

NOTES

BRINGING DOWN THE WALLS: HOW TECHNOLOGY IS BEING USED TO THWART PARALLEL IMPORTERS AMID THE INTERNATIONAL CONFUSION CONCERNING EXHAUSTION OF RIGHTS

*Ryan L. Vinelli**

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* Executive Editor, *Cardozo Journal of International and Comparative Law*. Candidate for Juris Doctor, Benjamin N. Cardozo School of Law, May 2009.

I. INTRODUCTION

In 2006, a Hong Kong online video game retailer called Lik Sang shut down—another casualty of a war between property owners and unauthorized importers.¹ Lik Sang was famous among video game aficionados for carrying hard to find Japanese products which were either released earlier in Japan or found only in Japan.² The High Court of London held that Lik Sang had violated Sony's trademark, copyright, and design rights because it sold the PlayStation Portable to customers in the United Kingdom before Sony had officially released the product there.³ Under an onslaught of litigation, Lik Sang closed its “doors” and posted an explanatory letter on its website.⁴ Far from a rare case, Lik Sang's story is instead typical of an importer selling highly anticipated gray market goods.

Intellectual property right holders, like Sony, are able to take advantage of the lack of global legal uniformity in intellectual property right law by segmenting markets, or selling goods at different prices in different markets.⁵ Much of this legal uncertainty stems from the complicated and diverse approaches countries have taken as to when an intellectual property right exhausts, or becomes unenforceable. Market segmentation greatly benefits rights holders and manufacturers by increasing profits and staggering product releases. However, importers disrupt these plans when they provide consumers with the same products earlier and at lower prices. If a rights holder is capable, it will use local laws to stop gray marketers from parallel importation – such as in Lik

¹ See Lik-Sang.com Out of Business due to Multiple Sony Lawsuits, <http://www.lik-sang.com/> (last visited Nov. 16, 2007).

² See Lik-Sang shuts shop, names PSP-purchasing senior Sony staffers, <http://www.out-law.com/page-7419> (last visited Feb. 12, 2008); see also Daemon Hatfield, IGN: Lik-Sang PSP Sales Blocked in Europe, <http://psp.ign.com/articles/740/740825p1.html> (last visited Feb. 12, 2008).

³ Hatfield, *supra* note 2.

⁴ Lik-Sang.com Out of Business due to Multiple Sony Lawsuits, *supra* note 1.

⁵ “The doctrine of exhaustion of rights provides the legal basis for ‘parallel importation.’” FREDERICK M. ABBOTT, *PARALLEL IMPORTATION: ECONOMIC AND SOCIAL WELFARE DIMENSIONS* 4 (2007) [hereinafter ABBOTT, *PARALLEL IMPORTATION*]. “Laws restricting parallel importation permit producers to segment the international market.” *Id.* at 5. “If national approaches to the exhaustion of rights issue differ, arbitrage will occur.” Pamela Samuelson, *Intellectual Property Arbitrage: How Foreign Rules Can Affect Domestic Protections*, in *INTERNATIONAL PUBLIC GOODS AND TRANSFER OF TECHNOLOGY UNDER A GLOBALIZED INTELLECTUAL PROPERTY REGIME* 635, 638 (Keith Maskus & Jerome H. Reichman eds., 2005).

Sang's case. However, the lack of global legal uniformity and consensus as to the ability of the rights holder to stop this practice has induced electronics companies to create and embed technologies that bolster the walls of market segmentation that parallel importers attempt to sidestep.⁶

Gray market importers give electronic companies cause for concern because they purchase goods globally and sell them alongside the same authorized product at a lower cost than the original manufacturer. Even worse for electronics companies, importers break down the artificial barriers companies erect to segment markets by allowing consumers to access products they could not purchase domestically. Removal of these barriers creates unwanted competition for rights holders. Due to the legal uncertainty of the length of time for which a rights holder can control its product, individual companies and the electronics industry as a whole are creating new technologies that give them post-sale control of their products. Familiar examples abound in our technology-orientated world: consumer movies (DVDs⁷ and Blu-Ray discs),⁸ printers,⁹ video games (Personal Computer video games, Microsoft's Xbox and Xbox 360,¹⁰ and Sony's Playstation 2 and 3),¹¹ and cell phones (most notably Apple's iPhone series). Each of these products uses embedded technology to segment the mar-

⁶ Parallel importers have worked around market segmentation through e-commerce and creating online stores like Lik Sang and using Amazon.com, Yahoo.com, or Ebay.com. See Matthew Fornaro, *Parallel Problem: Grey Market Goods and the Internet*, 8 J. TECH. L. & POL'Y 69, 80 (2003) (discussing how the internet facilitates the movement of gray market goods).

⁷ "The DVD world is divided into six major geographical regions, with two additional regions reserved for specialized use." How DVD Region Codes Affect The Consumer: What You Need To Know, <http://hometheater.about.com/cs/dvdlaserdisc/a/aaregioncodesa.htm> (last visited Nov. 16, 2007).

⁸ See PLAYSTATION 3 Troubleshooting, http://www.us.playstation.com/Support/PS3/Troubleshooting/s_ps3_hs_dt.html (last visited Nov. 16, 2007) ("If the DVD or BD does not match the region code set in the PLAYSTATION™3, it cannot be played."); see also Blu-ray To Have Region Codes, <http://hometheater.about.com/b/2006/01/19/blu-ray-to-have-region-codes.htm> (last visited Nov. 16, 2007) [hereinafter PLAYSTATION 3 Troubleshooting].

⁹ This trend exists even outside the realm of electronics. Perhaps the strangest example is that of genetically modified hypoallergenic cats. See JOHN LOTT, FREEDOMNOMICS: WHY THE FREE MARKET WORKS AND OTHER HALF-BAKED THEORIES DON'T 25 (2007) (explaining that Allerca's hypoallergenic cat is neutered "in order to forestall the creation of secondary markets by customers who buy the cats and breed them themselves . . .").

¹⁰ See Xbox 360 Regional Differences, <http://support.microsoft.com/kb/917977?sd=xbox> (last visited Nov. 16, 2007).

¹¹ See PLAYSTATION 3 Troubleshooting, *supra* note 8.

ket and allow the rights holder to retain some level of control after sale.¹²

In an effort to retain market control, most electronic manufacturers rely on software and region coding technologies. Video discs and some video games are coded based on where they are sold.¹³ Video playing hardware and discs are sold in specific geographic regions and programmed with a “region code” that corresponds to the intended sale location.¹⁴ If the region code of the player does not match the region code of the disc, the disc will not play.¹⁵ Some PC games are also sold in specific geographic locations and, if installed outside of that location, cannot be played.¹⁶

Even ink-jet printers and ink cartridges have been subject to region coding technology.¹⁷ As with other products, the rationale for regionalizing the lowly ink cartridge is to reduce price alterations as currencies fluctuate and to dissuade gray marketers.¹⁸ A major impetus for regionalization of all products has been the decline of the dollar, which makes products in the United States much cheaper than those sold in Europe or other countries with a stronger currency.¹⁹ Hewlett Packard, like many multinational companies from the United States, receives increased domestic revenue when it is “boosted by sales in [E]uros and other strong currencies.”²⁰

¹² See Samuelson, *supra* note 5, at 641.

¹³ See JIM TAYLOR, EVERYTHING YOU EVER WANTED TO KNOW ABOUT DVD: THE OFFICIAL DVD FAQ, 18 (2003); see also DVD CCA Welcomes you!, <http://www.dvdcca.org/faq.html> (last visited Nov. 16, 2007) (explaining that DVD regions are implemented to allow movie distributors the freedom to release a movie on DVD while still in theatres in another part of the world.).

¹⁴ *Id.*

¹⁵ *Id.*; See Why Can I Play Some DVD Movies, But Not Others, on My Computer DVD-ROM?, <http://computer.howstuffworks.com/question474.htm> (last visited Nov. 17, 2007) for a full explanation of how and why DVD region codes are used.

¹⁶ See Valve Locking Out User Accounts for Incorrect Territory, <http://arstechnica.com/journals/thumbs.ars/2007/10/25/valve-locking-out-user-accounts-for-incorrect-territory> (last visited Nov. 16, 2007) (“Valve apparently has taken issue with the region-specificity of some international versions and has begun locking out accounts of those living in North America . . .”).

¹⁷ See David Pringle & Steve Stecklow, *Electronics With Borders: Some Work Only in the U.S.*, WALL ST. J., Jan. 17, 2005, at B1 (“[H.P.] introduced region-coding on several printers in the summer so it won’t have to keep altering prices to keep pace with currency movements, says Kim Holm, vice president for H.P.’s supplies business in Europe, the Middle East and Africa.”).

¹⁸ *Id.*

¹⁹ *Id.*

²⁰ *Id.*

Cell phones share this segmentation principle, but the methods differ. Cell phones in the United States are programmed in a way that segments the market along the lines of a wireless provider, a practice known as “locking” the phone, rather than by geographic region.²¹ A locked cell phone only works on a pre-defined carrier’s network or within a specific territory. An excellent example of this has been Apple’s eagerly anticipated series of cell phones, the iPhone, which were solely licensed within the United States for use with AT&T’s wireless service.²² As purchased, the phone would not work on a network other than AT&T’s. However, within two months of being released, a teenager was able to hack into the phone and “unlock” it to be used on other networks.²³ Apple has since released software updates to the phone that attempt to counteract this hacking.²⁴ In an extraordinary move, Apple stopped taking cash for iPhone sales, instead requiring credit cards in order to enforce a two iPhone limit per person (as cash did not allow the purchaser to be tracked).²⁵ In implementing this arguably drastic measure, Apple hopes to stop purchasers from buying a large number of the phones and then unlocking them to be used or resold for use on other networks.²⁶ Many of these measures were repeated and expanded when the iPhone 3G debuted.²⁷

These post-sale controls are unwelcome by consumers because they segment the international market by, reducing choices, raising prices, or, at the extreme end, entirely preventing the purchase of a product. Segmentation practices run contrary to the liberal notion

²¹ See LAWRENCE HARTE ET AL., *GSM SUPERPHONES* 235 (1999) (explaining how subscriber identity module (SIM) cards are used to lock cell phones); see also ANDREW MENNEN, *COMPLETE GUIDE TO MOBILE PHONES: MONEY SAVING TIPS FOR USERS* 89-93 (2005) (describing various methods for locking cell phones, including SIM locking).

