as amended by Temporary Law No. 71, of 2001). Article 37 reads:

"A. The provisions of this law shall not prevent any person from importing any materials or goods from a third party if that party enjoys the legal protection of the same patent protected in the Kingdom and if that importation is lawful, complies with the principles of commercial competition and fairly takes into account the economic value of the protected patent.

B. In spite of the inclusions of paragraph (A) of this article and without prejudice to the provisions of the related International conventions, goods covered by patent of invention may not be imported by any Licensee, if the Licensing contract prohibits him from importation to the kingdom, provided that the patent owner notify in writing the Customs Administration and the Registrar in this respect. The Registrar shall, at the expense of the patent owner, publish this notification in at least one of Local daily gazettes; and the applicable legislations shall apply to this case."

23. Article 37 of the Jordanian Law takes an approach that is opposite to that of Oman: in principle, exhaustion of patent rights is international. However, where the parallel imports are deemed not to comply “with the principles of commercial competition,” the patent owner is entitled to oppose them. Under paragraph B, the patent owner is also entitled to prohibit parallel imports by means of clauses in licensing agreements. The Jordanian solution might be called *controlled international exhaustion* (exhaustion being international, in principle, but with the possibility of transforming it into national exhaustion when one of the circumstances mentioned in Article 37(A) arises).

24. One would need to see both solutions put to practice to see how they operate. But at a first approach, the Jordanian solution seems to be more burdensome for the patent owner, and therefore it is not as much FDI-friendly as the statute of Oman.

## (B) EXAMPLES EXTRACTED FROM CASE LAW

25. Case law, mainly in major economies, provides for more examples of the interaction between exhaustion of IP rights and antitrust. Even though generalizing in this regard may be risky, because it may lead to overlooking special cases and circumstances, it can be submitted that national (as well as regional) courts have addressed that interaction in two main contexts. Firstly, exhaustion is used to help define the limits of the legal scope of IP rights. The use of rights (in particular, their enforcement) beyond those limits is deemed an abuse (or misuse).<sup>14</sup> Secondly, exhaustion is invoked to prevent the segmentation of national or international markets in the event the IP owner has market dominance and the way he is using the rights in question have anti-competitive effects. Let us see briefly how courts have adopted these two different approaches – which can be complementary.<sup>15</sup>

### (i) Exhaustion as a tool to define the limits of the legal scope of IP rights

26. In this context, exhaustion is a tool that helps courts assert the occurrence of an abuse or misuse of rights. Where the IP owner attempts to affirm or enforce a right in spite of it being exhausted, an abuse takes place. In this case, the IP owner is not authorized to prevail (under the unclean hands doctrine<sup>16</sup>) and, where the abuse has anti-competitive effects, it may be subject to antitrust-related sanctions. This approach has been frequently followed by United States courts.

27. The first time the United States Supreme Court addressed the issue of exhaustion of patent rights was in *Bloomer v. McQuewan* (1853).<sup>17</sup> The *Bloomer* case involved a patent

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<sup>14</sup> Comment added by the United States:

“The paper makes interchangeable use of the terms ‘anticompetitive use of IP rights’ (in the preamble), ‘abuse of IP rights’ and ‘misuse of IP rights’. The term ‘misuse’ is confusing for readers from Common Law systems, for whom ‘patent misuse’ is a specific patent defense that is not identical to anticompetitive use of IP. The term ‘abuse’ is vague outside of the context of Article 40 of the TRIPS agreement, which uses the term ‘an abuse of intellectual property rights having an adverse effect on competition in the relevant market.’

<sup>15</sup> We gratefully acknowledge the invaluable contribution of Prof. Nguyen Nhu Quynh, of the Law School of the University of Hanoi, for her research on and analysis of case law involving exhaustion in an antitrust context.

<sup>16</sup> The unclean hands doctrine means that “a court of equity may deny relief to a party whose conduct has been inequitable, unfair and deceitful, but doctrine applies only when the reprehensible conduct complained of pertains to the controversy at issue.” Black’s Law Dictionary (abridged 6th ed., West Publ., St. Paul, 1991).

<sup>17</sup> In a previous case, *Wilson v. Rousseau*, 45 U. S. 646 (1846), the Supreme Court had scrutinized a contract under which the patent rights were assigned (with territorial restrictions). The issue at bar, even if it has certain similarities with discussion in *Bloomer*, was nevertheless different. In the latter case, exhaustion resulted from the sale of the patented article and, as the doctrine would be fixed later on, was limited to the commercial use of the

[Footnote continued on next page]

whose term was extended by an Act of Congress. The patentee attempted to enforce the rights against someone who had acquired a patented machine and obtained a license for using it during the patent term. In denying the patentee's right against that purchaser, the Court drew a distinction between a license of the patent right and the acquisition of a patented machine. In the event someone acquires a license for the duration of the first patent term, the renewal of that term does not generate automatically the renewal of the license. The patent owner is entitled to license again or exclude the former licensee from using the invention for the remaining term. "But the purchaser of the implement or machine for the purpose of using it in the ordinary pursuits of life stands on different ground. In using it, he exercises no rights created by the act of Congress, nor does he derive title to it by virtue of the franchise or exclusive privilege granted to the patentee. The inventor might lawfully sell it to him, whether he had a patent or not, if no other patentee stood in his way. And when the machine passes to the hands of the purchaser, it is no longer within the limits of the monopoly.<sup>18</sup> It passes outside of it, and is no longer under the protection of the act of Congress."<sup>19</sup>

28. The United States Supreme Court reaffirmed the exhaustion doctrine, in *Adams v. Burke* (1873). In this case, the licensee had the right to make, sell, and use patented coffin-lids within a ten-mile circle around Boston. The licensee sold a coffin-lid in Boston to the defendant, who then took it outside of Boston and used it outside the ten-mile circle. The license restriction was clearly a proper and valid limitation on the grant of patent rights, but the Court held that the patent was exhausted nevertheless because there were no conditions on its subsequent use by the defendant: "The right to manufacture, the right to sell, and the right to use are each substantive rights, and may be granted or conferred separately by the patentee. But in the essential nature of things, when the patentee, or the person having his rights, sells a machine or instrument whose sole value is in its use, he receives the consideration for its use and he parts with the right to restrict that use. The article, in the language of the Court, passes without the limit of the monopoly. [note omitted] That is to say the patentee or his assignee having in the act of sale received all the royalty or consideration which he claims for the use of his invention in that particular machine or instrument, it is open to the use of the purchaser without further restriction on account of the monopoly of the patentees. [...] It seems to us that although the

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[Footnote continued from previous page]

article. In *Wilson*, exhaustion was the result of the transfer of the right itself. This is a matter of contract law, rather than of patent law.

