Parallel imports are goods purchased in foreign markets by third parties and then imported into the domestic market without the authorization of the original manufacturer. The act of importing these goods is referred to as "parallel importation." Parallel imports may be goods which are manufactured outside the jurisdiction of, or under the authority of, the owner of an intellectual property right relating to those goods. However, they may also be manufactured in the owner's country, which are then resupplied into foreign markets, but then imported back into the country by third parties. Parallel importation can also occur in a situation where goods are imported into the market of an exclusive licensee of an intellectual property owner without the owner's consent. For example, besides the owner appointing an exclusive licensee for country X, it also appoints an exclusive license to distribute its goods only in country Y. However, these goods are then imported into country X without the owner's consent.

Parallel importation occurs mainly because of price differences in the global market place. That is, the price of a product in one country is cheaper than that of the same product in another country. The price difference can exist because of a marketing strategy. For example, a manufacturer tries to sell its products in a very competitive foreign market. In order to compete with other products in that market, the manufacturer sells its products at a substantial discount, that is, much cheaper than the price of its products in its domestic market. This situation enables a trader to purchase the products in the foreign market and then import them into the domestic market or into another market in which the same products are more expensive.

Apart from the deliberate price discrimination strategy usually undertaken by a company with market power mentioned above, the price difference causing parallel importation could exist because of currency fluctuations. For example, a product costs $5 in country X. Because of the weakness of country Y's currency to the dollar, it costs only $7 in country Y. This situation drives a trader to
import the product from country Y into country X and sell it for, say, $11.

The difference in costs of marketing and after sales services can also contribute to the price difference. The costs of marketing can take the form of advertising costs and training costs for sales and service personnel. Examples of costs of after-sales services are warranty costs, insurance and safety compliance costs, costs for dealing with customer complaints and costs for adequate stock inventories. Intellectual property owners or their licensees must incur the costs whereas parallel importers can minimize them. As a result, the latter can import foreign, cheap and genuine goods into the former's market.

The legality of parallel importation remains controversial. Opponents of parallel importation claim that intellectual property rights in every country are separate and independent. Consequently, an intellectual property owner in a particular country always has the right to control the distribution of its products in that country. This means that the sale by an intellectual property owner of its products in one country does not exhaust its right to control the distribution of the said products in any other country. Thus, the owner can prevent parallel importation. However, relying on the "exhaustion principle," proponents of parallel importation claim that if a product embodying an intellectual property is lawfully put on the market in one country, the intellectual property owner or with its consent, then the owner could not block the parallel importation of the said product into any other country in the world. In copyright law, for example, the "exhaustion principle" means that when a copyright owner sells or authorizes others to sell its goods embodying the copyright, the owner's right is exhausted and, as a consequence, it cannot control any subsequent dealing with the goods. Thus, a country's copyright law provides that a copyright owner's first sale of its goods outside the country exhausts its copyright in the country, the owner cannot prevent the parallel importation of its goods into the country.

The exhaustion principle is a very important theory to answer the question whether parallel importation is an infringement of an intellectual property right in a country. Because parallel importation always involves a situation where the same intellectual property right is applied first in one country and then in another country. But in this exam, the student was asked only to

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It is held in at least two different countries, it is necessary to know how a particular country applies the principle in a situation where the first sale of goods embodying the right occurs in that country or in a foreign country. If, for example, according to the first country, it is only the sale within the first country which exhausts the right, then parallel importation of goods first sold in the foreign country is an infringement. However, if the first sale in the foreign country also exhausts the right in the first country, or, in other words, if the first sale in any of the two countries exhausts the right in the other one, the parallel importation is not an infringement. Thus, although a country recognizes the exhaustion principle, its application of the principle can be narrow or broad.

After exploring the meaning of the exhaustion principle, this paper will discuss the narrow and broad application of the principle in relation to the issue of parallel importation. It will analyze the United States' and the European Union's approach. As mentioned below, the United States' approach to the parallel importation of copyrighted goods is similar to that in the European Union. The United States limits the application of the exhaustion principle to parallel imports originally manufactured and sold within the country. Similar to this approach, the European Court of Justice (ECJ) does not apply the principle to parallel imports from outside (a non-member of the European Economic Area (EEA)).

Next, the paper will examine the rationale behind the United States' and the European Union's approach. As discussed below, the rationale behind the application of the exhaustion principle to domestic (regional) sales does not apply to parallel importation. For example, the United States' concern over the primary objective of patents, trademarks, and copyrights, which is to "promote the progress of science and the useful arts," does not constitute a rationale for the country's application of the principle to the parallel importation of copyrighted goods. Instead, it is the country's intention to protect the country's copyright owners' economic interests which becomes the rationale. Similarly, the ECJ's concern over the "free movement of goods," the rationale for the application of exhaustion principle to parallel importation within the EEA, does not become the rationale for the Court's application of the principle to the parallel importation of goods from a third country.

2. The Meaning of the Exhaustion Principle

According to this principle, the lawful initial sale of an intellectual property owner's goods effectively exhausts the owner's right to control any subsequent dealing with the goods. Thus, a purchaser of the goods is free to deal with the goods without infringing the owner's intellectual property rights.

In effect, on the one hand, the principle is a limitation on the owner's rights, and, on the other hand, it gives the purchaser of the goods the unrestricted right not only to reuse the goods but also to dispose of them. In relation to a patent, for example, in *United States v. Union Loco Co.* (1924), the United States Supreme Court stated:

*It is possible that an intellectual property right is not protected in a certain country. However, many international agreements on intellectual property rights among nations, including the TRIPS Agreement, will certainly minimize that possibility. *The EEA consists of the Community, Iceland, Liechtenstein, and Norway. See Silhouette International Schneid Gestaltung mbH & Co. KG v. Hartner Handelsgeellschaft mbH, Case C-355/96, (1998) ECLI:EU:C:1998:551, par. 3.

3 316 U.S. 241 (1942). In this case, the patent owner on eyeglasses licensed its patent to another to manufacture the frames and sell them to licensed wholesalers, finishing retailers and prescription retailers. As part of a system of resale price maintenance, the license contained restrictions on the ability of the wholesalers and prescription retailers to sell the processed lens blanks. The United States Government brought actions against the owner claiming that the owner's practices violated the United States' Antitrust law. Ibid. at 241, 244 – 45.
The patentee’s monopoly remains so long as he retains the ownership of the patented article. But sale of it exhausts the monopoly in that article and the patentee may not thereafter, by virtue of his patent, control the use or disposition of the article.10

The Supreme Court reasoned that the patentee had reaped the benefits of his patent monopoly by receiving the purchase price of the first sale of its patented article. The Court also reasoned that to permit the patentee to control the price of the article after the first sale would exceed its statutory monopoly.11

In essence, the Supreme Court has defined the meaning of a patentee’s statutory monopoly which is the “exclusive right to make, use, and vend the invention or discovery.”12 The Court has limited the meaning of “vend” to the “first sale.” However, the Court also stated that the patent owner must receive the reward of its patent in order for its right to be exhausted.13 This means that, according to Unisys Ltd., it is not the first sale itself but the reward of the first sale which exhausts the patent right.14 Thus, if a patent holder does not receive the reward by the first sale, its right is not exhausted. This is true if, for example, A, the United States patent owner assigns its exclusive right in the United States to B, an independent company. B now becomes a patent holder for the United States market. A continues to sell its patented product by itself in Australia. C purchases the products in Australia and then imports them into the United States. Because company B does not benefit from the first sale of the product in Australia, its right in the United States is not exhausted.15

The European Court of Justice (ECJ) in Centreforum v. Sterling16 has expressed a similar view to that of the United States Supreme Court in Unisys Ltd. In Centreforum, the ECJ stated that the patent right could not be “exercised” to protect anything other than the specific subject matter of patents which was: the guarantee that the patentee, to reward the creative effort of the Inventor, has the ECJ soop chasi the e ow with exce

10 Ibid at 250. See also Adams v. Buxb. BRUS. (17 Wall) 453 (1873) (“When the patentee...refers machine or instrument...it receives the consideration for the use and the profit to which it can be put.”)

11 The exclusive right to make, use, and vend the invention or discovery.

12 The Court stated: “the purpose of the patent law is fulfilled with respect to any particular article when the patentee has received the reward for his invention by the sale of his article, and that once that purpose is fulfilled the Inventor’s right to prevent others from making use of it expires.”

13 See Keler v. Standard Oil Co., 153 U.S. 605, 661 (1894) which is in line with this opinion in Unisys Ltd. See also Appleby W.A., above, note 9 at 145 concluding that the decision in Keler has indicated that the right of the patentee to the patent is a very important issue on which the United States “court adopts the exhaustion principle.”