²² iPhone Exclusively from AT&T and, <http://www.wireless.att.com/cell-phone-service/specials/iPhoneCenter.html> (last visited Feb.6, 2008) (“iPhone will only be available with wireless service from AT&T.”).

²³ Brad Stone, *With Software and Soldering, a Non-AT&T iPhone*, N.Y. TIMES, Aug. 25, 2007, at C1.

²⁴ See Elaine Chow, *Apple Leopard 10.5.6 Update Pwns Pwnage, Breaks Jailbreak*, GIZMODO, Dec. 16, 2008, <http://gizmodo.com/5110996/apple-leopard-1056-update-pwns-pwnage-breaks-jailbreak> (last visited Jan. 1, 2009).

²⁵ See *Apple Refusing to Accept Cash for iPhone, Limits ‘em to two per person*, ENGADGET, <http://www.engadget.com/2007/10/27/apple-refusing-to-accept-cash-for-iphone-limits-em-to-two-per/> (last visited Nov. 16, 2007).

²⁶ See *Apple Limits Sale of iPhones: Two Per Person and No Cash*, N.Y. TIMES, Oct. 27, 2007, at C2.

²⁷ See *Where to Buy*, <http://www.apple.com/iphone/buy/> (last visited Aug .16, 2008).

of free markets and competition, which promotes the free flow of goods with no barriers to trade as a way to maximize consumer and societal benefit.²⁸ As a result of limited choices, consumers are often left paying much higher prices for products.

Concurrently, property rights owners are faced with a myriad of international laws, which conflict regarding when or how owners can control their products after being sold. These right holders are upset at losing revenue to middlemen who import their goods at lower prices. Their concerns have led to the invention of methods of control, which can be embedded into their products. Yet, creating, implementing, and maintaining these technologies add yet another cost to developing products, which in turn is passed on to the consumer.²⁹

In order to address this conflict, an international standard should be established for exhaustion of rights with regards to electronics. A uniform standard will set a legal foundation to which owners and purchasers can refer to when confronted with an issue concerning post-sale control. However, this measure will not necessarily resolve the problem of segmenting markets to combat parallel importation and gray markets. In order to promote the removal of these barriers, a new system must be implemented to discourage companies from dividing markets.

There are two ways to carry out this task: utilizing non-governmental entities or relying on governments. To stop segmentation through non-governmental means, two different mechanisms will be discussed: creating a standard for barrier-free electronics devices through an internationally recognized standards group, and relying on competing products and market forces. The second option is resorting to government legislation and competition regulation to discourage market segmentation.

Part II will begin by laying out the foundation for a discussion on market segmentation by discussing exhaustion of rights, gray markets, and parallel importation. This Part will then illustrate the lack of an international consensus by examining the current status

²⁸ See CAMPBELL R. McCONNELL ET AL., *MICROECONOMICS* 40-42 (2004); *see also id.* at 362-63 (discussing the benefits of free trade: promoting competition, deterring monopolies, linking national interests, and breaking down national animosities).

²⁹ Neils Rump, *Definitions, Aspects, and Overview*, in *DIGITAL RIGHTS MANAGEMENT: TECHNOLOGICAL, ECONOMIC, LEGAL AND POLITICAL ASPECTS* 3, 14 (Eberhard Becker et al. eds., 1998) (explaining that all digital rights management costs are paid for by the consumer).

of exhaustion in treaties. Particular attention will be paid to the World Trade Organization's (WTO) efforts and failures and in particular the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS).³⁰ Next, the three most common methods for determining when a property owner's rights have been exhausted will be identified and examined. Lastly, this section will analyze the implementations of exhaustion of rights laws in the United States, European Union, Japan, and Australia and case law, as well as international agreements concerning intellectual property. Part III will propose a two-part answer to the problem of companies embedding mechanisms into their products for post-sale control: the WTO should choose and implement an international standard, and another international structure must be put in place to deter any further market segmentation.

II. THE CAUSES OF PARALLEL IMPORTATION AND GRAY MARKETS

The term "gray market goods" refers to products sold outside the normal, authorized, or exclusive distribution arrangements that are established by the product's manufacturer or owner.³¹ The international practice is known by the less pejorative name of "parallel importation."³² Parallel importation occurs most often due to importers taking advantage of the price fluctuations of an internationally available product, as currency markets vary and consumers seek the lowest price.³³ However, companies deliberately sell their products at different prices in different markets relative to what the market will bear, a practice known as price discrimination.³⁴ In order for price discrimination to be effective, the seller must be able to control the output and price of his or her product, the tar-

³⁰ Agreement on Trade-Related Aspects of Intellectual Property Rights, Apr. 15, 1994, 33 I.L.M. 81 [Hereinafter, TRIPS].

³¹ See Megeed Ragab & C. Andrew Costlow, *When Business Strategy and the Law Are in Conflict: The Case of Parallel Importation in Canadian Border Communities*, in INTERNATIONAL TRADE AND INTELLECTUAL PROPERTY: THE SEARCH FOR A BALANCED SYSTEM 3, 5 (George R. Stewart et al., eds., 1994); see also Dale F. Duhan & Mary Jane Sheffet, *Gray Markets and the Legal Status of Parallel Importation*, 52 J. MARKETING 3, 75-83 (1988) (examining parallel importation as a form of gray marketing and placing it in the context of a general framework of legal and illegal marketing activities).

³² "The term parallel import refers to a good or service that is first sold under a corresponding or parallel [intellectual property right] in another country, and then imported into the national territory." ABBOTT, PARALLEL IMPORTATION, *supra* note 5, at 5.

³³ See DUHAN & SHEFFET, *supra* note 31, at 76.

³⁴ See generally LOUIS PHILIPS, THE ECONOMICS OF PRICE DISCRIMINATION (1983).

get markets must be segregated from each other, and the initial purchasers must be prohibited from reselling.³⁵ Supporters of price discrimination and market segmentation argue that these practices often increase competition,³⁶ citing economic analyses that indicate that a “limited ability to engage in price discrimination . . . may serve to promote technology transfer and an efficient allocation of resources internationally.”³⁷

Beneficial price discrimination arguably increases competition by giving businesses more tools with which to compete.³⁸ By charging different consumers different prices companies can compete more effectively with other businesses which have a uniform or different asymmetric pricing strategy.³⁹ Further, the prudent or relative price point for one market/industry is not necessarily the same as another.⁴⁰ Allowing price discrimination facilitates entry of companies into new and lower-priced markets.⁴¹ Without the ability to charge different prices, companies might not be able to tailor their price to the local market, which would result in a lack of sales that would deter and stop further market expansion.⁴²

Price discrimination can also help selected consumer groups and raise social welfare. For example, when companies give stu-

³⁵ See MCCONNELL ET AL., *supra* note 28, at 208.

³⁶ See Robert D. Anderson et al., *Intellectual Property Rights and International Market Segmentation in the North American Free Trade Area*, in COMPETITION POLICY AND INTELLECTUAL PROPERTY RIGHTS IN THE KNOWLEDGE BASED ECONOMY 397, 424-25 (Robert Anderson & Nancy Gallini eds., 2007) (explaining that stopping the practice of free-riding increases competition); see also M. E. BEESLEY, *PRIVATIZATION, REGULATION AND DEREGULATION* 74 (2d ed. 1997).

³⁷ Robert D. Anderson, *The Interface Between Competition Policy and Intellectual Property in the Context of the International Trading System*, J. INT'L ECON. L. 655, 674 (1998) (citing Malueg & Schwartz, *Parallel Imports, Demand Dispersion and International Price Discrimination*, 37 J. INT'L ECON. 167-95 (1994)).

³⁸ “Uniform . . . pricing can be less competitive than systematic price discrimination. This is because uniform . . . pricing provides the producer fewer possibilities of retaliation than does a price discrimination situation.” HERVE DUMÉZ & ALAIN JEUNEMAÎTRE, *UNDERSTANDING AND REGULATING THE MARKET AT A TIME OF GLOBALIZATION: THE CASE OF THE CEMENT INDUSTRY* 83 (2000).

³⁹ *Id.*

⁴⁰ See MILTON MOORE, *HOW MUCH PRICE COMPETITION?: THE PREREQUISITES OF AN EFFECTIVE CANADIAN COMPETITION POLICY* 43 (1970) (explaining that different prices at which a product is profitable relies on the price sensitivities of sales within different industries).

⁴¹ See Shanker A. Singham, *TRIPS and the Interface between Competition and Patent*, 26 BROOKLYN J. INT'L L. 363, 407 (2000).

⁴² See Mattias Ganslandt & Keith Maskus, *Intellectual Property Rights, Parallel Imports and Strategic Behavior* (2007), <http://ssrn.com/abstract=982241>.

dent or senior discounts, they allow consumers who might not be able to purchase their products to do so.⁴³ Also price discrimination is particularly important for manufacturing products that have large development costs and relatively small production costs, since companies can produce cheaply and profit more with larger distribution and increased consumption.⁴⁴ Thus by reducing costs to groups and being able to recuperate large development costs, price discrimination can improve welfare and expand consumption.