<sup>18</sup> The association of patents with monopolies is a recurrent one, both in courts as well as in treatises. However, that is not an accurate one. Patentees, when they exploit their inventions (most patented inventions never come to the market), face the competition of other articles as well as the prospect of alternative inventions being created. It is not a coincidence that those countries where patents are more often acquired and enforced are those in which the levels of inter-firm rivalry are the highest. As one British historian of the patent system has put it, the association of patents with monopolies is a stigma that has resisted common sense since the enacting of the Statute of Monopolies, of 1624. Christine MacLeod, *Inventing the Industrial Revolution – The English Patent System, 1660-1800*, at 186 (Cambridge Univ. Press, Cambridge, 2002).

Comment added by the United States:

"The term 'Monopoly' is used in two senses – a legal one and a market one. In the patent sense, 'monopoly' means an exclusive legal right. In the antitrust sense, it means something like market power which is the ability profitability to maintain prices above, or output below, competitive levels for a significant period of time. The footnote should explain more clearly that it is defining monopoly in the antitrust sense. The explanation found in Section 2.2 of the DOJ-FTC Antitrust Guidelines for the Licensing of Intellectual Property is helpful. It states: "Although the intellectual property right confers the power to exclude with respect to the *specific* product, process, or work in question, there will often be sufficient actual or potential close substitutes for such product, process, or work to prevent the exercise of market power. If a patent or other form of intellectual property does confer market power, that market power does not by itself offend the antitrust laws. As with any other tangible or intangible asset that enables its owner to obtain significant supracompetitive profits, market power (or even a monopoly) that is solely 'a consequence of a superior product, business acumen, or historic accident' does not violate the antitrust laws."

<sup>19</sup> *Bloomer v. McQuewan*, 55 U.S. 539, 549 (1853). The Court reiterated the exhaustion doctrine in the context of the extension of the patent term in various other cases, namely in *Bloomer v. Millinger*, 68 U.S. 340 (1863) and in *Mitchell v. Hawley*, 83 U. S. 544 (1872).

right of [the licensee] to manufacture, to sell, and to use these coffin lids was limited to the circle of ten miles around Boston, that a purchaser from them of a single coffin acquired the right to use that coffin for the purpose for which all coffins are used. That so far as the use of it was concerned, the patentee had received his consideration, and it was no longer within the monopoly of the patent. It would be to engraft a limitation upon the right of use not contemplated by the statute nor within the reason of the contract to say that it could only be used within the ten-miles circle. Whatever, therefore, may be the rule when patentees subdivide territorially their patents as to the exclusive right *to make* or *to sell* within a limited territory, we hold that in the class of machines or implements we have described, when they are once lawfully made and sold, there is no restriction on their use to be implied for the benefit of the patentee or his assignees or licensees."<sup>20</sup>

29. The exhaustion doctrine has been consistently reaffirmed by U.S. courts, as shown by the recent *Jazz* cases.<sup>21</sup> The cases involved the imports of used and refurbished single-use cameras, which were covered by U.S. patents. The patent owner alleged infringement. The cases discussed two substantive (and related) issues: whether refurbishing was permitted under the doctrine of permissible repair; and whether the disposal of the cameras abroad led to the exhaustion of Fuji's U.S. patents. In *Jazz I*, the Court of Appeals for the Federal Circuit held that

"Underlying the repair/reconstruction dichotomy is the principle of exhaustion of the patent right. The unrestricted sale of a patented article, by or with the authority of the patentee, "exhausts" the patentee's right to control further sale and use of that article by enforcing the patent under which it was first sold. In *United States v. Masonite Corp.*, 316 U.S. 265, 278, ... (1942), the Court explained that exhaustion of the patent right depends on 'whether or not there has been such a disposition of the article that it may fairly be said that the patentee has received his reward for the use of the article.' ... Imported LFFPs of solely foreign provenance are not immunized from infringement of United States patents by the nature of their refurbishment."<sup>22</sup>

30. In *Jazz II* the court said further that

"This court does not construe the 'solely foreign provenance' language or the *Boesch* citation to dictate a narrow application of the exhaustion principle. Specifically, this court does not read *Boesch* or the above language to limit the exhaustion principle to unauthorized sales. *Jazz* therefore does not escape application of the exhaustion principle because Fuji or its licensees authorized the international first sales of these LFFPs. The patentee's authorization of an international first sale does not affect exhaustion of that patentee's rights in the United States. Moreover, the 'solely foreign provenance' language does not negate the exhaustion doctrine when either the patentee or its licensee sells the patented article abroad."<sup>23</sup>

31. Neither of these opinions addressed antitrust-related issues (the Sherman Act would be enacted later, in 1890). Nevertheless, they are relevant in the sense that they established one of the principles that are at the core of antitrust-relevant post-sale restrictions, i.e., that once a patented good is sold, the purchaser is free to use it without restrictions, since the producer has waived his/her rights on that particular good.

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<sup>20</sup> *Adams v. Burk*, 84 US 453, 456, 457 (1873).

<sup>21</sup> *Jazz Photo Corp. v. ITC*, 264 F.3d 1094 (CAFC 2001), *cert. denied*, 536 U.S. 950 (2002) (*Jazz I*); *Fuji Photo Film Co., Ltd. v. Jazz Photo Corp.*, 394 F.3d 1368 (CAFC 2005); and *Jazz Photo Corp. v. United States*, 429 F.3d 1344 (2006).

<sup>22</sup> *Jazz I*, at 1105.

<sup>23</sup> *Jazz II*, at 1376.

32. In *United States v. Univis Lens Co.* (1942), the Supreme Court revisited the exhaustion doctrine, but this time in the context of the interface between patent law and antitrust. The issue at bar was a price resale maintenance (RPM) clause.<sup>24</sup> Univis Lens Co. was the owner of a patent covering lens blanks as well as the process of grinding and polishing them, by which the blanks are converted into finished lenses for use as eyeglasses. The patentee granted a license agreement which included an RPM clause. The licensee was authorized to buy lens blanks from Univis Lens Co. at set prices, finish them as lenses according to the patented process, and sell the lenses to other licensees who were authorized to sell them to the public. Sale prices were set by the patent owner. The Supreme Court invoked the exhaustion doctrine to conclude that the setting of prices by the patentee was a violation of antitrust law. The Court concluded that “[a]greements for maintaining prices of goods in interstate commerce, including restrictions imposed by the seller upon resale prices, held unreasonable restraints within the meaning of the Sherman Act.”<sup>25</sup> Rather, the restraints were not protected by Univis’s patent rights from condemnation under the antitrust laws because those rights had been exhausted by the sale. Once Univis’s patent rights were exhausted the antitrust laws could be applied to the restraints Univis sought to impose. At the time the *Univis* case was decided, resale price maintenance (“RPM”) restraints were per se unlawful and therefore Univis’s restrictions on the resale prices of lenses were found to violate the Sherman Act.