14 The attempt in Featherstone v. Oskarsson Cycle Company, 55 F. 110 (CC NY 1892) exemplified this scenario in this case, an invention patented prior to his cycle being in Great Britain and in the United States. The inventor assigned the American rights to the plaintiff. The holder of the British patent licensed the defendant to use the then three cycles made in Great Britain. The defendant then sold to sell the cycles in the United States. The court granted the plaintiff’s injunction against the defendants. Ibid at 111.

15 Case 107/74, 1974 E.C. C.A. Lexis 926 in this case, rapturous holds parallel patents in several states of the European Economic Area including Britain and the Netherlands. The product protected by those patents are identical marketed in those states by licensees of the patentee. Subsequently, third parties purchase the products from Britain and then resell them into the Netherlands.
exclusive right to use an invention with a view to manufacturing industrial products and putting them into circulation for the first time, either directly or by the grant of licenses to third parties, as well as the right to oppose infringements. (Emphasis added).  

In this case, the ECI used the term "exercise" and the Court only limits the meaning of the "exercise" of patents. In essence, the Court has stated that to get the reward for its creativity, a patentee has the right to exercise its right only once, that is when releasing its patented products for the first time. In this case, as in Univis Lens, the reward is an important factor to determine the exhaustion of rights. In other words, the patentee must benefit from the first sale of its products in order for its right to be exhausted. If the first sale is made by its licensor, the patentee must participate in the sale by giving the licensee a consent. Thus, if the patentee does not benefit from or does not participate in the first sale of its patented product, its right is not exhausted.

Apparently, similar to Univis Lens, the ECI in Contraroma has used the "beyond-scope" doctrine or "beyond-the-existence of exclusive right" doctrine to justify its adoption of the exhaustion principle. That is, to give a patent owner the right to control a subsequent dealing with its product after the first sale would exceed the scope or the essence of its patent.  

In Univis Lens, the scope of a patent is based on the United States' patent statute. However, unlike Univis Lens, in Contraroma, the meaning of "the essence of the exclusive rights" is not clear. If it refers to national laws of member states of the European Union, the ECI has accordingly interpreted the provisions of the national laws. Therefore, in this case, it is not proper for the ECI to use the "beyond-the-existence of exclusive right" doctrine to justify its adoption of the exhaustion principle.

3. The Exhaustion Principle in Relation to Parallel Importation

For national transactions, both the United States and the European Union strictly apply the exhaustion principle to all intellectual property rights. However, in relation to parallel importation, they limit the application of the principle to a certain situation. The United States does so especially in relation to copyrights. The country applies the principle to copyrights only if the imported articles are originally manufactured and sold within the country. In other words, in relation to copyrighted parallel imports, the United States applies what is called the "national exhaustion" principle. In this case,
the United States seems to be in favour of protecting the copyright owners' interest rather than that of the public. The European Union follows the United States' approach; this seems to be true in relation to all intellectual property rights. The ECI limits the application of the exhaustion principle to products first sold within the European Economic Area. In other words, the ECI in this case adopts what is referred to as "the European Economic Area (EEA)-wide exhaustion" principle. In this case, however, the concern over the wealth transfer to the regional intellectual property owners from international market segmentation is more important than that over the restraint of international trade or free movement of goods.

However, the United States' approach to the issue of parallel importation of patented goods appears to be more liberal since several courts in this country have applied the "international exhaustion" principle although for limited situations. This means that, in these situations, a United States patent owner cannot prevent the parallel importation of its patented articles which have been already sold anywhere in the world. Irrelevant to trade marks, several United States courts have also adopted the international exhaustion principle although only for such limited situations as that the domestic and foreign trade marks are owned by the same owner or the domestic and foreign trade mark owners are close related.

3.1 The National Exhaustion Principle

Under this principle, the first sale exhausts intellectual property rights only in the country

where the first sale takes place. For example, a holds an intellectual property right in both countries X and Y. A sells its products embodying the intellectual property right in both countries. Its sales of products in country X exhausts its right only in country X, and does not affect its right in country Y, and vice versa. As a result, it can prevent the importation of products from country X into country Y because its right in country Y remains intact. However, if the owner in country Y sells products in country X and the products are then exported to country X, and are subsequently imported back into country Y, the owner in country Y cannot prevent the importation because the first sale of the products in country Y has exhausted the owner's right in the country.

The United States copyright laws approach to the issue of parallel importation exemplifies the application of the national exhaustion principle. The Scorpion case explains this. In this case, CBS owned the copyright in sound recordings in the United States. CBS, Sony Japan had licensed the manufacture and sale of phonorecords in the Philippines to Viva Music Corporation. CBS (the United States) consented to the licence agreement. Scorpion bought the recordings in the Philippines and then, without consent from CBS, imported them into the United States. CBS filed a complaint alleging that Scorpion had violated s. 602(a) of the Copyright Act 1976. Scorpion argued that he was entitled to the s. 109(a) exhaustion defence. However, the court held that the first sale of the recordings in the Philippines did not exhaust CBS's right in the United States. The court stated that s. 109(a) only applies to copies that have been lawfully made and sold within the United States. The court added that the right to control the subsequent sales and use of those copies is derived from the copyright owner's initial creation of the copies.


United States

In that case, the defendant argued that
were exclusive right of distribution contained
in § 106(3) of the Copyright Act 1976 was
limited by s. 106(a) of the Act which provides:
Notwithstanding the provision of section
106(3), the owner of a particular copy or
phonorecord lawfully made under this title,
or any person authorized by such
owner, is entitled, without the authority
of the copyright owner, to sell or other-
wise dispose of the possession of that copy
or phonorecord.

In other words, the defendant argued that
the exhaustion principle (the first sale doctrine)
applied to the situation of the case. However,
the court stated that the defendant's argument
was wide because of the phrase “lawfully made
under the title” in s. 106(a). The court inter-
geran the meaning of the phrase very narrowly.
According to the court, the phrase only refers
to “copies which have been legally manufac-
tured and sold within the United States.”
Because the defendant's goods were manufac-
%74tured and sold in the Philippines, the
defendant could not use the s. 106(a) defence.
The court provided four reasons for its
decision. First, the protection of the United
States copyright law does not apply extraterrito-
rially because there is no express legislative
intent to the contrary. Second, if the defen-
dant can use the s. 106(a) defence, s. 106(a)
would supersede the prohibition on importa-
tion set forth in s. 602(a) and, as a conse-
quence, would render the last provision mean-
ingless. Fourth, if the defendant prevailed, the
copyright owner would lose its right to control
the number of copies of its work in circulation
within the United States.

It is clear that the court's most important
reason in support of its conclusion is that there
is no express provision in the Copyright Act
that the Act applies extraterritorially. Unfortu-
nately, the court has not explained any further.
This reasoning is weak since the absence of
such an express provision in the Act
does not necessarily mean that the provisions
of the Act must not apply extraterritorially.
In `Vee Jay Records', it is stated that, absent an
express statutory provision to the contrary, the
United States' Code can apply to any action
occurring outside the United States which has
an effect in the country. The first sale of record-
ings in the Philippines can be considered as
having an effect in the United States since the
goods are later imported into the country. Thus,
as far as this is concerned, the first sale should
have triggered the exhaustion principle men-
tioned in s. 106(a).

Furthermore, it is doubtful that the Con-
gress was of the view that the phrase “lawfully
made under this title” must be interpreted as
narrowly as the court's interpretation. In rela-
tion to this, the House Report did not indicate
that the phrase means that the goods must be

\footnotesize\textsuperscript{a} Ibid. at 49.
\footnotesize\textsuperscript{b} Section 106(2) provides: "Subject to sections 107 through 118, the owner of copyright under this title has the exclu-
sive rights to do and authorize any of the following: ... to distribute copies or phonorecords of the copyrighted work

to the public by sale or other transfer of ownership, or by rental, lease, or lending."

\footnotesize\textsuperscript{c} 509 F. Supp. 47, 49.

\footnotesize\textsuperscript{d} Ibid.

\footnotesize\textsuperscript{e} Section 102(a) provides: "Importation into the United States without the authority of the owner of the copyright
under this title of copies or phonorecords of a work that have been acquired outside the United States is an infinge-
ment of the exclusive right to distribute copies or phonorecords under section 106, actionable under section 501."

\footnotesize\textsuperscript{f} 509 F. Supp. 47, 49.

\footnotesize\textsuperscript{g} Ibid.