However, supporters of curtailing price discrimination, offer equally, if not more, compelling research.⁴⁵ According to this view, parallel importation promotes efficiency, competition, and an increase of the welfare for net-importing countries.⁴⁶ Consumers are also better protected, since price discrimination can more effectively charge individuals what they are capable of paying.⁴⁷ Rather than have each person's ability to pay match the product price, consumers are able to have a uniform price and potentially save money that a discrimination regime would have extracted.⁴⁸ Studies have found mix results for uniform pricing versus price discrimination. Factors such as transportation costs make a huge difference in which regime is more effective—uniform pricing is theoretically more effective with lower transportation costs.⁴⁹

As Professor Chiappetta noted, “[r]easonable people making valid points can, and do, reach conflicting conclusions.”⁵⁰ No con-

⁴³ See Mark Armstrong, *Price Discrimination* 3 (Oct. 2006), <http://mp.ra.ub.uni-muenchen.de/4693/>.

⁴⁴ Examples include movies, video games, and software. See Mattias Ganslandt & Keith Maskus, *Intellectual Property Rights, Parallel Imports and Strategic Behavior* 20 (2007), <http://ssrn.com/abstract=982241> (explaining that low production and high development costs products consumption expands under price discrimination improving welfare).

⁴⁵ See Frederick M. Abbott, *First Report (Final) to the Committee on International Trade Law of the International Law Association on the Subject of Parallel Importation*, 1 J. INT'L ECON. L. 607, 635 (1998) [hereinafter, *Report on Parallel Importation*].

⁴⁶ Theo Papadopoulos, *Copyright Law and Competition Policy: International Aspects*, AGENDA, 113, 114 (2002).

⁴⁷ Armstrong, *supra* note 43, at 7-8.

⁴⁸ *Id.*

⁴⁹ “Requiring the manufacturing firm to charge a uniform wholesale price may be optimal for low trade costs when the pro-competitive effect is substantial but may have a severe negative effect on consumer welfare when trade costs are high as the primary effect is that retail prices increase in all markets.” Mattias Ganslandt & Keith Maskus, *Wholesale Price Discrimination and Parallel Imports* 35, Soc. Sci. Research Network, Working Paper No. 1951 (2007), available at <http://www.ssrn.com/abstract=980665>.

⁵⁰ Vincent Chiappetta, *The Desirability of Agreeing to Disagree: The WTO, TRIPS, International IPR Exhaustion and a Few Other Things*, 21 MICH. J. INT'L L. 333, 360 (2000).

sensus or empirical data supports either view over the other.⁵¹ What is known is that for effective price discrimination, rights owners need to stop parallel importation and divide markets, both activities that drive up prices for many consumers.⁵² Price discrimination also does not work effectively, and therefore beneficially, if arbitrage and parallel importation occur, both practices that are rampant in our globalized, e-commerce, e-bay world.

The importers, who profit from the price differential between markets, by buying low and then selling high, engage in the practice known as "arbitrage."⁵³ While a boon to consumers, owners and manufacturers oppose arbitrage because they lose revenue and are not able to effectively utilize price discrimination. Companies can only combat parallel importation if their intellectual property rights have not yet exhausted.⁵⁴ Thus, parallel importation is directly related to the legal principle of exhaustion.

Different types of intellectual property share the common characteristic that their associated rights eventually exhaust,⁵⁵ meaning that the legal right is no longer enforceable or available.⁵⁶ When an intellectual property right exhausts, the intellectual prop-

⁵¹ See Catalin Cosovanu, *Piracy, Price Discrimination, and Development: The Software Sector in Eastern Europe and Other Emerging Markets*, 31 AIPLA Q.J. 165, 199-200 (2003).

⁵² See JACK HIRSHLEIFER ET AL., PRICE THEORY AND APPLICATIONS: DECISIONS, MARKETS, AND INFORMATION 238-43 (2005) (detailing how companies and monopolies can segment markets and price discriminate to charge according to ability to pay); see also MCCONNELL ET AL., *supra* note 28, at 208.

⁵³ See Wendy J. Gordon, *Intellectual Property as Price Discrimination: Implications for Contract*, 73 CHI.-KENT. L. REV. 1367, 1380 (1998). "Arbitrage is an ancient and honorable routine in market economies - the practice of buying a commodity in one local market where it is cheap, then selling it in a neighboring market where the price is higher and profiting from the fractional difference." WILLIAM GREIDER, ONE WORLD, READY OR NOT: THE MANIC LOGIC OF GLOBAL CAPITALISM 57 (1997).

⁵⁴ Parallel Imports Europe: A Big Day For Consumers, <http://www.prlog.org/10015850-parallel-imports-europe-big-day-for-consumers.pdf> (last visited Feb. 12, 2008) ("The manufacturer or the owner of an industrial or commercial right may indeed ask the national authorities or courts . . . to protect the specific subject-matter of these rights. But as soon as he markets his product for the first time . . . he loses his right to restrict the marketing of the product . . ."); see also ABBOTT, PARALLEL IMPORTATION, *supra* note 5 ("The IP right to exclude is limited by the doctrine of 'exhaustion of rights'").

⁵⁵ ABBOTT, PARALLEL IMPORTATION, *supra* note 5. "This doctrine is common to all legal systems." *Id.*

⁵⁶ Keith E. Maskus, *Intellectual Property Rights and Economic Development*, 32 CASE W. RES. J. INT'L L. 471, 501 (2000) ("Countries generally observe a 'first-sale doctrine' [for exhaustion] under which domestic sale of a protected good eliminates rights to prevent its further sale . . ."); see also ABBOTT, PARALLEL IMPORTATION, *supra* note 5 ("[exhaustion] provides that the IP-holder's control over goods or services ends (or is 'exhausted') once

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erty itself does not cease to exist; the right to further control market distribution does.⁵⁷ The how, when, and why an intellectual property right exhausts is subject to numerous factors. The answers to these questions are found within the legal system of the nation that issues or creates the property right. There are three major regimes that states employ to determine when rights exhaust: national or territorial exhaustion, community exhaustion, and international exhaustion.⁵⁸ This task is further complicated by nations' propensity to choose a different exhaustion regime for each type of intellectual property (copyright, patent/industrial design, trademark, etc.). This balkanization creates numerous problems, most evident in products that contain many types of intellectual property and are placed into international markets.

A. *International Treaties and Exhaustion*

The international community is replete with failed attempts to create a consensus on the issue of exhaustion. The current multilateral treaties concerning intellectual property rights are silent on exhaustion of rights.⁵⁹ The TRIPS agreement is proof of the battles waged over exhaustion.⁶⁰ Aside from TRIPS, other major intellectual property treaties are also ineffective in addressing exhaustion.

The Paris Convention for the Protection of Industrial Property (Paris Convention) was signed in 1883 and protects industrial property including: "patents, utility models, industrial designs or models, trademarks, service marks, trade names, [and] indications of

the particular good or service embodying the IP has been placed on the market (or 'first sold')").

⁵⁷ See Peter Ganea, *Exhaustion of IP Rights: Reflections from Economic Theory 2* (Hitotsubashi U. Inst. Innovation Res. Working Paper WP#06-02, 2006) (2006), available at <http://www.courts.go.jp/english/judgments/text/1997.07.01-1995-O-No.1988.html> (last visited Feb. 18, 2008).

⁵⁸ ABBOTT, PARALLEL IMPORTATION, *supra* note 5, at 5 ("There are three distinct geographic concepts of exhaustion and parallel importation: national, regional and international."). Other exhaustion regimes exist, but this note addresses specifically the three major regimes.

⁵⁹ See M. SORNARAJAH, THE INTERNATIONAL LAW ON FOREIGN INVESTMENT 254 (2004). See also World Intellectual Property Organization, *Implications of the TRIPS Agreement on Treaties Administered by WIPO*, 9, WIPO Pub. No. 464(e) (1996).

⁶⁰ See NUNO PIRES DE CARVALHO, THE TRIPS REGIME OF PATENT RIGHTS 62 (2005); see also BENEDICTE CALLAN, STUDY GROUP ON AM. INTELLECTUAL PROP. RIGHTS POLICY, PIRATES ON THE HIGH SEAS: THE UNITED STATES AND GLOBAL INTELLECTUAL PROPERTY 23 n. 39 (1998).

source or appellations of origin”⁶¹ In consideration of its member’s domestic legislation, the Paris Convention establishes minimum guarantees for the protection of intellectual property rights.⁶² The Paris Convention seeks to remove international discrimination for intellectual property,⁶³ but lacks any means to enforce violations or settle disputes between members.⁶⁴ The Paris Convention provides for the creation of a Union, which is now a part of the World Intellectual Property Organization (WIPO).⁶⁵ Despite the creation of this Union, the Paris Convention takes no stance on exhaustion of rights and parallel importation.⁶⁶

Three years after the Paris Convention, in 1866, the Berne Convention for the Protection of Literary and Artistic Works (Berne Convention), was created covering copyrights instead of industrial property.⁶⁷ The Berne Convention also requires certain minimum standards for protection and that members give other member states’ citizens the same national treatment as their own citizens.⁶⁸ It also creates an assembly, charged with furthering the objectives of the Berne Convention.⁶⁹ Yet, once again, the Berne Convention contains no provisions on exhaustion or parallel importation, and lacks the means to enforce the broad rights outlined.⁷⁰

Today the international community must contend with the latest iteration of a multilateral intellectual property treaty, TRIPS.⁷¹

⁶¹ Laurinda L. Hicks & James R. Holbein, *Convergence of National Intellectual Property Norms in International Trading Agreements*, 12 AM. U. J. INT’L L. & POL’Y 769, 778 (1997).