33. The Court stressed the general principle that the exercise of patent rights cannot go beyond what it may be considered reasonable to protect them; if that happens the unreasonable clauses will fall under antitrust scrutiny like any other clauses referring to unpatented goods: “The stipulations for maintenance of price derived no support from the patent, and must stand on the same footing under the Sherman Act as like stipulations with respect to unpatented commodities.”<sup>26</sup>

34. More recently, U.S. Federal Courts re-examined the exhaustion principle allowing some contractual provisions to strengthen the patent holder’s rights over the use of his/her invention. In particular this was analyzed in *Mallinckrodt Inc. v. Medipart, Inc.* (Fed. Cir. 1992).<sup>27</sup> In *Mallinckrodt*, the patentee sold patented devices (medical nebulizers) under a single-use clause, this meaning that it would not authorize the devices to be serviced so that they could be used again. Hospitals would send the used devices to the defendant, which after reconditioning them, would send them back to the hospitals. The patent owner sued Medipart on patent infringement and induced infringement. The District Court accepted the argument that hospitals had acquired the patented devices directly from the manufacturer, not from a licensee, and therefore the restraint would not apply to them. However, the Federal Circuit reversed, on the ground that the discussion was different and that the “For Single Patient Use Only” restriction was not a per se abuse even if applied to the final users. “The appropriate criterion” that the District Court should have applied was “whether Mallinckrodt’s restriction is reasonably within the patent grant, or whether the patentee has ventured beyond the patent grant and into behavior having an anticompetitive effect not justifiable under the rule of reason.”<sup>28</sup> Unless the

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<sup>24</sup> Today, in the United States, RPM is no longer per se unlawful. Taking notice of the fact that RPM restrictions can enhance competition, the U.S. Supreme Court determined in 2007 that such restrictions must be evaluated on a case-by-case basis under the rule of reason. This approach balances any anticompetitive effects from the restraint against its procompetitive benefits. Thus, RPM is generally only considered an antitrust violation if, on close examination, it is found to be unreasonable. The opinion that set this precedent is *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, 551 U.S. 877 (2007).

<sup>25</sup> *United States v. Univis Lens Co.*, 316 U.S. 241 (1942), at 252 (emphasis added).

<sup>26</sup> *Univis Lens*, at 251.

<sup>27</sup> *Mallinckrodt, Inc. v. Medipart, Inc.*, 976 F.2d 700 (Fed. Cir. 1992).

<sup>28</sup> *Mallinckrodt*, at 708.

single-use restriction violates some law or policy, such as antitrust, the patent owner retains the right to impose conditions on sale. The court held that the District Court had erred “in holding that the restriction on reuse was, as a matter of law, unenforceable under the patent law.”<sup>29</sup>

35. This ruling may serve of encouragement to IP holders for imposing distribution restrictions on customers – such as field-of-use, anti-repair, anti-enhancement, anti-modification, preventing arbitrage, and limiting channels of distribution – so long as they are careful to make the sale clearly “conditional” rather than “outright.”

36. In *Quanta Computer, Inc. v. LG Electronics, Inc.* (2008),<sup>30</sup> the Supreme Court reaffirmed the exhaustion doctrine in connection with “method patents.” The issue was “whether patent exhaustion applies to the sale of components of a patented system that must be combined with additional components in order to practice the patented methods.”<sup>31</sup> The Court held that it does apply: “Nothing in this Court’s approach to patent exhaustion supports LGE’s argument that method claims, as a category, are never exhaustible. A patented method may not be sold in the same way as an article or device, but methods nonetheless may be embodied in a product, the sale of which exhausts patent rights. Our precedents do not differentiate transactions involving embodiments of patented methods or processes from those involving patented apparatuses or materials.<sup>32</sup> [...] Eliminating patent exhaustion for method patents would seriously undermine the exhaustion doctrine. Patentees seeking to avoid patent exhaustion could simply draft their patent claims to describe a method rather than an apparatus.”<sup>33</sup> Consequently, the Court held, “The authorized sale of an article that substantially embodies a patent exhausts the patent holder’s rights and prevents the patent holder from invoking patent law to control post-sale use of the article. Here, LGE licensed Intel to practice any of its patents and to sell products practicing those patents. Intel’s microprocessors and chipsets substantially embodied the LGE Patents because they had no reasonable non-infringing use and included all the inventive aspects of the patented methods. Nothing in the License Agreement limited Intel’s ability to sell its products practicing the LGE Patents. Intel’s authorized sale to Quanta thus took its products outside the scope of the patent monopoly, and as a result, LGE can no longer assert its patent rights against Quanta.”<sup>34</sup>

37. The issue in *Mallinckrodt* was whether conditions imposed in a contract could be enforced in a patent infringement action. Neither *Quanta* nor *Mallinckrodt* really addressed whether contractually imposed conditions could be enforced as a matter of contract law when they could not be enforced by means of a patent infringement suit.

38. In conclusion, even if the doctrine is far from being completely drawn, it is clear that exhaustion can be used as a tool to limit or confine the IP rights. Any assertion of those rights beyond the lawful limits or confinement would be unenforceable. However, it should be noted that exhaustion means that the IP rights are unenforceable under IP laws, not necessarily other laws.

#### (ii) Exhaustion as a tool to prevent the segmentation of markets

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<sup>29</sup> *Mallinckrodt*, at 709.

<sup>30</sup> *Quanta Computer, Inc. v. LG Electronics, Inc.*, 553 U.S. 617 (2008).

<sup>31</sup> *Quanta Computer*, at 621.

<sup>32</sup> *Quanta Computer*, at 628-629.

<sup>33</sup> *Quanta Computer*, at 629.

<sup>34</sup> *Quanta Computer*, at 638.