\footnotesize\textsuperscript{h} Beechwood Music Corp. v. Vee Jay Records, 328 F. 2d 728, 729 (2d Cir. 1964) affg 226 F. Supp. 8 (SDNY).

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produced and sold within the United States for s. 109(a) to apply. In addition, historically, s. 109(a) was laid down not to deal with the issue of importation but rather to deal with the issue of restraint of trade within the United States’ domestic market. Therefore, it is difficult to infer that the Congress intended that the phrase “lawfully made under this title” in s. 109(a) must mean “legally manufactured and sold in the United States” since at that time the Congress had not been faced with the problem of unauthorized importation. Thus, logically, the Congress did not think that it was necessary to distinguish between goods manufactured and sold in the United States and those manufactured and sold outside the country.

Despite the weakness of Scorpino’s reasoning, many courts have followed it. For example, the court in Skaar has also held that the exhaustion principle of s. 109(a) only applies when the imported goods are originally manufactured and sold in the United States for s. 109(a) to apply. 

In relation to the phrase, the House Report briefly stated: “to come within the scope of section 109(a), a copy or phonorecord must have been ‘lawfully made under this title;’ though not necessarily with the copyright owner’s authorization. For example, any resale of an illegally ‘pirated’ phonorecord would be an infringement, but the disposition of a phonorecord legally made under the compulsory licensing section 115 would not.” (Footnote 21, above, note 9, p. 283) The Ninth Circuit, however, held in the case of Skaar, that the report’s that the copyright holder that the “disposition of a phonorecord legally made under the compulsory licensing provisions of section 115 ... falls within the scope of s. 109(a) even if the record was manufactured and sold in the United States to fall within the purview of the section. This is because it is clear that the Report only provides that the goods manufactured in the United States under s. 115 of the Copyright Act 1976 are an example of goods which are covered by s. 109(a) although they have been manufactured without the copyright owner’s authorization.”


Several copyright cases have followed the reasoning in Skaar. For example, Heart Corporation v. Stark, 69 F. Supp. 250 (N.D. Cal. 1946); B.B. Harris Company v. JEM Records, Inc., 519 F. Supp. 1759 (D.N.J. 1981); BMG Music v. Penn, 992 F. 2d 314 (9th Cir. 1993); cert. denied, 135 S. Ct. 2997 (1993) and the Ninth Circuit in the case of Skaar, California corporation who distributed without the authorization of the copyright holder. A whistleblower in the United Kingdom purchased and sold them to Stark, a California corporation, who then imported them into the United States. Heart alleged that Skaar had violated its exclusive distribution rights under 602(a). 

Id. at 976 - 977.

BMG Music v. Perry, 992 F. 2d 318 (9th Cir. 1993), cert. denied, 132 S. Ct. 2997 (2012) In this case, BMG owned copyrights on recordings. BMG licensed the manufacturer and sale of its recordings in many countries. Perry purchased the recordings in the Philippines and imported them into the United States. The case came to the Ninth Circuit on a contempt proceeding and Perry never inquired into the district court.

Id. at 319.
It is true that there are cases in which the courts have disagreed with the interpretation of s. 109(a) by Scorpio. However, in effect, the cases do not change the law because the situations in the cases involve imported goods that are originally manufactured and sold within the United States and the courts in the cases have held that the exhaustion principle mentioned in s. 109(a) applies to the situations. Thus, the result of the cases does not contradict that in Scorpio. However, unlike Scorpio, the result of the cases have proved that the optional exhaustion principle parallel importation can be allowed.

In Sebastian, for example, the Third Circuit disagrees with the interpretation of the phrase "lawfully made under this title" by Scorpio. The court states: "...the place of sale is not the critical factor in determining whether section 602(a) governs...In our view, a first sale by the copyright owner extinguishes any right later to control importation of those copies.

The court further states that s. 602(a) is not independent of s. 106(3) and, as a consequence, s. 602(a) is subject to s. 109(a). In other words, any sale of copies anywhere by the United States copyright owner exhausts its right in the United States to control any subsequent dealing with the copies.

The statement of the court appears to indicate that the court has adopted the international exhaustion principle. However, the court clearly limits its decision to the first sale made by the United States copyright owner in the United States.

Judge Weis stated: "The facts, seen here in the context of the first sale doctrine, are not complex. We do not confront a license agreement or copies produced in a foreign country under that agreement by someone other than the owner; instead, this case centers on actual copies of labels printed in this country by the copyright owner. Sebastian produced and sold the same copies which it now seeks to control."

And in footnote 3, Judge Weis stated: "This situation differs from that in which a licensee manufactures the copy. In that instance, the copyright holder does not own the tangible copy."

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61 Scorpio has held that the s. 109(a) exhaustion principle applies to goods lawfully manufactured and sold within the United States. See above, note 15 and accompanying text.

62 847 F. 2d 1993. In this case, the plaintiff, Sebastian, had manufactured hair care products in the United States. The plaintiff sold stocks of its products to Consumer Contact for sale only in South Africa. However, Consumer Contact promptly reshipped the products to Fabric Inc. in the United States to be distributed in the country. The plaintiff used a copyright in the labels attached to the products to try to block the importation.

63 The court states: "Section 602(a) does not purport to create a right in addition to those conferred by section 106(3), but states that unauthorized importation is an infringement of the exclusive (section 106(3)) right to distribute copies. Because that exclusive right is specifically limited by the first sale provisions of section 109(a), it necessarily follows that once transfer of ownership has cancelled the distribution right to a copy, the right does not survive so as to be infringed by importation." Ibid. at 1098.

64 See the discussion on the international exhaustion principle below (subchapter 3.3).

65 It is important to note that the Ninth Circuit in BMG Music v. Perry, 952 F. 2d. 312 (9th Cir. 1991) has limited the decision in Sebastian to its specific facts, that is the importation of copies originally made and sold in the United States. As mentioned above, Perry has held that s. 109(a) does not apply to copies manufactured and sold abroad.

66 847 F. 2d. 1993, 1098.

67 Ibid. The footnote refers to the court's statement: "...Because that exclusive right is specifically limited by the first sale provisions of section 109(a) it necessarily follows that once transfer of ownership has cancelled the distribution right to a copy, the right does not survive so as to be infringed by importation." Ibid.
It is clear from those statements that the Third Circuit’s adoption of the s. 109(a) exhaustion principle does not apply to the situation where the imported copies have originally been manufactured abroad by a licensee. Thus, although the court does not agree with the interpretation of s. 109(a) by Scorpio, the court has reached the result which does not contradict that in Scorpio.

L’anza is another case in which the reasoning, to some extent, is not in line with that in Scorpio. As mentioned above, in essence, the court in Scorpio stated that s. 602(a) must be independent of s. 109(a), if the prohibition on importation in s. 109(a) was subject to s. 109(a), s. 602(a) was ‘meaningless’. The Supreme Court in L’anza disagrees with this opinion in stating that the text of s. 602(a) unambiguously states that the unauthorized importation is ‘an infringement of the exclusive distribution right under section 106.’ In other words, the text of s. 602(a) clearly indicates that s. 602(a) is a species of s. 106. As a result, because s. 106(3) is subject to s. 109(a), s. 602(a) is also subject to s. 109(a). The Supreme Court also stated that s. 602(a) is not meaningless because it is only the “owner” of lawfully made copies who observes the prohibition afforded by s. 109(a) and therefore, the prohibition on importation in s. 602(a) applies to the “non-owner.” Furthermore, the Court stated that s. 109(a) does not apply to “any copy” but it applies only to a copy that is “lawfully made under this title.” Thus, the phrase, “lawfully made under this title” means in s. 109(a) as “legally manufactured and sold within the United States.” The last statement of the Supreme Court in L’anza mentioned above indicates that the Court partly agrees with the interpretation by Scorpio of s. 109(a), that is that the site of manufacture of copies must be in the United States in order for s. 109(a) to apply. However, the Supreme Court does not agree with the opinion in Scorpio that the copies must be first sold in the country as a requirement of the s. 109(a) exhaustion principle. The Court states that the owner of the copies is entitled to the protection of s. 109(a) in an action in the United States court “even if the first sale occurred abroad.”

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10 Quality King Distributors, Inc. v. L’Oréal Research International, Inc., 523 U.S. 135 (1998). In this case, L’Oréal Research International, Inc. was a California manufacturer and seller of hair care products in both the United States and international markets. L’anza extensively advertised its products and provided special training to its retailers within the United States. However, its foreign markets did not receive the same aggressive marketing strategies and, as a result, L’anza’s foreign prices were 35 percent to 50 percent lower than those within the United States. In 1992 and 1993, L’anza’s Malta distributer sold shipments of the products to Quality King at foreign prices. Without L’anza’s permission, Quality King imported the products into the United States and sold them to various distributors at a discount. Ibid. at 135-139.