⁶² *Id.*

⁶³ The Paris Convention furthered this through mandatory reciprocity, or “national treatment.” *Id.* at 779. Paris Convention for the Protection of Industrial Property, 21 U.S.T. 1583; 828 U.N.T.S. 305; 6 I.L.M. 806, art. 2 [hereinafter the “Paris Convention”].

⁶⁴ *Id.*

⁶⁵ *Id.* (WIPO is currently an organ of the United Nations and administers a myriad of Intellectual Property treaties, including both the Paris and Berne Conventions). *Id.* at 779-81; Paris Convention, at art. 1.

⁶⁶ World Intellectual Property Organization, *supra* note 59.

⁶⁷ Hicks & Holbein, *supra* note 61, at 779.

⁶⁸ *Id.*

⁶⁹ *Id.* (“Article 22 provides for an Assembly with the obligation to ‘take any . . . appropriate action designed to further the objectives of the Union’”); Berne Convention for the Protection of Literary and Artistic Works, 331 U.N.T.S. 217., art. 22.

⁷⁰ *Id.*

⁷¹ See generally JOHN R. THOMAS, CONGRESSIONAL RESEARCH SERVICE, PUBL’N NO. RL33205, INTELLECTUAL PROPERTY AND THE FREE TRADE AGREEMENTS: INNOVATION POLICY ISSUES (2005).

TRIPS, created in the Uruguay Round Agreements along with the WTO in 1994, set out a series of standards for intellectual property protection, including minimum standards of substantive protection.⁷² Most notably, it departs from prior intellectual property treaties by including a strong mechanism for enforcement.⁷³ TRIPS covers copyrights, trademarks and service marks, geographical indications, industrial designs, patents, integrated circuits designs, and trade secrets.⁷⁴ TRIPS also details many procedural elements that members are obligated to implement, such as effective remedies,⁷⁵ basic legal decisions (preferably in writing)⁷⁶ and an appeals process.⁷⁷ Part I, Article 3 of TRIPS provides for national treatment between nations concerning intellectual property rights, and Article IV provides that any intellectual property benefit that is given to one member nation must be given to all.⁷⁸ This means that a member nation can allow parallel importation, “as long as the practice is applied equally to all members.”⁷⁹ TRIPS attempted to address exhaustion of rights and parallel importation although, in the end, it took a hands-off approach and specifically excluded dispute resolution settlements on the topic.⁸⁰

The debate over exhaustion and parallel importation in TRIPS was controversial.⁸¹ Lines were drawn with developed countries on one side and emerging countries on the other. Access to pharmaceutical drugs formed the core of the debate.⁸² Emerging countries championed an international exhaustion regime that would allow

⁷² *Id.*

⁷³ See Hicks & Holbein, *supra* note 61, at 789 (“Part III of the TRIPS agreement contains provisions regarding the enforcement of intellectual property rights, such as civil and administrative procedures, provisional and final remedies, criminal penalties, and border enforcement, which is obligatory for counterfeit and pirated goods, but discretionary for other types of intellectual property.”).

⁷⁴ See TRIPS, *supra* note 30, at II.

⁷⁵ See TRIPS, *supra* note 30, at III.

⁷⁶ See TRIPS, *supra* note 30, at III, § 1, art. 41(3).

⁷⁷ See TRIPS, *supra* note 30, at III, § 1, art. 41(4).

⁷⁸ See TRIPS, *supra* note 30, at I arts. 3-4.

⁷⁹ Peggy B. Sherman & Ellwood F. Oakley, *Pandemics and Panaceas: The World Trade Organization’s Efforts to Balance Pharmaceutical Patents and Access to AIDS Drugs*, 41 AM. BUS. L.J. 353, 374 (2004).

⁸⁰ See TRIPS, *supra* note 30, at I art. 6 (“nothing in this Agreement shall be used to address the issue of the exhaustion of intellectual property rights.”).

⁸¹ Sherman & Oakley, *supra* note 79, at 371.

⁸² Donald P. Harris, *TRIPS’ Rebound: An Historical Analysis of How the TRIPS Agreement Can Ricochet Back Against the United States*, 25 NW. J. INT’L L. & BUS. 99, 107 n. 201 (2004).

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them to continue buying the cheapest drugs available,⁸³ while developed countries argued for a standard that would allow rights holders to retain some control after the initial sale.⁸⁴ The members' failure to reach an agreement left the status quo intact and each country to decide which regime it would implement.⁸⁵ Exhaustion remained unchanged even during the WTO's Doha Rounds for TRIPS, at which the European Union, United States, and Switzerland contended that parallel importation threatened price discrimination for drugs.⁸⁶ Currently, TRIPS still remains silent on exhaustion.

B. *Types of Regimes*

The current state of international debate on the exhaustion of intellectual property rights is a result of all the numerous exhaustion regimes employed by states. The three major exhaustion regimes, national or territorial, international, and, community are each discussed. The prominent features and ideologies of each regime are also discussed, along with their respective opponents and proponents.

1. *National Exhaustion*

The most widely used regime for exhaustion is that of national exhaustion.⁸⁷ A national exhaustion regime dictates that the intellectual property right to distribute exhausts only within the country that it is sold.⁸⁸ Under this regime the owner's distribution right still exists in every other country. This exhaustion regime effectively acts as a ban on parallel imports of that product and an importation right for the owner.⁸⁹ National exhaustion can be viewed as the most intuitive legally, since each country or nation, as a sovereign jurisdiction, creates the intellectual property and, therefore, the rights and obligations should only be affected by acts within that jurisdiction.

⁸³ *Id.*

⁸⁴ *Id.*

⁸⁵ *Id.*

⁸⁶ Sherman & Oakley, *supra* note 79, at 375 ("The Doha Declaration states: 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 . . .").

⁸⁷ Ganea, *supra* note 57, at 5.

⁸⁸ See Papadopoulos, *supra* note 46, at 115.

⁸⁹ ABBOTT, PARALLEL IMPORTATION, *supra* note 5, at 5.

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National exhaustion results in compartmentalizing intellectual property exhaustion by country with the result that in different countries, different rights exist.⁹⁰ This compartmentalization results in giving the property owner large flexibility in terms of creating price disparities between countries and even excluding their products from certain areas.⁹¹ National exhaustion also creates smaller markets, which can result in restraining competition.⁹² This regime results in the right holder or manufacturer dictating the price in the segmented markets rather than allowing the market or competition to decide.⁹³

2. *International Exhaustion*

Under international exhaustion, a property owner's right to control distribution is exhausted as soon as that property is legally sold anywhere in the world.⁹⁴ This would allow world-wide parallel imports after the first legal sale.⁹⁵ As a result, the international exhaustion regime is friendly to parallel importers, in contrast to national exhaustion's deference to the rights holder/property owner.⁹⁶ Finally, international exhaustion encourages competition and limits the scope of intellectual property rights.⁹⁷

There has been large disagreement concerning the repercussions of implementing such a regime. Research suggests that using an international regime globally could affect consumers negatively by making intellectual property less effective in safeguarding qual-

⁹⁰ See GUSTAVO GHIDINI, *INTELLECTUAL PROPERTY AND COMPETITION LAW: THE INNOVATION NEXUS* 40-41 (2006) (detailing how national and community exhaustion compartmentalize domestic markets).

⁹¹ See PHILIPS, *supra* note 34, at 17-18 (detailing the four methods of price discrimination: not serving customers, charging high prices, charging lower prices for a different good at a different net price, and charging a lower price and removing the consumer surplus.). See also NUNO PIRES DE CARVALHO, *supra* note 60, at 103 (2005).

⁹² Josef Drexler, *The Critical Role of Competition Law in Preserving Public Goods in Conflict with Intellectual Property Rights*, in *INTERNATIONAL PUBLIC GOODS AND TRANSFER OF TECHNOLOGY UNDER A GLOBALIZED INTELLECTUAL PROPERTY REGIME* 709, 725 (Keith Maskus & Jerome H. Reichman eds., 2005).

⁹³ Cosovanu, *supra* note 51, at 197-98.

⁹⁴ ABBOTT, *PARALLEL IMPORTATION*, *supra* note 5, at 5.

⁹⁵ *Id.*; see also Papadopoulos, *supra* note 46, at 115.

⁹⁶ SHANKER SINGHAM, *A GENERAL THEORY OF TRADE AND COMPETITION: TRADE LIBERALISATION AND COMPETITIVE MARKETS* 314 (2007) ("Advocates of parallel trading often claim that parallel trading is in reality no different from the doctrine of international exhaustion of rights.")

⁹⁷ Keith Maskus, *Parallel Imports*, in *THE WORLD ECONOMY: GLOBAL TRADE POLICY* 2000 179, 185 (2001).

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ity and in indicating where the product originated, thus leading to confusion for the consumer.⁹⁸ Further negative consequences include the inability of the owner to control the chain of distribution and the conditions in which the product are sold.⁹⁹ These criticisms of international exhaustion focus on aspects of intellectual property which are secondary in nature.¹⁰⁰ The classic rationale for implementing intellectual property is to give an incentive to create or invent in return for limited-time market exclusivity.¹⁰¹ While consumer confusion plays a significant role in determining trademark infringement, it is not the sole reason for seeking intellectual property protection in other intellectual property forms.¹⁰² Therefore consumer safety, product quality, and the owner's interest in presentation should all arguably be left outside of the concerns of intellectual property.