39. As said above, a second approach to the use of exhaustion by courts concerns the geographical extension of the enforcement of rights. It is generally understood that IP owners can impose territorial restrictions in licensing agreements. However exhaustion occurs as a consequence of the first authorized sale of the patented article. In other words, exhaustion is different from contractual restrictions. The legal query is whether the IP owner may impose geographically differentiated post-sale conditions upon those who acquire from him/her the patented article. This query has an antitrust dimension to the extent that it may involve vertical sales between the manufacturer and competing resellers. The latter may find themselves at a competitive disadvantage if the conditions (such as reselling prices) are different.<sup>35</sup> This market discrimination or segmentation may take place when the IP owner has a dominant position in the relevant market. This matter has been addressed by the highest courts in at least three jurisdictions: the United States, the European Union and Japan.

40. However, before mentioning a number of examples extracted from case law, it should be reminded that a number of WTO Members have made a similar point to the view expressed in the BIRPI Model Law Committee, as noted above,<sup>36</sup> in favor of allowing for parallel imports: “The view was expressed that intellectual property rights that enabled right holders to prevent parallel imports could be employed in an anti-competitive manner to segregate markets and restrict international trade. [note omitted] It was suggested that the issue of parallel imports and appropriate regimes for the exhaustion of intellectual property rights might be a subject of further work by the Working Group. [note omitted].”<sup>37</sup>

- Exhaustion and (national) market segmentation (United States)

41. The United States Supreme Court analyzed the territorial dimension of exhaustion in *Keeler v. Standard Folding Bed Co.* (1895). This case involved a patent which had been assigned to different beneficiaries in different territories. The defendants had purchased a certain amount of the patent articles in Michigan, where they had been manufactured by the assignees of the patent for that state, and sold them in the State of Massachusetts, where the same patent had been assigned to another company. The latter sued on grounds of infringement of his rights in the State of Massachusetts. A divided Supreme Court held that the defendants, “having purchased the patented articles in Michigan from the assignee of the patent for the territory included in that state, had a right to sell them anywhere within the United States, including Massachusetts, where the patent rights had been assigned to another assignee.”<sup>38</sup> The reason was that the first sale had exhausted the patent rights in the entire territory of the United States: “Where the patentee has not parted, by assignment, with any of his original rights, but chooses himself to make and vend a patented article of manufacture, it is obvious that a purchaser can use the article in any part of the United States, and, unless restrained by

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<sup>35</sup> When an IP owner exports articles bearing or embodying the IP in question to two different countries, such as pharmaceuticals, it may be tempted to charge different prices so as to capture more rents from those consumers who live in richer countries and are, therefore, considered to be better off. This may be an issue of consumer protection or of public health, but it is not an issue of competition law, to the extent that end-consumers do not compete in legal terms. But if the IP-bearing or embodying article is a machine, for example, or a raw material, or an ingredient, different prices at the international level may put the purchasers of that machine at a competitive disadvantage. The manufacturer that has paid more for the machine or has accepted restrictive post-sale conditions will necessarily be at a competitive disadvantage with another manufacturer, in another country, that has paid less or has not been obliged to accept the same post-sale conditions. It is in this dimension only that international exhaustion becomes an issue of competition law.

<sup>36</sup> See *supra* note 8 and accompanying text.

<sup>37</sup> See *Report (1998) of the Working Group on the Interaction between Trade and Competition Policy to the General Council, WT/WGTCP/2*, of 8 December 1998, at paragraph 120.

<sup>38</sup> *Keeler v. Standard Folding Bed Co.*, 157 U.S. 659, 660 (1895).

contract with the patentee, can sell or dispose of the same. It has passed outside the monopoly, and is no longer under the peculiar protection granted to patented rights.”<sup>39</sup>

42. After a review of the Court’s case law, Justice Shiras concluded: “Upon the doctrine of these cases, we think it follows that one who buys patented articles of manufacture from one authorized to sell them becomes possessed of an absolute property in such articles, unrestricted in time or place. Whether a patentee may protect himself and his assignees by special contracts brought home to the purchasers is not a question before us, and upon which we express no opinion. It is, however, obvious that such a question would arise as a question of contract, and not as one under the inherent meaning and effect of the patent laws. The conclusion reached does not deprive a patentee of his just rights, because no article can be unfettered from the claim of his monopoly without paying its tribute. The inconvenience and annoyance to the public that an opposite conclusion would occasion are too obvious to require illustration.”<sup>40</sup>

43. Three justices dissented. Based on the same grounds invoked by the Supreme Court in the case in which it refused international exhaustion (*Boesch v. Graeff* (1890)<sup>41</sup>), the Justices expressed their concern with the possibility that the majority’s opinion opened for purchasers of patented articles to enter into competition with local licensees. Eventually, the patentee could assign or license his rights in all states but his own and then undersell his assignees/licensees, “drive them out of business, and utterly destroy the value of their licenses.”<sup>42 43</sup>

#### - Exhaustion and (regional) market segmentation (European Union (EU))

44. The exhaustion doctrine has been used extensively by EU Courts for the main purpose of strengthening the common market implementation. The enforcement of a regional exhaustion principle was aimed at preventing segmentation of the European market into national territories.<sup>44</sup>

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<sup>39</sup> *Keeler*, at 661.

<sup>40</sup> *Keeler*, at 666-667.

<sup>41</sup> *Boesch v. Graeff*, 133 U.S. 698 (1890).

<sup>42</sup> *Keeler*, at 672-673.

<sup>43</sup> Comment added by the United States:

(a) In *Boesch* the Supreme Court did not have any occasion to address what we normally think of as exhaustion and it is incorrect to say that in *Boesch* the Supreme Court “refused international exhaustion.” The question before the Court was whether someone who bought from Hecht in Germany and imported those burners into the United States was free to use or sell them without permission from the U.S. patent holder. In essence, the Court held that a German prior user statute, giving you the right to make and sell a patented article even though you do not have authorization from the patent owner to do so, does not control whether you have such rights in the United States.

(b) Although the dissent in *Keeler* discusses *Boesch*, it does not rely on the same grounds invoked by the Court in *Boesch*. The dissent seems to argue that the prior cases on which the majority relied were not quite on point, because they dealt with use rather than resale, and extending the doctrine of authorized sale to resale was not good public policy. *Boesch*, by contrast, rested on entirely different grounds as described above.

(c) It is unclear why the discussion of the dissent from this case, decided in 1895, is relevant.”

<sup>44</sup> The objective of establishing an internal market was provided at Article 2 of the Treaty on the European Union and Article 2 and Article 2(3) of the Treaty of Lisbon.