36 See above, note 37.

37 See above, note 33 and accompanying text.

36 F. Supp. 47 at 45. Unfortunately, the court in Scorpio did not explain this statement.

38 See above, note 74.


40 Ibid. at 146-147. The Court provides examples of “non-owner,” namely, a retailer, a licensee, a consignee, or one whose possession of a copy of a work is unlawful. Ibid.

41 Ibid. at 147.


It appears that the Court in L'Azra has adopted the international exhaustion principle. However, it is clear that the Court itself has limited its decision to imported goods which have originally been manufactured within the country. At a consequence, the United States copyright law's position on parallel imports originally manufactured abroad is still unclear. Furthermore, some commentators have stated that L'Azra only adopted the national exhaustion principle. In addition, Justice Ginsburg's unaccompanied concurring opinion implies that L'Azra did not adopt the international exhaustion principle.

3.2. The Community or European Economic Area - Wide Exclusion Principle

This principle has been adopted by the ECJ in dealing with the issue of parallel importation. This principle means that a lawful sale in the European Economic Area (EEA) exhausts intellectual property rights only within the Area, not internationally, and it is only a lawful sale within the Area which exhausts intellectual property rights in the Area. For example, A, a German company, holds an intellectual property right in Germany, the United Kingdom and Singapore for a certain product. A sells the product in these three countries. The product sold in Singapore is 30 - 35% cheaper than that sold in Germany and that sold in the United Kingdom is 15 - 20% cheaper than that sold in Germany. As a result, someone imports the product from Singapore into Germany and someone else also imports the product from the United Kingdom into Germany. According to the EEA - wide exhaustion principle, the sale in Singapore does not exhaust A's right in Germany; it is only the sale in the United Kingdom which exhausts A's right in Germany. Accordingly, A can prevent the importation of the product from Singapore but not from the United Kingdom.

The recent trade mark case Silhouette illustrates how the principle applies. In this case, Silhouette International produced spectacles under the trade mark "Silhouette," registered in Austria and other countries. Silhouette sold its products of an outdated model to Union Trading, a Bulgarian company, instructing that the products be sold only in Bulgaria (non-member of the EEA) or the states of the former Soviet Union and not elsewhere. However, Hartlauer managed to acquire the products from Bulgaria and then imported them to Austria. Silhouette, the plaintiff, pleaded infringement of its trade mark.

In answering the question whether Article 7(1) of the First Council Directive 89/104/EEC...
EEC of 27 December 1988 allowed national laws to adopt the exhaustion principle of trade mark rights in respect of products sold outside the EEA, the ECI said: "...national rules providing for exhaustion of trade mark rights in respect of products put on the market outside the EEA under that mark by the proprietor or with his consent are contrary to Article 7(1) of the Directive..." In essence, the ECI holds that the exhaustion principle set forth in Article 7(1) of the Directive only applies to goods sold within the EEA. It does not apply to goods put on the market outside the EEA. Thus, Silhouette can prevent the parallel importation of goods bearing its trade mark first sold in Bulgaria. The ECI stated that the text of Article 7(1) of the Directive itself provided that exhaustion occurs only if the products had been sold within the EEA. In support of this statement, the Court reasoned that Article 7(1) contained a substantive provision which the Directive sought to harmonize. The Court further stated that a situation when some member states could adopt the international exhaustion principle while others adopted the community-wide exhaustion principle would give rise to "barriers to the free movement of goods and the freedom to provide services." According to the Court, the Directive aimed to remove this negative effect by harmonizing the exhaustion principle within the EEA. In other words, the Court has said that Article 7(1) is a provision to harmonize the exhaustion principle in the EEA; therefore, it cannot be construed broadly so as to argue that the Article allows member states to adopt the exhaustion principle other than the community-wide exhaustion principle of the EEA. The argument of the ECI is not free from criticism. The Court's statutory construction is fine and reasonable. Unfortunately, the Court did not elaborate why the situation where some member states adopted the international exhaustion principle while others adopted the EEA exhaustion principle would create barriers to trade in goods and services. The Court statement could probably be explained in this way: if member states adopt different exhaustion principles, parallel importation would be allowed in some member states but not allowed in others. This situation will increase competition and reduce prices in the former member states. The Court probably assumes that the price of the same goods in the latter member states will not change, and, as a result, the goods cannot move to the former member states where the price of the same goods is cheaper. If this speculation is true, then, in the writer's view, the Court's assumption may not be true since people will import the cheaper goods (from member states which adopt the international exhaustion principle) into the member states where the same goods are more expensive. This, in turn, will reduce the price in the latter member states. Thus, the international exhaustion principle adopted by some consuming member states, the Court made this price gap, and this gap in price in the parallel imports, a little wider than it should have been.
the ECI's decision in *Coubert* sends the same message to the EEA. The ECI has not dealt with this issue in *Silhouette*, but in *Silhouette*, the ECI has decided that the main function of a trade mark is a bundle of rights. By its decision in *Silhouette*, the ECI has differentiated between the main function of a trade mark for goods sold within the EEA and for those sold outside the EEA, the former being a bundle of rights whereas the latter being a bundle of control (protection of goodwill). This means that the ECI, in effect, has given more protection to trade mark owners who sell their goods abroad than those who just sell their goods within the EEA. In addition, the decision may impede the free flow of goods from outside into the EEA markets especially in a situation like in *Silhouette*, where the trade mark owner does not sell the same goods in the EEA. *Silhouette* has adopted the Community-wide exhaustion principle only in respect of trade marked goods. For copyrights and patents, the ECI will probably take the same approach as that in the two cases. This is because a similar provision to Article 7(1) of the Trade Mark Directive has been adopted in relation to copyrights and patents: Article 9(2) of the Directive on Resale Right on Copyrights Related to Copyrights provides: "this distribution right shall not be exhausted within the Community in respect of each object..." except where the first sale in the Community of that object is made by the rightholder or with his consent. In relation to patents, a similar provision to Article 7(1) of the Trade Mark Directive has also been laid down in Article 16 of the Regulation on Community Plant Variety Rights.

3.3. The International Exhaustion Principle

This principle means that an intellectual property right does not confer upon its owner the right to control any subsequent dealing with
its protected product once it has been put on the market anywhere by the world by the owner or with its consent. For example, if A owns an intellectual property right for a certain product in countries B, C, D, and E, its first sale of the product in country B exhausts its right in all of the other countries. It is immaterial whether the first sale occurs in B, C, D, or E; the first sale in any of the countries exhausts the owner’s right in all of the other countries.

3.3.1. Patents

Holiday v. Mattheson, a United States’ case, exemplifies the adoption of the international exhaustion principle of patent rights. In this case, the plaintiff owned the United States patent and sold its patented article in England. The defendant purchased the article in England and brought it to the United States. The court held that the sale in England exhausted the plaintiff’s patent rights around the world. The court stated:

When the owner sells an article without any reservation respecting its use, or the title which is to pass, the purchaser acquires the whole right of the vendor in the thing sold; the right to use it, to repair it, and to sell it to others;...The presumption arising from such a sale is that the vendor intends to part with all his rights in the thing sold, and that the purchaser is to acquire an unqualified property in it.

The court provides an important argument in this case, that is, the presumption of the owner’s intention to part with all its rights while selling its article and that the purchaser acquires an unqualified property in the article. It is clear that the court’s presumption only applies if a sale by the owner is without any reservation or restriction. Thus, the owner can restrict the application of the exhaustion principle by imposing conditions on the sale. But, probably, it is more difficult to presume the intention of an owner than to presume the purchaser’s right to acquire the unqualified property. This is so, for example, when the owner mistakenly sells the article without conditions. In this case, it is difficult to presume that the owner has the intention to part with all its rights, but it is far to presume that the purchaser must acquire all of the owner’s rights. Thus, in essence, the court’s reasoning relates to the question of fairness in the transaction between the parties. It is fair to presume so because the purchaser is informed that there is no condition of the sale.

The decision in Holiday was followed by Curtiss Aeroplane (Curtiss). In Curtiss, the plaintiff owned the United States and Canadian patents for airplane-related inventions. During World War I, the plaintiff licensed the British government without restriction to practice its patents on airplanes in Canada for use in the war. After the war, the defendant purchased some of the airplanes from the British government and then imported them into the United States for resale. Relying on Holiday, the Second Circuit stated:...If the vendor’s patent monopoly consists of foreign and domestic patents, the sale frees the article from the monopoly of both his foreign and his domestic patents, and where there is no restriction in the contract of sale the purchaser acquired the complete title and full right to use and sell the article in any and every country.