3. *Community Exhaustion*

The emergence of the European Union necessitated the maintenance of unimpeded markets among member countries and has resulted in the adoption of another exhaustion regime.¹⁰³ Community exhaustion expands upon the national exhaustion regime by enlarging the area affected after the first legal sale.¹⁰⁴ After this sale, the owner's right to distribute in the community has ex-

⁹⁸ Singham, *supra*, note 41 (citing the National Economic Research Association report on the consequences of an international exhaustion regime on trademarks in Europe). R

⁹⁹ *Id.*

¹⁰⁰ *Id.*

¹⁰¹ See Maskus, *supra* note 56, at 473 (explaining the two goals of IP rights: promoting investments in knowledge creation and business innovation by establishing exclusive rights and promoting widespread dissemination of new knowledge); see also *Protecting Intellectual Property – A Capital Asset*, in *INTELLECTUAL PROPERTY PROTECTION IN ASIA* 1–9, § 1.03 (Arthur Wineburg ed., 2d ed. 2006) (“Western countries believe that granting private property rights encourages advances in the sciences and the arts. In order to encourage individuals to invent and to create works . . . rewards [are offered] to them by granting a legal right to exclude others in the community from using their invention of creative work.”). R

¹⁰² See GREGORY J. BATTERSBY & CHARLES W. GRIMES, *TRADEMARK & COPYRIGHT DISPUTES: LITIGATION FORMS AND ANALYSIS* § 6.06[B] (2003) (comparing the rationales for trademark law with copyright and patent); see also JAY DRATLER, *INTELLECTUAL PROPERTY LAW: COMMERCIAL, CREATIVE, AND INDUSTRIAL PROPERTY* 1A-75 (2006) (explaining that the TRIPS agreement art 16(1) introduces a confusion standard which is the mandatory standard for infringement in international trademark law).

¹⁰³ See DAVID T. KEELING, *INTELLECTUAL PROPERTY RIGHTS IN EU LAW: FREE MARKET & COMPETITION LAW* 78 (2003).

¹⁰⁴ Michael R. Ryan, *Gray Markets, Intellectual Property Rights, and Trade Agreements in the International Marketplace*, available at <http://www.cherry.gatech.edu/t2s2006/>

hausted (not simply in the nation where the sale first occurred).¹⁰⁵ This has the effect of allowing parallel imports between community members post-sale, but limiting parallel imports between members and non-member states, since the right to distribute in countries not within the community remain unaffected.¹⁰⁶

Community exhaustion allows for a streamlined process between member states, but still does not solve the problem at the international level. Many of the complex issues created by national exhaustion remain under community exhaustion since international trade between members and non-members is the same as under a national regime.¹⁰⁷ Additionally, this method of exhaustion requires individual nations to group together to address exhaustion, rather than to negotiate or decide on their own.¹⁰⁸

C. Exhaustion Regime by Country

For a deeper understanding of the exhaustion regimes detailed above, various national implementations need to be examined. The United States, European Union, Japan, and Australia all take different positions on the exhaustion of intellectual property rights. By examining the positions of these various nations, commonalities and differences can be exposed and taken into account when considering possible international harmonization.

1. Exhaustion in the United States

The United States has largely adopted a national exhaustion regime.¹⁰⁹ However, this is not uniform with regards to different forms of intellectual property.¹¹⁰ How rights exhaust for the three major types of intellectual property, copyright, trademark, and patents, have been determined through either case law or statute.

papers/ryan-3003-2-T.pdf (last visited Feb. 18, 2008) (discussing the similarities in scope between national and community exhaustion).

¹⁰⁵ *Id.*

¹⁰⁶ *Id.*

¹⁰⁷ *Id.* (discussing how both the proponents of national and community exhaustion regimes favor criminalizing grey markets). *See also* PIRES DE CARVALHO, *supra* note 60, at 112 (“[R]egional exhaustion operates as if it were national exhaustion . . .”).

¹⁰⁸ “Therefore for the purposes of exhaustion, the sum of territories of a regional trading block constitutes a single territory.” PIRES DE CARVALHO, *supra* note 60, at 112.

¹⁰⁹ Miranda Forsyth & Warwick Rothnie, *Parallel Imports and Exhaustion*, in *THE INTERFACE BETWEEN INTELLECTUAL PROPERTY RIGHTS AND COMPETITION POLICY* 429, 441 (Steven D. Anderman ed., 2007).

¹¹⁰ *Id.*

Copyrights in the United States are subject to exhaustion under the first sale doctrine.¹¹¹ Under United States law, copyright owners are granted the exclusive rights to their work involving reproduction, derivatives, distribution, public performance, public display, and retransmission.¹¹² However, this expansive bundle of exclusive rights is limited by further law.¹¹³ A copyright owner's exclusive right to distribute is further limited by the first sale doctrine.¹¹⁴ This doctrine states that once a copyright owner has knowingly sold a copy of his or her work, the exclusive right to distribute can no longer be exercised.¹¹⁵ Case law has addressed the scope of the first sale doctrine, whether the right to distribute exhausts nationally, communally, or internationally, and the doctrine's role in parallel importation.

The Supreme Court held in *Quality King* that the first sale doctrine limited a domestic manufacturer's exclusive right to distribute once his or her copyrighted product was sold internationally.¹¹⁶ This decision promotes parallel importation and supports a copyright exhaustion regime in the United States that is more international in character.¹¹⁷ Subsequent case law, however, is conflicting, leaving the issue unresolved.¹¹⁸ So while the United States appears to establish an international exhaustion regime for re-importation, in *Quality King*, other permutations of copyright exhaustion are unsettled.¹¹⁹

¹¹¹ See 2 MELVILLE B. NIMMER & DAVID NIMMER, NIMMER ON COPYRIGHT § 8.12 (2008).

¹¹² 17 U.S.C. § 106 (2006).

¹¹³ See 17 U.S.C. §§ 107-112, 117, 119, 121, 122 (2006).

¹¹⁴ See Nimmer, *supra* note 111, § 8.12[B][1]. See also TIMOTHY P TRAINER & VICKI E. ALLUMS, PROTECTING INTELLECTUAL PROPERTY RIGHTS ACROSS BORDERS, § 3:11 (2007).

¹¹⁵ *Id.*

¹¹⁶ *Quality King Distributors Inc. v. L'anza Research International*, 523 U.S. 135 (1998).

¹¹⁷ Frederick M. Abbott, *Political Economy of the U.S. Parallel Trade Experience: Toward a More Thoughtful Policy*, in INTELLECTUAL PROPERTY: TRADE, COMPETITION, AND SUSTAINABLE DEVELOPMENT 177, 181 (Thomas Cottier et al. eds., 2003) [hereinafter *U.S. Parallel Trade Experience*].

¹¹⁸ See Trainer & Allums, *supra* note 114, at n. 3 (discussing conflicting Third and Ninth Circuit Court of Appeals decisions).

¹¹⁹ For example, if copyrighted goods are made outside of the United States and then parallel imported.

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Trademark law in the United States derives its regime of rights exhaustion from federal, state, and common law.¹²⁰ For example, at the federal level, the Lanham Act bars entry into the United States of items that “copy” or “simulate” a domestic manufacturer’s products.¹²¹ The Lanham Act also prohibits false representations or advertisements, including misrepresentation of a product’s origin, concerning goods, regardless of whether the trademark is registered or unregistered.¹²² Similarly, the Tariff Act prohibits importation of goods that use any registered United States trademark, unless the trademark holder agrees to the usage in writing.¹²³ These laws have been construed as creating a national exhaustion regime for trademarks in the United States.¹²⁴

Two important distinctions have arisen in United States case law concerning trademarks, exhaustion and parallel importation. The first distinction is whether the foreign importer and the United States trademark holder are related companies.¹²⁵ If the companies are related, courts typically allow the importation.¹²⁶ The second distinction turns on the differences between the products. The United States Federal Circuit recently explained:

[G]ray market theory recognizes both the territorial boundaries of trademarks and a trademark owner’s right to control the qualities or characteristics associated with a trademark in a certain territorial region. As such, the basic question in gray market cases . . . [is] whether there are differences between the foreign and domestic product and if so whether the differences are material.¹²⁷

¹²⁰ See ARNOLD P. LUTZKER, *CONTENT RIGHTS FOR CREATIVE PROFESSIONALS: COPYRIGHTS AND TRADEMARKS IN A DIGITAL AGE* 97-98 (2002); For information on United States trademark protection at common law and under state law, see 1 MICHAEL D. SCOTT, *SCOTT ON INFORMATION TECHNOLOGY LAW*, § 4.02-4.03 (3d. 2007).

¹²¹ See 15 U.S.C. § 1124 (2006).

¹²² See 15 U.S.C. § 1125 (2006).

¹²³ See Tariff Act of 1930, 19 U.S.C. § 1526(a) (2005).

¹²⁴ Forsyth & Rothnie, *supra* note 109, at 443 (citing *A. Bourjois & Co. v. Katzel*, 260 U.S. 689 (1923)).

¹²⁵ *Id.*

¹²⁶ *K Mart Corp. v. Cartier, Inc.*, 486 U.S. 281 (1987) (permitting customs to promulgate regulations to interpret the Tariff act, which prohibits importing “into the United States any merchandise of foreign manufacture if such merchandise . . . bears a trademark owned by citizen of, or by a corporation or association created or organized within the United States . . .”).

¹²⁷ *Bourdeau Bros. v. Int’l Trade Comm’n*, 444 F.3d 1317, 1321 (Fed. Cir. 2006) (internal citation and quotation marks omitted).

The Federal Circuit concluded that the threshold for materiality was low, only requiring proof that consumers would consider the product differences.¹²⁸ Thus, trademark law in the United States incorporates judicial clarifications into the statutory framework to deal with exhaustion and parallel imports.