45. The single market is identified “as a key strategic objective for Europe” and “the cornerstone of Europe’s integration and sustainable growth.”<sup>45</sup> It is characterized by “an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured”<sup>46</sup> and “a system ensuring that competition is not distorted.”<sup>47</sup> Based on this objective, a regional exhaustion regime was developed as an industrial policy tool.<sup>48</sup> If the owner of a national patent or trade mark were allowed to rely on his/her right to prevent parallel imports from other Member States, this would not be compatible with the ban on quantitative restrictions on imports and on measures having equal effect provided in Article 28 of the EC Treaty. This would also be clashing with the very foundation of a single EU market. Therefore, the Court of Justice (CJEU) held in a series of cases that, once the goods were put on the market with the IP owner’s consent within the Community, his distribution rights were exhausted. The exhaustion of IP rights in intra-Community trade should be governed essentially by the same considerations that are applicable to exhaustion in a domestic market. Thus, in the EU national exhaustion has been replaced by the concept of regional exhaustion.<sup>49</sup>

46. The principle of regional/community exhaustion is closely linked to the rules of free movement of goods/services and competition law, since they share the common purpose of establishing and maintaining an efficient and competitive single market. The principle of regional/community exhaustion was developed by CJEU during the early 1970s on the basis of the rules on free movement of goods under Articles 28 and 30 TEC (and now Articles 34 and 36 TFEU) and was subsequently codified in EU legislation for different categories of IP rights. The EU competition rules were laid down in Articles 81 and 82 TEC (now Articles 101 and 102 TFEU).

47. In the earlier cases on territorial partitioning of the internal market, CJEU used competition law to deal with IP-related anti-competitive practices. In *Grundig-Consten*,<sup>50</sup> the CJEU held that Article 81.1 of the Treaty had been infringed by an agreement under which Grundig allowed Consten to register Grundig’s trademark in France in Consten’s name, so that Consten could use the trademark to block parallel imports of Grundig products from Germany. Consten would be unable to invoke the trademark to oppose the import and sale of goods marketed by Grundig in another Member State and therefore the marketing took place with Consten’s consent. The Court held that the Consten-Grundig agreement was contrary to Article 81 and the main reason was that “Since the agreement [...] aims at isolating the French market for Grundig products and maintaining artificially, for products of a very well-known brand, separate national markets

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<sup>45</sup> Mario Monti, *A New Strategy for The Single Market*, Report to the President of European Commission José Manuel Barroso, 9 May 2010, available at <[ec.europa.eu/bepa/pdf/monti\\_report\\_final\\_10\\_05\\_2010\\_en.pdf](http://ec.europa.eu/bepa/pdf/monti_report_final_10_05_2010_en.pdf)>. See also *WTO Implementation and single market completion lead to greater liberalization in the European Union*, Press/ TPRB/65, 12 November 1997, available at <[www.wto.org/english/tratop\\_e/tp\\_r\\_e/tp\\_r65\\_e.htm](http://www.wto.org/english/tratop_e/tp_r_e/tp_r65_e.htm)>.

<sup>46</sup> Article 14.2 TEC and Article 26.2 TFEU. The free movement of goods is provided in Part Three, Title Ia of the Treaty of Lisbon and Part Three, Title II of TFEU. The free movement of persons is provided at Article 2(2) of the Treaty of Lisbon.

<sup>47</sup> Protocol on the internal market and competition, OJ C 306/156.

<sup>48</sup> About this argument, see W.R. Cornish and D. Llewelyn, *Intellectual Property: Patent, Copyright, Trade Marks and Allied Rights* (5<sup>th</sup> edition, Thomson Sweet & Maxwell, 2003).

<sup>49</sup> Ansgar Ohly, *Trade Marks and Parallel Importation – Recent Developments in European Law*, IIC, Volume 30, 1999, page 514. In this respect it is important to underline that in the well known *Silhouette* case (Case C-355/96, Judgment of the Court of 16 July 1998), the Court of Justice explicitly excluded the possibility of enforcing an international exhaustion principle, therefore stressing the applicability of the geographically more restrictive regional exhaustion standard.

<sup>50</sup> Joined cases 56 & 58/64, *Etablissement Consten SARL & Grundig-Verkaufs-GmbH v. EC Commission*, [1966] ECJ 299.

within the Community, it is therefore such as to distort competition in the Common Market.” This reasoning reflects the same principle at the basis of the exhaustion doctrine.

48. The *Grundig-Consten* case was dealt with under the competition rules of the Treaty, although it clearly concerned the free movement of goods as much as competition law. In fact it was not until the early 1970s that parallel importers began to invoke the provisions of Articles 28 *et seq.* The explanation for that may be that the prohibition of measures equivalent to quantitative restrictions did not become effective until the end of the transitional period on 31 December 1969. As one commentator said, “If the case were to arise now, the parallel importer would invoke Article 28 before national court in which the proprietor of the trade mark brought infringement proceedings against him and that court would have to apply the exhaustion doctrine established by the ECJ”.<sup>51</sup>

49. Five years after *Consten-Grundig*, in the landmark judgment of *Deutsche Grammophon*,<sup>52</sup> the CJEU considered a case of parallel imported goods for the first time under the free movement rules (Articles 28 and 30) and departed from the previous competition law approach (Articles 81 and 82). In that case, Deutsche Grammophon attempted to prevent the resale in Germany of records which its French subsidiary had marketed in France. To do so, it invoked the exclusive distribution right as a producer of phonograms (a right akin to copyright under German law). The Court established the principle of Community-wide exhaustion of IP rights whereby whenever the proprietor of the right consents to the marketing of goods in any Member State, he is precluded from invoking the right to prevent importation of the goods into any other Member State.<sup>53</sup>

50. After *Deutsche Grammophon*, in a series of subsequent cases, the CJEU used the principle of regional/community exhaustion based on the rules of free movement of goods to prevent IPR owners from segmenting the internal market.

51. In *Terrapin*,<sup>54</sup> to some extent, the Court examined the interaction among the rules of free movement of goods, the principle of exhaustion and competition rules. The Court affirmed that the trademark owner may invoke the first sentence of Article 36 of the European Economic Community Treaty - EEC Treaty (now Article 30 TFEU)<sup>55</sup> “to prevent the importation of products of an undertaking established in another Member State and bearing by virtue of the legislation of that State a name giving rise to confusion with the trade-mark and commercial name of the first undertaking.”<sup>56</sup> However, the enforceability of the right was denied when there was a restriction on competition or evidence of artificial partitioning of the common market.<sup>57</sup> Once found the anti-competitive practice, then the principle of exhaustion came into play if the IP-protected product was put on the market by the IP owner himself or with his consent. The Court

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<sup>51</sup> Keeling T., David, *IPRs in EU Law*, Volume I, Free Movement and Competition Law, at 81 (Oxford University Press, 2003).