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Like Holiday, Curtiss clearly adopted the international exhaustion principle. Curtiss has even further explained that even if the patentee has divided its monopoly rights into several different territories, the sale of its article exhausts its rights in all of the territories. Unfortunately, Curtiss does not elaborate on this. The statement of the Court is very broad. This can probably mean that the patent owner's effort to partition the markets by, for example, an agreement not allowing its exclusive licensee in a territory to sell the article to another territory cannot prevent a third party purchaser in the first territory from selling the article in the other territory as long as there is no restriction in the sales contract between the purchaser and the licensee. It is only the licensee itself who cannot sell the article in the other territory unless he or she breaks the agreement.

However, that speculation contradicts the decision in Sanofi, which limited the decision in Curtiss to its particular facts. According to Sanofi, the Court in Curtiss only held that the "exhaustion doctrine applied where the seller already had contractual authority to sell in the United States." Because the seller in Curtiss, that is, the British government, had the absolute authority to sell the aeroplane in the United States, the plaintiff could not enjoin the defendant's importation of the aeroplane into the United States.

Furthermore, Sanofi held that when a patent owner gives an exclusive licence to someone to sell its product in the United States, this has the effect of the seller of the product in a foreign country losing any authority to sell the product in the United States. Accordingly, the exclusive licensee can prevent the importation of the product by a third party purchaser from the foreign country into the United States. The court reasoned that to allow the importation "would discourage the assignment and licensing of patent rights by making those rights less valuable and more susceptible to circumvention through transactions initiated in foreign countries by the United States patentees who have previously transferred rights under their patents." The above-mentioned discussion indicates that, in relation to patents, the United States adopts the "limited international exhaustion principle. There appears to be two limitations on the application of the principle. First, as mentioned above, the United States courts require that the sale be unconditional or without any reservation in order for a patent owner's right to be exhausted. Accordingly, a patent
owner can counteract the effect of the exhaustion principle by making express provisions prohibiting purchasers of its patented articles sold abroad from importing them into the United States. Second, the exhaustion principle only applies to unrestricted sales made by persons having rights to sell in the United States. Accordingly, an unrestricted sale abroad cannot exhaust the United States patent rights which have been transferred to an exclusive licensee of the patent owner. This is a result reached in Samoff. But it is important to note that the result in Samoff is not consistent with cases which apply the exhaustion principle to domestic sales. In essence, the cases state that a person who buys patented articles from a person who has a right to sell within a restricted territory, has a right to use and sell such articles in all and any part of the United States. Thus, in strict relation to exhaustion, the United States has discriminated between domestic sales and parallel importation.

3.3.2. Trade Marks

In Apollinaris, the Circuit Court of the Southern District of New York adopted the international exhaustion principle. In this case, Apollinaris, a British company, had acquired the exclusive right to sell Hungarian "Hunyadi Janos" mineral water in the United States and the United Kingdom. The defendant bought the mineral water from a German dealer and then imported it into the United States. The Court stated:

The defendant is selling the genuine water, and therefore the trade-mark is not infringed. There is no exclusive right to the use of a name or symbol or emblematic device except to denote the authenticity of the article with which it has been identified by association. The name has no office except to vouch for the genuineness of the thing which it distinguishes from all counterfeiters.

The court in essence has said that the primary function of a trade mark is to indicate the genuineness of goods. Accordingly, provided the defendant's goods are genuine, there is no right which is infringed by the defendant. Thus, it is clear that the Court has adopted the international exhaustion principle since the defendant can bring the genuine goods around the world without infringing the trade mark owner's right.

The Second Circuit's decision in Katzel also adopted the international exhaustion principle. The French firms, A. Bourjois & Cie., and E. Wertheimer & Cie, had manufactured "Java" and "Bourjois" face powder in France and sold the product in the United States. In 1913, the French firms sold their United States business together with their goodwill and the registered trade marks to the plaintiff A. Bourjois & Co., Inc., a New York corporation. The plaintiff purchased and imported the product from France, and then packed and sold it in both the United States and the United Kingdom.

See, for example, Dickinson v. Tufling, 44 F. 192, 194 (N.D. Ill. 1897)(a patent owner who had placed on every packet of his pharmaceutical sold abroad a printed prohibition of importation into the United States could prevent parallel importation of the product into the country).

See the decision in Samoff, above, note 94 and accompanying text.

See, for example, Addis v. Burke, 84 U.S. 157 Wall. 425 (1873) and Kester v. Standard Folding-Box Co., 157 U.S. 659 (1895).


See, for example, Addis v. Burke, supra.

Kester v. Standard Folding-Box Co., supra.


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The plaintiff spent much money in advertising the business so that the business expanded considerabily and the public understood that the product came from the plaintiff. Without the plaintiff’s authorization, Anna Katznel import- 
ing the same genuine product from France for sale in the United States. Relying on three 
poor cases, the Second Circuit held that the defendant had the right to import the product 
and sell it in the United States under the same 
trade mark because the trade mark truly indi- 
cated its origin. The court stated: 
Trade-marks, . . . are intended to show 
without any time limit the origin of the 
goods they mark, so that the owner and 
the public may be protected against the 
sale of one man’s goods as the goods of 
another man. If the goods sold are the 
genuine goods covered by the trade-mark, 
the rights of the owner of the trade-mark 
are not infringed. 

The Second Circuit’s statement establishes 
the international exhaustion principle since 
the sale of the product in France exhausted the 
rights in the United States. The decision is too 
liberal, because, in fact, the United States trade 
mark in the case had already been assigned to 
the plaintiff and, as the United States trade 
mark owner, the plaintiff was completely 
independent of the French manufacturer. 
The United States Congress did not like the 
liberal approach taken by the Second 
Circuit in Katznel. In re Applying to the discretion, 
Congress enacted 526 of the Tariff Act 1922 
which, in essence, prohibited an unauthorized 
importation of goods bearing a United States 
trademark owned by a United States’ citizen, 
corporation or association. Clearly, this section 
is not in line with the Second Circuit’s deci- 
sion which had allowed the defendant’s unau- 
thorized importation although the plaintiff had 
actually become the owner of the registered 
trade marks “Java” and “Boujou.” 
The liberal approach taken by the Second 
Circuit was later quashed by the Supreme Court 
decision in the same case. The Supreme Court 
ruled: It is said the trademark here is that of 
the French house and truly indicates the origin 
of the goods. But that is not accurate. It is 
the trademark of the plaintiff only in the U.S. 
and indicates in law, and it is found, by 
public understanding, that the goods come 
from the plaintiff although not made by it. 

\[\text{\textsuperscript{26}}\text{Cf. at 540.}\]
\[\text{\textsuperscript{27}}\text{See Appliance Co. Ltd. v. Scherer, 275 F. 18 (C.C.S.D.N.Y. 1916); Russian Cenot Co. v. Freundeher, 133 F. 518 (Cir. 1904); Gittell v. Schoening 238 F. 780 (24 Cir. 1916). In essence, the three cases held that the United \nStates trade mark owner could not prevent parallel importation of the same genuine trade marked goods manu-
factured abroad because the primary function of a trade mark was to indicate the origin of the goods. See the court’s \nstatement in Appliance, above, note 107 and accompanying text.}\]
\[\text{\textsuperscript{28}}\text{See above, note 109 and accompanying text.}\]
\[\text{\textsuperscript{29}}\text{See Well Ceramics and Glass Inc. v. Utopia, 878 F. 24, 659, 666 (24 Cir. 1989) (stating that Katznel involved special 
circumstances; the United States trade mark owner was completely independent of the foreign manufacturer, 
adquired the manufacturer’s trade mark rights in an “arm’s-length” transaction, obtained control over the product’s 
quality in the United States, but had no control at all over the product sold abroad).}\]
\[\text{\textsuperscript{30}}\text{See supra, note 109.}\]
\[\text{\textsuperscript{31}}\text{The relevant part of this section provides: “It shall be unlawful to import into the United States any merchandise of 
foreign manufacture if such merchandise . . . bears a trade-mark owned by a citizen of, or by a corporation or associa-
tion created or organized within the United States, and manufactured in the Parent and Trademark Office by a person 
domiciled in the United States. . . unless written consent of the owner of such trademark is produced at the time of 
making entry.”}\]
\[\text{\textsuperscript{32}}\text{A. Boujou & Co. Inc. v. Katznel, 260 U.S. 689 (1923).}\]
\[\text{\textsuperscript{33}}\text{See supra, note 109.}\]
The Supreme Court's holding in Kassel appears to establish the territoriality of a trade mark, that is, it has a separate legal existence in every country. However, many cases have limited Kassel to its special facts, that is, the Supreme Court held only because there had been an assignment of a trade mark, or the plaintiff was actually an independent United States trade mark owner. In effect, the Supreme Court only held that the second Circuit's decision was wrong because the foreign trade mark owner, the French manufacturer, did not own the United States trade mark to be exhausted any more; it had assigned the trade mark to the New York corporation. Thus, the decision of Supreme Court does not annul the possibility that the international exhaustion principle can apply in different situations. In other words, the Supreme Court's decision results only in the limitation of the United States' application of the international exhaustion principle.