Unlike trademarks, patents in the United States are a matter of federal law only as dictated by the United States Constitution.¹²⁹ A United States patent is a right granted to the patentee to exclude others from making, using, selling, or importing the patented subject matter.¹³⁰ The Process Patents Amendment Act of 1989 gave United States patent holders the ability to sue when imported products were made according to their patent.¹³¹ Case law in the United States supports this national exhaustion regime.¹³² In *Boesch v. Graff*, the United States Supreme Court held that use or sale in the United States of a product patented in the United States and purchased abroad constituted patent infringement.¹³³ Recently, the Federal Circuit further defined patent exhaustion:

United States patent rights are not exhausted by products of foreign provenance. To invoke the protection of the first sale doctrine, the authorized first sale must have occurred under the United States patent Our decision applies only to [products] for which the United States patent right has been exhausted by first sale in the United States.¹³⁴

This decision appears to limit exhaustion to products that have been sold in the United States. However, if a patented product is manufactured in the United States and then sold abroad, the United States patent holder's rights exhaust.¹³⁵

¹²⁸ *Id.*

¹²⁹ U.S. CONST. art. I, §8 ("Congress shall have power . . . [t]o promote the Progress of Science and useful Arts, by securing for limited Times to Authors and Inventors the exclusive Right to their respective Writings and Discoveries.").

¹³⁰ See 35 U.S.C. § 154 (2000).

¹³¹ Forsyth & Rothnie, *supra* note 109, at 444.

¹³² *Id.*

¹³³ *Boesch v. Graff*, 133 U.S. 697 (1890).

¹³⁴ *Jazz Photo Corp. v. Int'l Trade Comm'n*, 264 F.3d 1094, 1105 (Fed. Cir. 2001) (internal citation omitted).

¹³⁵ Myra J. Tawfik, *Parallel Importation and Intellectual Property Law*, in *INTERNATIONAL TRADE AND INTELLECTUAL PROPERTY: THE SEARCH FOR A BALANCED SYSTEM* 19, 27 (George R. Stewart et al. eds., 1994).

2. Exhaustion in the European Union

While the United States follows a national-exhaustion regime, the European Union must follow a community-wide exhaustion in order to ensure that the internal market stays free of barriers.¹³⁶ The European Union endeavors to have an internal market without barriers for the free movement of goods and services.¹³⁷ The European Community Treaty prohibits member nations from using domestic intellectual property laws to hinder free trade within the internal market.¹³⁸ This implies that after the first consensual sale in the European Economic Area (EEA) the intellectual property owner's rights exhaust.¹³⁹ However, if the goods are sold outside of the EEA, no exhaustion occurs.¹⁴⁰ Rules, regulations, and cases address the many issues that arise from exhaustion and parallel importation.

Copyright exhaustion in the European Union follows the general mandate on community-wide exhaustion.¹⁴¹ Consequently, parallel importation can occur among member states of the European Union, but not between a member state and a non-member state. The European Court of Justice (ECJ) held in *Deutsche Grammophon* that copyrighted works must be “distributed throughout the community,” without owners preventing distribu-

¹³⁶ This complies with Article 30 of the European Community Treaty: “Quantitative restrictions on imports and all measures having equivalent effect shall, without prejudice to the following provisions, be prohibited between Member States.” Treaty Establishing the European Community, Nov. 10, 1997, 1997 O.J. (C340) 3 [hereinafter EC Treaty].

¹³⁷ Case 270/80, *Polydor v. Harlequin Record Shop*, 1982 E.C.R. 329, 330 (explaining that the purpose of the EEC Treaty is to “unite national markets into a single market reproducing as closely the conditions of a domestic market”); see also CHRISTOPHER STROTHERS, *PARALLEL TRADE IN EUROPE: INTELLECTUAL PROPERTY, COMPETITION AND REGULATORY LAW* 429 (2007).

¹³⁸ THOMAS HAYS, *PARALLEL IMPORTATION UNDER EUROPEAN UNION LAW* 7-8 (2004).

¹³⁹ Forsyth & Rothnie, *supra* note 109, at 445.

¹⁴⁰ *Id.* (European community exhaustion is also often called “fortress Europe”).

¹⁴¹ The European Commission, *Copyright: Commission pursues infringement proceedings against Belgium and Denmark* (Feb. 4, 2002), available at <http://europa.eu/rapid/pressReleasesAction.do?reference=IP/02/191&format=HTML&aged=1&language=EN&guiLanguage=en> (last visited Feb. 12, 2008) (“[P]erformers, producers of films and phonograms and broadcasters have the exclusive right to allow the objects protected by their rights to be made available to the public, or to forbid their being made available. This ‘distribution right’ is not exhausted except where the first sale in the Community of that object is made by the rightholder or with his consent”).

tion with their exclusive rights.¹⁴² Even after a sale in the EEA, the rental rights of the copyright do not exhaust.¹⁴³ The European Commission further contends that there is no exhaustion for digital downloads of copyrighted works after a first sale.¹⁴⁴

The European Union has adopted a regime of regional exhaustion under the Trade Marks Harmonization Directive.¹⁴⁵ In *Centrafarm v. Winthrop*, the Court held that a trademark encompasses only the right to place the trademarked good on the market for the first time.¹⁴⁶ After the good is on the market, the right to stop resale exhausts since it divides the internal market and is unnecessary to protect the property right.¹⁴⁷ Companies seeking to get around the community-wide exhaustion have tried to create multiple trademarks and use one per nation, thereby partitioning the internal market.¹⁴⁸ In *American Home Products*, the ECJ held that companies' use of a different mark in each country in order to divide the market was contrary to Article 28 of the internal market.¹⁴⁹

Patents also are subject to the community exhaustion regime. However, they differ from copyrights and trademarks due to their implementation.¹⁵⁰ There is no singular European patent, instead there is a single application and an administration coordinates the various member states' patents.¹⁵¹ Therefore, anyone seeking a

¹⁴² Yves Gaubiac, *The Exhaustion of rights in the analogue and digital environment*, 36 COPYRIGHT BULL. 4 (2002) (citing *Deutsche Grammophon v. Metro*, 1971 E.C.R. 487, 502 (1971)).

¹⁴³ Forsyth & Rothnie, *supra* note 109, at 447.

¹⁴⁴ *Id.* (citing Report on the implementation of the Software Directive, COM (2000), 17, (10 April 2000)).

¹⁴⁵ Claude Crampes et al., *Competition and Intellectual Property in the European Union*, in NEW DEVELOPMENTS IN UK AND EU COMPETITION POLICY 202–31 (Edward Elgar ed., 2006), available at <http://idei.fr/doc/wp/2005/crampes.pdf> (citing Trade Marks Harmonization Directive (89/104 (EEC) 21 December 1988)). See also Council Regulation 40/94, Community trade mark, 1994 O.J. (L 11) art. 13 (EC), available at <http://oami.europa.eu/en/mark/aspects/reg/reg4094old.htm> (last visited Feb. 18, 2008).

¹⁴⁶ LORNA WOODS, FREE MOVEMENT OF GOODS AND SERVICES WITHIN THE EUROPEAN COMMUNITY 149 (2003) (citing Case 16/74, *Centrafarm v. Winthrop*, 1974 E.C.R. 1183, 2 C.M.L.R. 480 (1974)).

¹⁴⁷ *Id.*

¹⁴⁸ See AMANDA MICHAELS, PRACTICAL GUIDE TO TRADE MARK LAW 143 (2002).

¹⁴⁹ *Id.* (citing Case 3/78, *Centrafarm v. American Home Products Corporation*, 1978 E.C.R. 1823).

¹⁵⁰ However trademarks are the only intellectual property rights granted by the European Union. See Crampes et al., *supra* note 145, at 204.

¹⁵¹ *Id.* (“[A] European patent is just a bundle of national patents granted by the European Patent Office . . .”).

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patent in Europe files one application and theoretically receives a patent from each member nation. Case law in the European Union supports the community-wide exhaustion regime, even though each member nation still issues its own patent. In 1974, the ECJ held:

It cannot be reconciled with the principles of free movement of goods . . . if a patentee exercises his rights under . . . one Member State to prevent marketing of a patented product in said state when the patented product has been brought into circulation in another.¹⁵²

Further, if a product is consensually marketed within a member nation of the European Union where the owner does not have a patent, the ECJ still holds that there is exhaustion.¹⁵³

3. *Exhaustion in Japan*

Japan has taken a stance that generally favors parallel importation and rights exhaustion.¹⁵⁴ Japan has incorporated an English common law doctrine in its intellectual property laws. The “implied license” doctrine leaves the product’s redistribution up to the right holder and the contractual agreement made with the licensee.¹⁵⁵ Thus, the sale of goods and exhaustion turn on whether the goods are marked as not for resale or export. Without such a mark, the right holder has tacitly consented to unrestricted resale of the goods.¹⁵⁶ This doctrine often plays a role in the outcomes of parallel importation cases.

The Japanese Copyright Act states that domestic or national exhaustion of printed works occurs when the first sale is in Japan or

¹⁵² NORBERT REICH, UNDERSTANDING EU LAW: OBJECTIVES, PRINCIPLES, AND METHODS OF COMMUNITY 168-69 (citing Case 15/74, *Centrafarm B.V. and Adriaan de Peijper v. Sterling Drug Inc.*, 1974 E.C.R. 1147).

¹⁵³ NEIL J. WILKOF & DANIEL BURKITT, TRADE MARK LICENSING 351-52 (2005) (citing *Merck & Co. Inc. v. Stephar*, 1981 E.C.R. 2063).