<sup>52</sup> Case 78/70, *Deutsche Grammophon GmbH v. Metro-SB-Grossmarkte GmbH & Co KG*, [1971] ECR 487.

<sup>53</sup> Keeling, *supra* note 44, at 114.

<sup>54</sup> Case 119/75, *Société Terrapin (Overseas) Ltd. v Société Terranova Industrie CA Kapferer & Co.*, [1976] 2 ECR 1039.

<sup>55</sup> Accordingly, quantitative restrictions on imports, exports, and all measures having equivalent effects as provided in Articles 34 and 35 EEC Treaty (now Articles 34 and 35 TFEU) are compatible with Article 36 based on “the protection of industrial and commercial property.”

<sup>56</sup> Case 119/75, *Société Terrapin (Overseas) Ltd. v Société Terranova Industrie CA Kapferer & Co.*, [1976] 2 ECR 1039, paragraph 8.

<sup>57</sup> *Id.*, paragraphs 6 and 7.

held that: “It follows from the above [the rules of free movement of goods and the rules of competition] that the proprietor of an industrial or commercial property right protected by the law of a Member State cannot rely on that law to prevent the importation of a product which has lawfully been marketed in another Member State by the proprietor him self or with his consent.”<sup>58</sup>

52. Since the 1990s, the CJEU had many opportunities to enforce the exhaustion principle to prevent trademark owners from partitioning the Community pharmaceutical market by preventing parallel imports of repackaged trademarked pharmaceuticals.<sup>59</sup> In the EU parallel trade of pharmaceuticals has flourished due to product price differentials among Member States. The reasons are found in the significant differences among EU Member States both in terms of their macro-economic conditions and in their respective health systems<sup>60</sup> as well as in the policy of price controls. The European Commission is of the view that “[p]arallel importation of a medicinal product is a lawful form of trade within the Internal Market based on article 28 of the EC Treaty.”<sup>61</sup> The adoption of parallel trade in general and parallel imports of pharmaceuticals in particular is aimed at achieving the goal of a single internal market.

53. In *Pharmacia & Upjohn SA v. Paranova A/S*,<sup>62</sup> similarly to *Terrapin*, the CJEU continued to affirm that trademark owners may prevent repackaging and/or reaffixing of trademarked pharmaceuticals in the light of Article 30 of the EU Treaty. Nevertheless, pharmaceutical companies are no longer entitled to do so when anti-competitive conducts are detected. The CJEU started with explaining the link between Article 7(1) of the Directive 89/104/EEC on Community exhaustion<sup>63</sup> and Article 30 of the Treaty (now Article 34 TFEU) on the rules of free movement of goods. The Court stressed that “[The] trade mark proprietor may rely on his rights as proprietor to prevent an importer from marketing a product put on the market in another

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<sup>58</sup> *Id.*, paragraph 6.

<sup>59</sup> For instance, see Joined cases C-427/93, C-429/93 and C-436/93, *Bristol-Myers Squibb v Paranova A/S* (C-427/93) and *C. H. Boehringer Sohn, Boehringer Ingelheim KG and Boehringer Ingelheim A/S v Paranova A/S* (C-429/93) and *Bayer Aktiengesellschaft and Bayer Danmark A/S v Paranova A/S* (C-436/93), 1996, ECJ I-03457; Joined cases C-71/94, 72/94 and 73/94 *Eurim-Pharm Arzneimittel v. Beiersdorf* [1996] ECR I-3603; Case 232/94 *MPA Pharma v. Rhone-Poulenc Pharma* [1996] ECR I-3671; Case C-143/00, *Boehringer Ingelheim KG v. Swingward Ltd.*, [2002] ECR I-3759.

<sup>60</sup> According to Commission Dec 2001/791 Glaxo Wellcome [2001] OJ L302/1, paragraph 162: Austria, Denmark, Finland, Ireland, Sweden and United Kingdom are high price countries; Belgium, France, Greece, Italy, Portugal and Spain are “countries with relatively lower prices”. About the European pharmaceutical market, see Commission Communication on the Single Market in Pharmaceuticals, COM (98)588 final, Brussels, 25 November 1998.

<sup>61</sup> COM(2003) 839 final, the Commission Communication on parallel imports of proprietary medicinal products for which marketing authorizations have already been granted, Brussels, 30.12.2003. Parallel trade in pharmaceuticals has been ruled lawful in many decisions by the CJEU. See e.g., Joined Cases C-468/06 to C-478/06 *Sot. Lelos kai Sia EE v. GlaxoSmithKline AEVE* [2008] ECR I-7139, *Bristol-Myers Squibb v. Paranova A/S*, Case C-247/93, 1996 ECR 3457; *Peak Holding v. Axolin-Elinor*, Case C-16/03, 2004 ECR 11 3 13.

<sup>62</sup> Case C-379/97, *Pharmacia & Upjohn SA v Paranova A/S*, 1999 ECR I-6927. In this case, the Upjohn Group (a Denis company) used different trademarks for marketing clindamycin in the Community, particularly the trademark Dalacin' in Denmark, Germany and Spain, the trade mark Dalacine' in France and the trade mark Dalacin C' in the other Member States. Paranova (another Denis company) purchased clindamycin capsules in France, which were packaged in packets of 100 and placed on the market by the Upjohn Group under the trade mark Dalacine', in order subsequently to market them in Denmark under the trade mark Dalacin'. Paranova also purchased in Greece injection phials of clindamycin marketed by the Upjohn Group under the trade mark Dalacin C'. After repackaging by Paranova, this product was marketed in Denmark under the trade mark Dalacin'. Upjohn brought a lawsuit to prohibit Paranova from placing on the market and selling those pharmaceutical products under the trademark Dalacin'.

<sup>63</sup> Directive 89/104/EEC in 1988 to approximate the laws of the Member States relating to trademarks, OJ 1989 L 40, page 1 (now replaced by Directive 2008/95/EC of the European Parliament of 22 October 2008 to approximate the laws of the Member States relating to trademarks, OJ L 299, page 25).