That the United States trade mark law adopts the international exhaustion principle can also be shown by the fact that the United States Customs Service indeed allowed certain kinds of parallel importation of trade marked goods manufactured abroad. Implementing s. 526 of the Tariff Act, the Customs Service enacted Regulation 133.21 (1972) which prohibits unauthorized importation of trade marked goods manufactured abroad but with two exceptions. First, the "common control" exception: (1) "both the foreign and the United States trademark or trade name are owned by the same person or business entity," or (2) "the foreign and domestic trademark or trade name owners are parent and subsidiary companies or otherwise subject to common ownership or control." Second, the "authorized use" exception: "the articles of foreign manufacture bear a recorded trademark or trade name applied under authorization of the United States owner." The legalization of parallel importation by the Regulation is broad enough. Of the various contexts in which parallel importation can occur explained by K. Marz, there is only one context in which parallel importation is prohibited by the Regulation, that is where a United States trade mark owner is independent of the foreign trade mark owner. The Regulation

395 U.S. 610 (1953).

396 See Champion Spark Plug Co. v. Saabson, 331 U.S. 122, 128 (1947). The Supreme Court itself states that Kassel was a case when the defendant imported goods "of one make under the trade name of another." E. G. Geiger & Co. v. B. T. Stoltz, 289 F. Supp. 1163, 1174 (SDNY 1968). Stating that the Supreme Court's decision in Kassel meant that the exhaustion principle cannot apply when the domestic trade mark owner has developed a separate, substantially independent goodwill from that of the foreign manufacturer; Champion Corp. v. United States, 752 F.2d 317, 322-23 (Fed. Cir. 1985); stating "We are inured to this conclusion by the fact that in Pressmanoff, Inc. v. Corp.,... the Supreme Court suggested that Kassel had limited application to any but its own special facts." West Currence & Glass, Inc. v. Dash, 67 F.3d 466 (Fed. Cir. 1995); explaining that Kassel involved a circumstance in which the plaintiff was completely independent of the foreign manufacturer and rejecting an argument that Kassel created a broad territoriality principle applicable to every instance.


18 CFR s. 133.211 cited to Chukun D.S. and Jacobs M.A., above, note 121 at 5 - 269.

17 K. Marz Corp. v. Carrier, Inc. 481 U.S. 281 (1988). Justice Kennedy in K. Marz describes five situations in which "gray market" goods may exist: First, a domestic company purchases from an independent foreign company the rights to register and use the latter's trade mark and sell its foreign-manufactured goods there. Then, a third party imports the same foreign-manufactured goods into the United States. Second, a United States trade mark owner is a subsidiary of a foreign manufacturer. A third party then imports the parent company's goods into the United States. Third, a United States trade mark owner is the parent company of a foreign manufacturer. Fourth, a United States trade mark owner manufactures its goods abroad by using its own unincorporated manufacturing division. Fifth, a United States trade mark owner "authorizes an independent foreign manufacturer to use it." Ibid at 286 - 287.

16 This is the first content described by K. Marz. See above, note 121.
clearly allows parallel importation where the foreign and United States trade marks are owned by the same person. In relation to s. 526, it means that the trade marks are owned by a United States citizen or corporation. But it can also mean that the trade marks are owned by a foreign citizen or corporation because s. 526 prohibits parallel importation only where the parallel imports bear a United States trade mark owned by a United States citizen or corporation.

The adoption of the international exhaustion principle by the United States Customs Regulation was later limited by K Mart. The Supreme Court in K Mart struck down the "authorized use" exception since, according to the Court, it was contrary to s. 526 of the Tariff Act. Thus, as in Kassel, the Supreme Court in K Mart has limited the application of the international exhaustion principle.

The discussion above indicates that the United States' application of the international exhaustion principle of a trade mark has been limited. It is even further limited by several subsequent cases by the "materially different" concept. In essence, the cases held that a trade mark owner can prevent parallel importation of goods which are "materially different" from those authorised to be sold in the United States. The reason of the courts in those cases is that the product differences could give rise to consumer confusion over the source of the product and, as a consequence, could harm the trade mark owners' goodwill. The important thing to note in this regard is that no consistent rule has developed on the standard of materiality of the product differences which causes the barring of parallel imports. As a consequence, a court can use the materially different concept so broadly that certain parallel imports can easily be barred. This means that the materially different concept may easily be used to avoid the application of the international exhaustion principle.

4. The Rationale Behind the Exhaustion Principle

4.1. The Rationale for the Exhaustion Principle for Domestic (Regional) Sales

For domestic sales in the United States, the underlying rationale behind the exhaustion principle is
principle of patents and copyrights is the cornerstone of the primary objective of patent and copyright laws, that is, to promote the development of science and arts for the public benefit and the concern for the free movement of goods which is also for the public benefit. For trade marks, the rationale is the notion that the primary function of a trade mark is to indicate the source of origin of goods.

4.1.1. Patents and Copyrights

It has been held that the primary objective of patent and copyright laws is to "promote the progress of science and the useful arts." In this case, the public interest seems to be more important than that of the patent and copyright owners. To achieve this objective, patent and copyright laws, on the one hand, give the owners exclusive rights to make or multiply, use and vend their products. On the other hand, in relation to the owner's product, the laws limit their right of control to the sale of the product. This means that when they have received the price of the product by the first sale, they are considered to have received the consideration for their creation and, as a consequence, they no longer have any right to control any subsequent alienation of the said product. In essence, the primary objective of patent and copyright laws is to provide incentive to invent or create by giving the owners the means of profiting from their creativity while ensuring that their rights do not extend what is necessary to achieve this objective. Thus, they only have a limited monopoly and this limited monopoly will benefit the public because the owner will disclose their invention or works to the public while not overburden the public by excessively payment from the public.

The exhaustion principle in the United States conveys the policy of balancing the two competing interests, namely the intellectual property owners' interest and the public interest. In Keeler, for example, in holding that the patentee's right was exhausted by the first sale, the court stated: The conclusion reached does not deprive a patentee of his rights because no article can be resold without the consent of the patentee. In the Keeler case, it was held that the mere fact that the article was resold without the consent of the patentee did not deprive the patentee of his rights. The court held that the patentee's right was exhausted by the first sale.

be unfettered from the claim of his monopoly without paying its tribute. The inconvenience and annoyance to the public that an opposite conclusion would entail are too obvious to require illustration. 11

To uphold the policy, the court in *Pieratt & Manck Co.* explained that although the court held that the copyright owner’s right was expropriated by the first sale, the court rejected the “absolutist” contention that “anyone in lawful possession of copyrighted goods may sell them without infringement.” 12 Furthermore, the court stated that the consideration for the owner’s creativity in the form of a “satisfactory” price for its product or the authority to sell the product was a must. 13 The courts in *Universe Lens* and *Bobs-Merrill* have the same opinion. 14

However, whether the owner has received a satisfactory price (incentive) by the first sale is a point which is controversial. In essence, the courts have asserted that the payment by the first sale to the owner is a satisfactory price for its creativity and to give the owner more than that would be beyond the scope of its statutory right. 15 Apparently, the assertion by courts does not satisfy intellectual property owners (including trade mark owners). They contend that they have not received a satisfactory price by the first sale of their products 16 and that the more they get the reward the more they become creative and, as a consequence, the more they are beneficial to the society. 17 To respond to this contention, again, courts have simply stated that to get more than the reward by the first sale would exceed the necessary incentive to create and will hinder free competition. 18 In other words, limiting the reward to the first sale, it is contended that if encouraging the owner’s necessary incentive of investment requires the owner to get “maximum return,” by extending its right beyond the first sale, the owner’s right should not be exhausted by the first sale. But if the “maximum return” provides the owner with “surplus returns,” which consequentially overburdens the society, the non-exhaustion of the owner’s right is appropriate. 19 In essence, this suggestion tries to propose the idea of the proper balance between the protection of the owner’s interest and the public interest. However, it is not easy to measure whether the maximum return obtained by the owner is a “necessary” incentive or becomes “surplus return.” One commentator says that to encourage high investment in certain industries (for example: pharmaceuticals) as well as to bolster certain activities which can produce...
significant social benefits (for example: increased agricultural products or new medical technologies) a high level of return by extending the right beyond the control on the first sale may be required. However, this suggestion needs a case-by-case consideration and requires considerable efforts to determine who of intellectual property owners deserves non-exhaustion.