¹⁵⁴ Christopher Heath, *Exhaustion and Parallel Imports in Japan*, in PARALLEL IMPORTS IN ASIA 51, 51 (Christopher Heath ed., 2003). Furthermore, the “Japanese Fair Trade Commission (FTC) has taken an active stance in promoting parallel imports in order to weed out inefficiencies in Japan’s notoriously complicated distribution system.” *Id.*; see also Tait R. Swanson, *Combating Gray Market Goods in a Global Market: Comparative Analysis of Intellectual Property Laws and Recommended Strategies*, 22 Hous. J. INT’L L. 327, 352 (1999).

¹⁵⁵ Ganea, *supra* note 57, at 5.

¹⁵⁶ *Id.* at 6.

abroad.¹⁵⁷ However, cinematographic and phonographic works have been provided a distribution right that survives the first sale.¹⁵⁸ Further there has been no case law on the topic of international exhaustion of copyrighted works.¹⁵⁹ Yet a Tokyo District Court has dealt with Disney video cassettes purchased in the United States and then imported into Japan.¹⁶⁰ The Court concluded that although these cassettes were first sold abroad and then brought into Japan, the right holder still retained rental/lending rights.¹⁶¹ Therefore, the unauthorized sale was an infringement of the domestic distribution right of Disney.¹⁶²

Japan has loosely adopted international exhaustion for trademarks,¹⁶³ although presently there is no legislation dealing with the subject.¹⁶⁴ Japanese case law has prohibited use of trademarks when there is confusion of origin.¹⁶⁵ Case law concerning trademark exhaustion and parallel importation has centered on three elements: differences in the origin, quality, and the association between the Japanese and foreign trademark holder.¹⁶⁶ When there are no differences in origin or quality and the trademark holders are related as foreign subsidiaries, licensees, etc., parallel importation is allowed and international exhaustion would occur.

As with trademarks, there is currently no legislation in Japan that explicitly addresses parallel importation for patents, and by inference, exhaustion of rights.¹⁶⁷ Under Japanese case law, international exhaustion applies to patented goods.¹⁶⁸ In 1997, the Japanese Supreme Court stated:

¹⁵⁷ Christopher Heath, *Internet Trade, Digital Works and Parallel Imports*, in *COPYRIGHT LAW AND THE INFORMATION SOCIETY IN ASIA* 79, 80 (Christopher Heath & Kung-Chung Liu eds., 2007).

¹⁵⁸ Heath, *supra* note 154, at 66-67 (citing sec. 26bis, 95ter and 97ter of Japan's Copyright Act). R

¹⁵⁹ *Id.* at 67.

¹⁶⁰ *Id.* (citing Tokyo District Court, 1 July 1994, 27 IIC 570, 571 1996 – “Beauty and the Beast”).

¹⁶¹ *Id.* at 67-68.

¹⁶² *Id.*

¹⁶³ See Swanson, *supra* note 154, at 352. R

¹⁶⁴ See Heath, *supra* note 154, at 58. R

¹⁶⁵ *Id.* at 59.

¹⁶⁶ *Id.* at 61.

¹⁶⁷ *Id.* at 51-52.

¹⁶⁸ Patricia Egli & Juliane Kokott, *INTERNATIONAL DECISION: Sebago Inc. And Ancienne Maison Dubois & Fils SA V. GB-Unic SA*, 4 *AM. J. INT'L L.* 386, 389 (2000) (citing Sup. Ct., July 1, 1997 (Kraftfahrzeugelgen III), 1998 GRUR—INT'L 168).

[A] domestic patentee who markets patented products abroad and wishes to exclude their sale and use in our country by subsequent purchasers, has to make clear his intention of such a restriction when dealing with the transferee, and has to clarify such restriction on the patented goods for the benefit of subsequent purchasers.¹⁶⁹

Once a Japanese patent holder sells a good on the international market the patent holders' rights exhaust absent an agreement and notice limiting the purchaser from re-importing the goods into Japan (the aforementioned "implied license doctrine"). In sum, an assumption of exhaustion can be rebutted by evidence of any limitations placed on importation.¹⁷⁰

4. *Exhaustion in Australia*

Like Japan's, Australia's intellectual property system favors international exhaustion.¹⁷¹ Australia's stance on exhaustion varies by type of intellectual property and even by product.¹⁷² Australia has consistently liberalized its intellectual property laws through amendment to encourage parallel importation.¹⁷³ These piecemeal amendments have collectively furthered parallel importation and a regime of international exhaustion.¹⁷⁴ Australia has gone so far as to advocate international exhaustion during multilateral intellectual property treaty negotiations.¹⁷⁵

However, Australia's bias towards international exhaustion contrasts with its national exhaustion regime for copyrighted

¹⁶⁹ Ganea, *supra* note 57, at 6 (citing BBS Car Wheels III, 29 IIC 331 (1998)).

¹⁷⁰ Heath, *supra* note 154.

¹⁷¹ See VIVIEN IRISH, *INTELLECTUAL PROPERTY RIGHTS FOR ENGINEERS* 171 (2005). See also Gene Grossman & Edwin Lai, *International Protection of Intellectual Property*, 94 AMER. ECON. REV. 1635, 1642 n. 11 (2004).

¹⁷² See Forsyth & Warwick, *supra* note 109, at 451.

¹⁷³ Maskus, *supra* note 97, at 187. See also AUSTRALIAN COMPETITION AND CONSUMER COMMISSION, *PARALLEL IMPORTS & INTELLECTUAL PROPERTY RESTRAINTS: THE AUSTRALIAN COMPETITION & CONSUMER COMMISSION'S PERSPECTIVE* 4 (2000), available at <http://www.accc.gov.au/content/item.phtml?itemId=255574&nodeId=ce8c5b47a27218def17c223630418e56&fn=Parallel%20imports%20%20intellectual%20property%20restraints.pdf>.

¹⁷⁴ See Louise Longdin, *Parallel Importing Post TRIPS: Convergence and Divergence in Australia and New Zealand*, 50 INT'L & COMP. L. Q. 54, 58-61 (2001) (discussing the initial three stages of lifting bans on parallel imports. First books, packing labels and physical items, and then sound recordings).

¹⁷⁵ See Vaidyanatha Ayyar, *Interest or Right?: The Process and Politics of a Diplomatic Conference on Copyright*, 1 J. WORLD INTELL. PROP. 3, 16-17 (1998); see also Longdin, *supra* note 174, at 54 n. 2 (2001).

works, though recent major amendments have begun to change this.¹⁷⁶ In 1990, the Copyright Act was amended to permit the parallel importation of books.¹⁷⁷ In 1998, the Australian government repealed the prohibitions on parallel imports for copyrighted musical works.¹⁷⁸ In 2000, new legislation removed a previous twelve-month waiting period for importers to await the Australian copyright holder's release of the work domestically.¹⁷⁹ Most recently in 2003, parallel importation was permitted for computer software and electronic versions of books, periodicals, and sheet music.¹⁸⁰ Through amendment, Australia has allowed for a regime of international exhaustion for many different types of copyrighted works. The impetus for these changes was rights holders' use of market control to raise prices.¹⁸¹

Trademarks in Australia are governed by a regime of international exhaustion.¹⁸² The Australian Trademark Act requires only that a mark be affixed to the product by or with the consent of the owner of the trademark.¹⁸³ However the factual deference given to parallel importers under this law is currently in question. The Australian Federal Court recently held that consent is still needed from the Australian trademark holder for parallel import and that such consent cannot be inferred from internationally related companies.¹⁸⁴

¹⁷⁶ See Matthew Burgess & Lewis Evans, *Importation and Service Quality: An Empirical Investigation of Competition between DVDs and Cinemas in New Zealand*, 1 J. COMPETITION L. & ECON. 747, 749 (2000); The Australian Copyright Act of 1968 originally instituted national exhaustion. See Forsyth & Warwick, *supra* note 109, at 452.

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¹⁷⁷ The legislation changed the definition of "non-infringing" and added a new section to allow for importation. See Heath, *supra* note 157, at 67.

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¹⁷⁸ See AADITYA MATTOO & PHILIP ENGLISH, *DEVELOPMENT, TRADE, AND THE WTO: A HANDBOOK* 377 (Bernard Hoekman ed., 2002).

¹⁷⁹ See UNCTAD-ICTSD, *RESOURCE BOOK ON TRIPS AND DEVELOPMENT* 111 (2005).

¹⁸⁰ See OFFICE OF THE UNITED STATES TRADE REPRESENTATIVE, 2004 NATIONAL TRADE ESTIMATE REPORT ON FOREIGN TRADE BARRIERS: AUSTRALIA 13, available at http://www.ustr.gov/assets/Document_Library/Reports_Publications/2004/2004_National_Trade_Estimate/2004_NTE_Report/asset_upload_file744_4736.pdf (last visited Mar. 8, 2008).

¹⁸¹ See Forsyth & Warwick, *supra* note 109, at 452 (quoting the Explanatory Memorandum to the Copyright Amendment Act, which concluded that the power to control distribution of imported copyrighted materials enabled owners to exercise market control and charge higher prices and noting the inefficiencies from lack of competition).

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¹⁸² See Forsyth & Warwick, *supra* note 109, at 453.

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¹⁸³ Swanson, *supra* note 154, at 363-65 (citing Section 123(1) of the Australian Trademarks Act of 1995).