Member State by the proprietor or with his consent, where that importer has repackaged the product in new packaging to which the trade mark has been reaffixed [...]. However, [...] the exercise by the proprietor of his trade-mark right may constitute a disguised restriction under Article 36 of the Treaty if it is established that reliance on the trade-mark right by the proprietor, having regard to the marketing system which he has adopted, would contribute to the artificial partitioning of the markets between Member States.<sup>64</sup>

54. The CJEU went further by concluding that “the practice of using different packaging and that of using different trade marks for the same product, in contributing similarly to the partitioning of the single market, adversely affect intra-community trade in the same way.”<sup>65</sup> Consequently, if trademark owners were allowed to prohibit parallel importers to reattach the trademark to the product after repackaging, this would cause “obstacles to intra-community trade giving rise to artificial partitioning of the markets between Member States [...], whether or not the proprietor intended such partitioning.”<sup>66</sup>

55. In more recent cases on parallel imports of repackaged drugs, the CJEU focused more on the role of the exhaustion principle rather than that of the rules of free movement of goods in preventing segmentation of the community pharmaceutical market. In *Swingward II*,<sup>67</sup> the CJEU stressed that trademark owners may rely on Article 7(2) to oppose parallel imports of repackaged pharmaceuticals.<sup>68</sup> Nevertheless, this right is exhausted when “it is established that reliance on trade mark rights by the proprietor in order to oppose the marketing of the overstickered product under that trade mark would contribute to the artificial partitioning of the markets between Member States.”<sup>69</sup> In other words, the principle of regional exhaustion becomes effective when trademark owners exploit their rights for artificially partitioning national markets.

56. Under EU law, even when exhaustion has already occurred, re-packaging of pharmaceuticals is lawful only if the following conditions are met: (i) a necessity to repackage; (ii) repackage did not adversely affect the original condition of the product; (iii) the presentation of the repackaged product must not damage the reputation of the trademark and its owner; (iv) an identification of re-packer, manufacturer, and additional articles; and (v) the proprietor of the trademark receives prior notice before the repackaged product is put on sale.<sup>70</sup>

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<sup>64</sup> Id., at paragraphs 17 and 31.

<sup>65</sup> Case C-379/97, *Pharmacia & Upjohn SA v Paranova A/S*, 1999 ECR I-6927, paragraph 38.

<sup>66</sup> Case C-379/97, *Pharmacia & Upjohn SA v Paranova A/S*, 1999 ECR I-6927, paragraph 39.

<sup>67</sup> Case C-348/04, *Boehringer Ingelheim v Swingward II*, [2007] ECR I-3391.

<sup>68</sup> Article 7 of the Directive 89/104/EEC (now the Directive 2008/95/EC) states that:

1. The 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.

<sup>69</sup> Emphasis added and words omitted. Case C-348/04, *Boehringer Ingelheim v Swingward I*, [2007] ECR I-3391, paragraph 32.

<sup>70</sup> The conditions for repackaging were also referred to in the Commission Communication on parallel imports of proprietary medicinal products for which marketing authorizations have already been granted, Brussels, 30.12.2003. See also a series of CJEU cases: *Hoffmann-La Roche v. Centrafarm*; C-427/93, 429/93 and 436/93 *Bristol-Myers Squibb v. Paranova* [1996] ECR I-3457 paragraph 53; Joined cases C-71/94, 72/94 and 73/94 *Eurim-Pharm Arzneimittel v. Beiersdorf* [1996] ECR I-3603; Case 232/94 *MPA Pharma v. Rhone-Poulenc Pharma* [1996] ECR I-3671; Joined cases C-71/94, 72/94 and 73/94 *Eurim-Pharm Arzneimittel v. Beiersdorf* [1996] ECR I-3603; Case 232/94 *MPA Pharma v. Rhone-Poulenc Pharma* [1996] ECR I-3671; Case C-143/00, *Boehringer Ingelheim KG v. Swingward Ltd*, [2002] ECR I-3759; Case C-379/97, *Pharmacia & Upjohn SA v Paranova A/S*, 1999 ECR I-6927; Case C-348/04, *Boehringer Ingelheim v Swingward II*, [2007] ECR I-3391.

57. In conclusion, it can be said that exhaustion has been effectively used by the CJEU as a tool to bar artificial partitioning of the community market in general and pharmaceutical markets in particular. In most cases, the exhaustion doctrine has involved trademark-related issues.

(iii) The Japanese Supreme Court cases related to the exhaustion of patent rights<sup>71</sup>

58. The doctrine of patent right exhaustion in Japan is not stipulated in statute, but domestic exhaustion of patent right can be found in Japanese cases. The leading Japanese case on parallel importation of patented product is *BBS v. Racimex and Jap Auto* (Supreme Court, 1 July 1997)<sup>72</sup>. There, the plaintiff BBS Kraftfahrzeug Technik A.G. (BBS), a German company, held a patent called “Wheel for Automobile” in Japan and its corresponding patent in Germany for the same invention. The defendant K. K. Jap Auto Products (Jap Auto), a Japanese company, imported into Japan the aluminum wheels (the patented product) manufactured and distributed by the plaintiff in Germany. The codefendant K. K. Racimex Japan (Racimex), also a Japanese company, sold the patented products imported by Jap Auto. BBS sued Racimex and Jap Auto on the grounds that the acts of importation and resale of the patented products in the Japanese market without BBS’s authorization were infringements of BBS’s Japanese patent. In the first instance, the Tokyo District Court did not recognize international exhaustion of patent right, stating that the Patent Act in Japan did not support that the voluntary transfer of ownership of products, covered by a Japanese patent, outside Japan exhausted the patent right over the very products, and found infringement of BBS’s Japanese patent. On the other hand, in the second instance, the Tokyo High Court reversed the first judgment that had acknowledged patent infringement, stating that the patent right was exhausted even though the ownership of the patented product was transferred outside Japan on the grounds that the patent holder had a chance to obtain compensation for the disclosure of the invention in putting the patented products into circulation in the market.