The concern over free movement of goods is another rationale for the exhaustion principle. This is especially true in cases where the parties' transaction contained an express condition which was anti-competitive. In *Univis Lens*, for example, the Supreme Court stated that the control on subsequent dealing in the form of price fixing in Univis Lens' licensing system violated the United States Antitrust law. The Court added that the price fixing was "unreasonable restraint within the meaning of the Sherman Act" because they eliminate competition. Similarly to this case, *Bobbs-Merrill* also held that the copyright owner's attempt to fix the resale price of its products was "in violation of the acts to restrain combinations creating a monopoly or directly tending to the restraint of trade." Similarly, the European Union case *Centrafarm*, which involved the parallel importation of patented articles from one Member State into another Member State of the European Union, the ECJ stated:

An obstacle to the free movement of goods may arise out of the existence...of provisions laying down that a patentee's right is not exhausted when the product protected by the patent is marketed in another Member State, with the result that the patentee can prevent importation of the product into his own Member State when it has been marketed in another state.

This rationale provides consumers with benefits in the form of increasing product choices and lower prices. Parallel importation can increase product choices in a domestic market because parallel importers can buy and then import certain kinds of products which are not sold by intellectual property owners in the market. In addition, parallel importation can strike down the owners' attempts to isolate themselves from competition with their own cheaper products. This will benefit consumers since the price of the products in the market will decrease. This means that the exhaustion principle can prevent owners from attempting to restrict their output and then set high prices.

4.1.2. Trade Marks

The notion that the primary function of a trade mark is to indicate the source of origin of goods has become the underlying rationale for courts to conclude the exhaustion of a trade mark. In *Katzel*, for example, the Unites States' Second Circuit stated that a trade-mark was intended "to show without any time limit..."
the origin of the goods” it marked. The court further stated that by this function, a trade mark could protect the trade mark owner and the public “against the sale of one man’s goods as the goods of another man.”

The last statement indicates that a trade mark will protect against counterfeit goods. Thus, in essence, the statement is in line with the United States Supreme Court’s opinion in *Proctor & Gamble Co. v. **Gulf *Petroleum Corp.*

Then what new rights does the trade-mark confer? It does not confer a right to prohibit the use of the word or words. It is not a copyright... A trade-mark only gives the right to prohibit the use of it so far as to protect the owner’s good will against the sale of another’s product as his.

In effect, the “source of origin” rationale supports the free movement of goods. This will increase competition. The increasing competition will benefit consumers in the form of multiple choices of products and cheap products. That is why it is reasonable that the rationale for the exhaustion of a trade mark within the European Union is the concern over the free movement of goods. In *Consanform*, a case which involved parallel importation within the European Union markets, for example, the ECI stated that the existence of national laws providing that a trade mark owner’s rights in one Member State were not exhausted when its products were marketed in another Member State was an obstacle to the free movement of goods.

This “source of origin” rationale for the exhaustion of a trade mark, however, cannot apply when the goods from a trade mark owner in one market (a foreign market) are imported into another market (a domestic market) in which the same trade mark is owned by another person independent of the former owner.

In this situation, the trade mark on the import-ed goods may still clearly indicate that they originate from the foreign market. However, because the trade mark in the domestic market is owned by another independent person, the trade mark in the domestic market’s not exhausted by the first sale of the goods in the foreign market. In other words, although the foreign trade mark is exhausted, the domestic trade mark is still intact. This situation may also engender confusion among consumers especially when the foreign and domestic trade marks are identical. Consumers are confused as to the source of origin of the goods they purchased.

4.2. The Rationale for the United States’ National Exhaustion Principle of Copyright and the United States’ Limited International Exhaustion Principle of Patents and Trade Marks

In *Scorpion*, the court stated that the protection of the United States copyright law did not apply extraterritorially. Accordingly, the...
the domestic price, which is higher than the foreign price.

That kind of concern was expressly stated in Givenschy. The court in this case reached the same decision as in Scoprio. Moreover, the court added that to preclude the United States copyright owner from preventing the importation of copies manufactured and lawfully sold abroad would be "to deprive the U.S. copyright holders of the power to authorise or prevent imports of the copies once the copies are sold abroad." According to the court, this outcome would deprive the owner of the opportunity to gain the "full value of each copy" sold within the United States. Unfortunately, the court failed to explain the meaning of "full value." In the writer's view, the court meant that allowing the foreign copies to compete with the domestic copies would deprive the United States copyright owner of the power to set or maintain the domestic price. Thus, irrespective of other relevant factors, this conclusion of the court will enable the owner to set the price at a level which is harmful to domestic consumers.

Sebastian and L'omme do not disagree with the above-mentioned economic rationale which is biased to the United States copyright owner. Sebastian only reached the result of allowing parallel importation of copies originally made and sold in the United States. The

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Third Circuit in this case was not confronted with an importation of copies manufactured and sold abroad. If it had been, it would have been biased to the protection of the economic interest of the United States copyright owner. \(L\) aura is no different from Sebastian. The effect of the Supreme Court's decision in \(L\) aura is also limited to imported copies originally manufactured and sold within the United States. Moreover, as the court in Scorsio, "the Supreme Court in \(L\) aura clearly stated that the s 109(a)-6 exhaustion defense does not apply to copies legally manufactured abroad under a foreign country's law. Thus, it is quite certain that \(L\) aura would also protect the interest of the United States copyright owner were it faced with the parallel importation of copies originally made and sold outside the United States.

As mentioned above, in reponse to parallel importation, several United States courts recognize, although in limited situations, the international exhaustion principle of patents and trade secrets. The rationale behind the adoption of the principle is not clear. But it is undoubted that the country's limitation of the application of the principle indicates that the country intends to protect its intellectual property owners' interest. This is so since the country's limitation of the application of the principle is in line with its position in the international arena which favors the national exhaustion principle. That position was clearly visible during the TRIPS Agreement negotiations in which the United States opposed the international exhaustion rule. Similarly, it was also clear at the 1996 W.I.P.O Diplomatic Conference on Certain Copyright and Neighboring Rights Questions in which the United States proposed that the national or regional exhaustion should be added to the Berne Protocol. It is also indicated by the fact that the United States reacted negatively to Australia's and New Zealand's adoption of legislation favoring parallel importation.

Additionally, it was observed from the negative reaction of the Clinton Administration to the Japanese Supreme Court's decision in BBS II which adopted the international exhaustion principle in relation to parallel importation of patented goods. Furthermore, the United States government has entered into international trade agreements with at least five countries to protect the United States copyright owners from parallel importation of copies of their works sold in the five countries. The above-mentioned economic rationale does not apply to domestic sales. For domestic sales, the United States favors free trade and consumer protection. That is why, in relation to copyrights for example, when parallel imports are originally manufactured and sold within the United States, the owner of the goods can use the s 109(a)-6 exhaustion defense. Sebastian"
and J. James have clearly indicated this. Thus, the United States has two different positions: favouring the protection of the United States intellectual property owners in dealing with parallel importation not favouring the protection of consumer interest in dealing with domestic sales.

4.3. The Rationale for the Community (EEA) Wide Exhaustion Principle

The rationale behind the adoption of the EEA-wide exhaustion principle is: first, the protection of the national intellectual property owners’ interests and, second, the protection of the national economic interest. The rationale can be inferred from the decision in Silhouette.

The first rationale is clear in the statement of the Advocate General, Jacobs, that the ECF’s case-law on the badge of origin function of trade marks “was developed in the context of the Community, not the world market.” In effect, the statement indicates that the main function of a European trade mark in respect of goods imported from a third country is a badge of control. This certainly gives European trade mark owners a strong protection from parallel importation of their goods from a third country. Because this gives to parallel importers, this kind of protection enables the owners to discriminate as to prices of the same products between their national market and foreign markets. This means that owners can maintain a high price for the products in their national market. As a consequence, they can gain substantial profits in the market.

By that reasoning, in effect, Silhouette has overlooked the negative effect of the badge of control function of a trade mark on the European consumers. This kind of function of a trade mark certainly harms the consumers who must pay higher prices for the European trade mark owners’ products and have no access to the same cheaper foreign products.

The question which then arises is: why the European Union must favour the protection of their intellectual property holders’ interests while “neglecting” their own consumers’ interests. Chiappetta comments that the answer is that the European countries are “net creators of intellectual products” rather than “net intellectual property consumers.” This means that the protection of intellectual property owners’ interests is more fruitful to the European economy than to that of consumers’ interests. However, this logic fails to answer why some member states of the European Union have preferred the international exhaustion principle in respect of products from third countries. Apparently, the states favour the protection of consumers’ interests rather than that of intellectual property owners although they are net creators of intellectual products.

The second rationale for the Community-wide exhaustion principle is the protection of the national economic interest. This is obvious in Jacobs’ statement in Silhouette that “considerations of commercial policy and concern about the possible lack of reciprocity are among the reasons why the provision for inte-
national exhaustion... was not maintained..." Unfortunately, Jacobs failed to elaborate on his statement. He has only said that, because some third countries do not adopt the international exhaustion principle, the EEA's adoption of the principle would give rise to the "possible lack of reciprocity." In essence, Jacobs would appear to mean that the EEA would protect the EEA market from being open to goods from third countries because some third countries are not open to goods from the EEA.

Jacobs' statement is open to criticism. It is true that the lack of reciprocity can harm the European economy in a situation, for example, where parallel importation of some United States copyrighted articles legally manufactured and sold in France into the United States is successfully prevented by the United States copyright owner. This situation will impede the movement of articles from France to the United States and will deprive some European exporters of the opportunity to obtain a certain income. If the EEA adopts the international exhaustion principle, a United States exporter can export some French copyrighted articles legally manufactured and sold within the United States into France without the authorization of a French copyright owner. Thus, the EEA's adoption of the principle in this kind of situation benefits the United States exporter but harms European exporters. However, it is quite possible that a third country's not adopting the international exhaustion principle will otherwise benefit the EEA intellectual property owners. For example, a British copyright owner for certain goods gives an exclusive license to A to distribute the goods in Germany and B in Australia (a non-member state). In this case, the prevention of parallel importation of the goods from Germany into Australia will exactly benefit the British copyright owner since it can control the distribution of the goods and can maintain its price discrimination. It is important to note that the Community-wide exhaustion principle is more protective than the United States national exhaustion principle in relation to copyright. As mentioned above, two United States cases have held that an exporter of copyrighted goods manufactured within the United States cannot use the 1964 exhaustion defense. Conversely, Silhouette does not deem the site of manufacture as a factor which determines the exhaustion of rights. It is quite possible that the out-of-fashion spectacles, which were sold in Bulgaria and then imported back into Austria, had been produced by Silhouette within Austria or other member states of the European Union. But the ECI did not touch on this matter. This means that as long as the parallel imports were sold abroad, they could not enter the EEA. Thus, the Community-wide exhaustion may impede the movement of more foreign goods into the national market than the United States national exhaustion principle.

5. Conclusion

The exhaustion principle means that when an intellectual property owner sells its goods embodying the property, the owner's right is exhausted, and therefore, it cannot control any subsequent dealing with the goods. Thus, this principle not only limits the owner's right but also gives a purchaser of the goods an unrestricted right to use and dispose of them.

Several United States courts have set down a number of requirements in relation to the application of the exhaustion principle. First,
an intellectual property owner has to receive a reward for its right to be exhausted. In other words, the owner has to participate in the first sale of its product. Therefore, if the owner does not participate in the sale or does not receive the reward from the sale, the owner’s right is not exhausted although its goods have been released. Second, purchasers of the owner’s goods must have acquired the full dominion over the goods. In other words, the purchasers must have obtained “lawful ownership” in order that they can use the exhaustion defence. Third, the sale by the owner or its licensee must be without reservation or restriction. Accordingly, the owner can counteract the effect of the exhaustion principle by providing express conditions on the sale of its goods. Except for the first requirement, the ECI did not mention the others.

In relation to parallel importation, the United States and the European Union have limited the application of the exhaustion principle. The United States does so particularly in relation to copyrights by adopting the “national exhaustion” principle. This means that the exhaustion principle only applies to the imported works which are originally manufactured and sold within the country.

The European Union has a similar approach to that of the United States by adopting what is referred to as the “European Economic Area (EEA)-wide exhaustion” principle. This means that it is only the first sale within the Area which can exhaust an intellectual property owner’s right. In other words, the exhaustion principle does not apply to goods first sold in a third country (a non-member state). Unlike the United States’ national exhaustion principle, the EEA-wide exhaustion principle does not take into account the site of manufacture as a factor which determines the exhaustion of rights. Thus, although a product is manufactured within the EEA, if the first sale of the product occurs outside the EEA, the first sale does not engender the exhaustion of rights. In addition, unlike the United States’ national exhaustion principle, the EEA-wide exhaustion seems to apply to all intellectual property rights.

Several United States courts adopt the “international exhaustion” principle in relation to the parallel importation of patented articles. This means that the first sale lawfully anywhere in the world by a United States’ patent owner of its patented article exhausts the United States patent on the article. However, the courts have limited the application of the principle to unconditional or unrestricted sales. Thus, a patent owner can counteract the effect of the principle by providing conditions on its sale. Furthermore, the exhaustion principle only applies to unrestricted sales made by persons having rights to sell in the United States. Accordingly, an unrestricted sale abroad cannot exhaust the United States patent rights which have been transferred to an exclusive licensee of the patent owner.

In relation to trade marks, several United States courts have also adopted the international exhaustion principle although only for limited situations. The principle applies only when the domestic and foreign trade marks are owned by the same owner or the domestic and foreign trade mark owners are parent and subsidiary companies or subject to Common control. In addition, the principle applies only to imported goods which are not “materially different” from the authorized domestic goods.

For domestic sales, in the United States, one of the rationales behind the exhaustion principle of patents and copyrights is the belief that the main objective of patent and copyright laws is to promote the development of science and arts for the public benefit. Therefore, the reward to patent and copyright owners is given only as an incentive to achieve that main objective. In this case, several United States courts have asserted that the payment by the first sale to the owners is a satisfactory incentive for that purpose. This kind of rationale, however, is not visible in the European cases which adopt the principle to regional sales. The concern over the free movement of goods is another rationale.
behind the principle. In essence, it is stated that a patent and copyright owner’s attempt to control a subsequent dealing with its goods restrained the free movement of goods.

In relation to trade marks, the rationale behind the exhaustion principle is the belief that the primary function of a trade mark is to indicate the source of origin of goods embodying the trade mark. In essence, this means that as long as parallel imports embodying a trade mark still accurately indicate that they originate from the trade mark owner, the owner’s right is exhausted. The “source of origin” rationale is in line with the idea of the free movement of goods. Therefore it is reasonable that the rationale behind the exhaustion principle of a trade mark in the European Union is the concern over the free movement of goods.

The rationale underlying the United States’ national exhaustion principle of copyrights is the protection of domestic copyright owners’ economic interest. It is stated that to allow the parallel importation of copies made and sold abroad would be to deprive the U.S. copyright holders of the power to authorize or prevent imports of copies once the copies are sold abroad, and, as a consequence, the holder loses the opportunity to gain the full value of each copy sold in the United States. The protection enables the holder to obtain a reward more than once, that is the royalty from a foreign sale of its copies and the royalty from its importation authorisation of its copies into the United States.

While it is difficult to determine the rationale for the United States’ international exhaustion principle of patents and trade marks, it is submitted that the country’s limitation of the application of the principle indicates the country’s intention to protect its intellectual property owners’ interest. This is true since the limitation of the principle is in line with the country’s strong negative reaction to other countries’ favouring international exhaustion as well as the country’s position during the TRIPS Agreement negotiations and the 1996 WIPO Conference, which favours the national exhaustion principle.

The protection of the regional intellectual property owners’ interest and the protection of the regional economic interest are the rationale underlying the EU-wide exhaustion principle. In Silhouette, the Advocate General, Jacobs, has stated that a European trade mark owner has the right to use its mark to control the movement of its own goods sold in a third country. In effect, this can harm the European consumers who may pay higher prices and have no access to cheaper parallel imports. Jacobs also stated that the concern about “the possible lack of reciprocity” is an underlying reason why the international exhaustion is not adopted. However, Jacobs’ statement is weak since the lack of reciprocity in the form of a third country’s not adopting the international exhaustion principle may also benefit European intellectual property owners. For example, the right of an Australian exclusive licensee of a British trade mark owner to prevent parallel importation of the owner’s products from Germany into Australia exactly benefits the owner.
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