59. In the final instance, the Supreme Court recognized national exhaustion, in view of harmonizing between public interest achieved by smooth circulation of patented goods and protection of patentees through securing adequate opportunities to obtain interests from their patent rights, ruling that “if the patent holder or the licensee assigned the patented products in Japan, the patent right on the products has achieved its goal and has been exhausted, and the effect of the patent right does not extend to acts such as the use, assignment and rental of the products.”<sup>73</sup> However, the Supreme Court did not acknowledge international patent exhaustion, by holding that “this does not apply in the same way in cases where a patent holder in Japan assigned the patented good outside Japan,” on the grounds that “in the country where the assignment took place, the patent holder does not necessarily have the patent on the invention which is the same as the invention which is protected by the patent in Japan (hereinafter, ‘corresponding patent’).”<sup>74</sup> Furthermore, the Court noted that “even if the patent holder has a corresponding patent, in the light of the fact that the patent in Japan and the patent in the country of the place of assignment are separate rights, if the patent holder exercised the right based upon the patent right in Japan in relation to the goods which is protected by a corresponding patent, it cannot be regarded as profiting twice from the same patent.”<sup>75</sup>

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<sup>71</sup> Paragraphs 58 to 62 correspond to information provided by Japan, not as an example of ‘market segmentation’ but as mere reference information concerning the leading cases related to patent rights exhaustion in its jurisdiction.

<sup>72</sup> Japan Supreme Court, Case number 1995 (O) No.1988, decided on 1 July, 1997. An English version of the Supreme Court’s opinion is available at: <http://www.courts.go.jp/english/judgments/text/1997.07.01-1995-O-No.1988.html> (accessed on March 8, 2012).

<sup>73</sup> *Id.*

<sup>74</sup> *Id.*

<sup>75</sup> *Id.*

60. The Supreme Court also ruled that “freedom of circulation of goods including import of goods is required to be respected at the maximum” considering the circumstances of the broad-scale and advanced-mannered development of international commercial transactions; in light of this, “if a patent holder in Japan or an equivalent person assigns a patented product outside Japan to another person, the patent holder, unless there is an agreement with the assignee excluding Japan from the areas of sale or use of the said product, may not seek an injunction in Japan concerning the patented product on the basis of the patent right against the person who acquired the product from the assignee, except in cases where the above agreement has been made and is explicitly indicated on the product.”<sup>76</sup> The ruling grounds were (i) “if the patent holder assigned the patented products outside Japan without any reservation, it should be understood that the patent holder had implicitly granted the right to control the products to the assignee and the subsequent assignees without being restricted by the patent which the assignor has in Japan,” and (ii) “on the other hand, if one looks at the right of the patent holder, the patent holder should be understood to be entitled to reserve the right of exercising his patent right in Japan at the time of the assignment of the patented products outside Japan.”<sup>77</sup> It should be noted here that the Supreme Court did not affirm the principle of international exhaustion of the patent right as mentioned previously, but that it assumed that the right itself remained effective.

61. Accordingly, based on the Supreme Court decision mentioned above, in Japan, a patent right is exhausted only due to transfer of the ownership of patented products within Japan, and the doctrine of international exhaustion due to transfer outside Japan is not supported in Japan. In other words, it should be interpreted that, in Japan, the right itself of the patented products the ownership of which has been transferred outside Japan has not been exhausted.

62. In the so-called *Cannon Ink Jet Cartridge* case, the latest Supreme Court decision was given concerning patent exhaustion in Japan (Supreme Court, November 8, 2007).<sup>78</sup> In this case, while following the precedent decision of the *BBS* case mentioned above, the Supreme Court ruled that “if the patented product, assigned in Japan by the patent holder or the licensee who was licensed by the patent holder, has been modified or its components replaced, and as a result, it can be regarded as a novel production of the patented product which is not identical to the first patented product, the patent holder is entitled to exercise the patent right over this patented product.”<sup>79</sup> The Court also found that this is the same as in cases where a patented product was assigned abroad by a patent holder.<sup>80</sup> It should be noted that this case should be examined and discussed based on the *BBS* case stated above, but not be understood to bring changes about the position of international exhaustion stated in the *BBS* case.

## V. CONCLUSION

63. After this brief overview of multilateral, regional and national law that applies to exhaustion, the immediate conclusion is that, even if there is relative abundance of materials, there is little consensus and harmonization, if any, on how to address it. Whether harmonization would be useful or not is an issue that will not be dealt with here.

64. Moreover, even if there is relative abundance of material on exhaustion, the practical experience of using it to address IP abuses in general, and anti-competitive practices, in particular, is richer in major economies, such as the United States and the EU. Experience in

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<sup>76</sup> *Id.*

<sup>77</sup> *Id.*

<sup>78</sup> Japan Supreme Court, Case number 2006 (Ju) No.826, decided on 8 November, 2007. An English version of the Supreme Court’s opinion is available at: <http://www.courts.go.jp/english/judgments/text/2007.11.08-2006.-Ju-.No..826-165104.html> (accessed on March 8, 2012).

<sup>79</sup> *Id.*

<sup>80</sup> *Id.*

other territories, particularly in developing countries, is still very scarce. This may be the consequence of a lack of understanding of exhaustion and how it may interact with antitrust. One possible explanation is that certain authorities may be reluctant to use an instrument not very well known to sanction anti-competitive uses of IP rights, with the risk of mitigating those rights and thus putting in jeopardy the goals of national and international laws of promoting and disseminating new technologies.

65. This might serve as the basis for a recommendation for an additional study to be carried out in developing countries, so as to find case law where the interaction is explicitly or implicitly acknowledged, and to assess its implications. Such study could be made by means of a fact-finding exercise, which could resort to interviews to some targeted national experts and government officials as well as technical visits to certain stakeholders.

66. At this stage we are not in a position to recommend a specific geographical category of exhaustion to be adopted by Member States. National exhaustion is more supportive of rights to the extent it ensures the exclusive right to import. It also protects foreign investors against competition arising from parallel imports of their own products made and sold in other countries where production costs are eventually lower. On the other hand, national exhaustion may leave a Member defenseless in the case an IP owner with a dominant position in the relevant international market abuses its rights with the purpose of partitioning that market and discriminating purchasers in different territories.

67. A number of Member States accept that, by means of contractual provisions, IP holders may avoid international exhaustion and, consequently, parallel imports. This approach, however, is confined to situations in which the IP holder and the manufacturer and/or the importer are bound by a contract. Obviously it does not apply on the grey market. Therefore, perhaps the most flexible and convenient solution is that of Oman, which retains the positive aspects of national and international exhaustion, and discards their negative consequences.<sup>81</sup>

[End of Annex and of document]

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<sup>81</sup> Moreover, to the extent the Omani statute submits international exhaustion to the practice of abuses (anti-competitive or not) or, more generally, to public interest, probably it is not constrained by the principle of territoriality implicit in the Paris Convention as far as patent and trademark rights are concerned.