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¹⁸⁴ See Andrew McRobert, *Parallel Importation of Trade-Marked Goods*, DEACONS, Nov. 14, 2007, <http://www.deacons.com.au/UploadedContent/NewsPDFs/LU-141107-Par>

Patent exhaustion in Australia is similar to that in Japan, where exhaustion is premised upon an implied license.¹⁸⁵ If an Australian patentee sells internationally without noting any restrictions, it is implied that the subsequent purchaser has license to sell the patented product within Australia.¹⁸⁶ The assumption of an implied license can be defeated if a patentee expressly prohibits importation into Australia.¹⁸⁷ Therefore unless the Australian patentee makes the first sale without any express restrictions, national exhaustion occurs.¹⁸⁸ Australia and the United States signed a bilateral free trade agreement in 2004, adding further complexity to the regime of patent rights exhaustion.¹⁸⁹ This agreement permits parallel importation unless the patent holder specifies otherwise by contract.¹⁹⁰ Therefore, regardless of future changes to Australian patent law, eligible parties can contract around the issue of exhaustion, by specifying territorial limitations for distribution.¹⁹¹

III. ADDRESSING REGIONALIZED ELECTRONICS

Solving the problem of companies and manufacturers segmenting the international market as they please is a daunting task. Rights holders incorporate technical barriers into their products to compensate for the lack of certainty as to when their rights exhaust and to counteract parallel importers who attempt to circumvent market segmentation. The confusion is further compounded by different countries with different approaches to the exhaustion of rights for each type of intellectual property. Nevertheless, by dividing the problem and then reducing it to its fundamentals, a com-

allel_Importation_of_Trade-Marked_Goods.pdf (citing *Brother Industries Ltd v. Dynamic Supplies Pty Ltd* (2007) F.C.A. 1490, where Brother America imported printers to Australia without the consent of Brother Japan, which was found to violate the Australian Trade-mark statute even though the companies were related).

¹⁸⁵ See Swanson, *supra* note 154, at 365.

¹⁸⁶ *Id.*

¹⁸⁷ See Forsyth & Warwick, *supra* note 109, at 453.

¹⁸⁸ See Swanson, *supra* note 154, at 365.

¹⁸⁹ Daniel Cahoy, *Patent Fences and Constitutional Fence Posts: Property Barriers to Pharmaceutical Importation*, 15 FORDHAM INTELL. PROP. MEDIA & ENT. L.J. 623, 658 n. 147 (2005) (citing U.S.-Australian Free Trade Agreement, May 18, 2004, Art. 17.9, P 4).

¹⁹⁰ *Id.*

¹⁹¹ See UNCTAD-ICTSD, *supra* note 179, at 115 (describing the Moroccan and Australian Free Trade Agreements with the United States); see also Kevin Outterson, *Pharmaceutical Arbitrage: Balancing Access and Innovation in International Prescription Drug Markets*, 5 YALE J. HEALTH POL'Y, L. & ETHICS 193, 210-11 (2005).

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promise is possible. To stop manufacturers and right holders from regionalizing electronics, international exhaustion should be adopted by the WTO through TRIPS and further pressure for change should be applied through an international standards organization, market forces, or domestic competition law.

A. *Creating a Consensus on Exhaustion*

In creating a uniform exhaustion regime, many factors must be addressed. First, the regime chosen should be amenable to both developed and emerging economies. Second, since exhaustion of rights is such a divisive topic, the focus should be entirely on electronics in the interest of progress towards a consensus.¹⁹² Finally, this author argues that the WTO is the appropriate forum to resolve the issue by including solutions in TRIPS.

An examination of the various legal systems currently in effect, or their traditions, was not considered in the initial negotiations of TRIPS.¹⁹³ Negotiating without regard to any national legal tradition sped the process up, but also set the stage for an intractable fight over exhaustion. In order to actually reach a consensus, a survey of the various regimes implemented should be seriously considered and any major conflicts should be noted and ameliorated.

1. *Using an International Exhaustion Regime*

A national exhaustion regime will not work as the international standard. To promote free and liberal trade, countries that currently employ a national exhaustion regime will have to move to an international regime. The disadvantages of a national regime instituted internationally would be overwhelming.¹⁹⁴ Despite the

¹⁹² Leaving pharmaceuticals out of the negotiations and focusing strictly on consumer electronics will be a key factor. Drugs were the prime, if not sole point of contention in past international negotiations. See PETER DRAHOS & JOHN BRAITHWAITE, *INFORMATION FEUDALISM: WHO OWNS THE KNOWLEDGE ECONOMY* 37 (2002). Drugs represent a nexus between life, health and protection of property, and therefore, these should be avoided for the sake of progress. Sherman & Oakley, *supra* note 79. This also has the added benefit of cutting out the lobbyists (although undoubtedly not all of them). See CHARAN DEVEREAUX ET AL., *CASE STUDIES IN US TRADE NEGOTIATION: MAKING THE RULES* 101 (2006) (illustrating the prominent role of lobbyists, protestors and politics in the TRIPS negotiations). Lastly, removing this sector from any proposed exhaustion regime will promote participation and compliance.

¹⁹³ See DRAHOS & BRAITHWAITE, *supra* note 192, at 196.

¹⁹⁴ See discussion of national exhaustion, *supra* part II.

consensus, rights holders would be able to segment markets and enforce price discrimination piecemeal and at will. Doing so would expand the property right at the expense of consumers in each market and of poorer nations; it would moreover act as a barrier to free trade.¹⁹⁵ For the same reasons, community exhaustion should not be implemented in an international scale. The expansion of the markets would be minimal, as they would still segment the global market, this time along customs union and trade treaty lines.¹⁹⁶ Researchers have noted that parallel trade and international exhaustion can bring significant benefits to consumers,¹⁹⁷ sellers, and developing countries.¹⁹⁸ Others indicate that intellectual property holders prevent competition that benefits consumers, because it reduces the profit earned from their products.¹⁹⁹

International exhaustion would also be beneficial since it would avoid an impasse with the European Union's inability to use a national exhaustion regime.²⁰⁰ Countries like Japan and Australia that promote parallel importation would readily accept an international system. Nations that currently favor the national system

¹⁹⁵ Carsten Fink, *Entering the Jungle: the Exhaustion of Intellectual Property Rights and Parallel Imports*, in *INTELLECTUAL PROPERTY AND DEVELOPMENT: LESSONS FROM RECENT ECONOMIC RESEARCH* 171, 176 (Carsten Fink & Keith E. Maskus eds., 2005) ("Undoubtedly, a system of national exhaustion poses a nontariff barrier to trade.").

¹⁹⁶ See GHIDINI, *supra* note 90, at 41; see also STROTHERS, *supra* note 137, at 335-36 (2007) (discussing the European Union Commission's original proposals for the Trade Mark Directive which called for international exhaustion to avoid marks being used to compartmentalize the world market).

¹⁹⁷ See Tommaso M. Valletti & Stefan Szymanski, *Parallel Trade, International Exhaustion and Intellectual Property Rights: A Welfare Analysis*, *J. INDUS. ECON.* 14 (forthcoming), available at <http://ssrn.com/abstract=934536> (last visited Feb. 18, 2008); see also Maskus, *supra* note 97 (discussing research done that shows market segmentation supports collusion amongst companies and that international exhaustion is a means for aiding competition).

¹⁹⁸ See Duncan Mathews & Viviana Munoz-Tellez, *Parallel Trade: A User's Guide*, in *IP HANDBOOK OF BEST PRACTICES*, 1429, 1430-33, available at <http://www.iphandbook.org/handbook/chPDFs/ch15/ipHandbook-Ch%2015%2004%20Matthews-Munoz-Tellez%20Parallel%20Trade.pdf> (last visited Feb. 18, 2008) (discussing the benefits, to consumers, developing countries, retailers, wholesalers, and traders, as well as, providing model provisions for international exhaustion).

¹⁹⁹ See Darren E. Donnelly, *Parallel Trade and International Harmonization of the Exhaustion of Rights Doctrine*, 13 *SANTA CLARA COMPUTER & HIGH TECH. L.J.* 445, 498-99 (1997).

²⁰⁰ As noted earlier Article 30, as well as, ECJ case law state that a community-wide standard must be the floor for exhaustion. See KEELING, *supra* note 103, at 143 (noting that treaty provisions do not preclude member states from adopting international exhaustion and the European Union Commission observed that it must be allowed to create bilateral and multilateral treaties where international exhaustion would be introduced).

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could be convinced of the superiority of the international system through emphasis on benefits such as free trade, globalization, and the advantages derived there from.²⁰¹ Because much of the United States' position on exhaustion comes from case law, legislative change would permit institutionalization of the international system.²⁰² With decisions like *Quality King* and its progeny, even United States courts demonstrate a willingness to move to a more liberal regime.

2. *The WTO as the Forum for Developing an International Consensus*

The WTO is a natural choice to undertake this Herculean task due to its large membership and its promotion of free trade.²⁰³ The WTO espouses that free trade correlates with economic growth, making it a natural candidate.²⁰⁴ Market segmentation and banning parallel imports act as barriers to trade and are inconsistent with many of the core ideals of the WTO.²⁰⁵ In order to fulfill the goals of the WTO, it should oppose these trade-blocking behaviors.²⁰⁶

The WTO is also suited to develop this consensus because its international system features reliability, transparency, and a fast dispute settlement system to deal with problems between members.²⁰⁷ If a member refuses to comply with WTO standards, it

²⁰¹ These benefits are especially important in light of any recession in the world's large economies, since consumer spending will be strained. See LOUIS E. BOONE & DAVID L. KURTZ, *CONTEMPORARY BUSINESS* 2006 85 (2006); see also DOUGLAS FISHER, *INTERMEDIATE MACROECONOMICS: A STATISTICAL APPROACH* 109, 452 (2001) (discussing the role of consumer spending in recessions).

²⁰² Given the extensive research, development and testing that goes into drug creation, the pharmaceutical lobbying groups would no doubt put immense pressure on the United States government to not allow a liberalizing of the exhaustion regime.

²⁰³ Currently there are 151 members to the WTO. Understanding the WTO members, http://www.wto.org/english/thewto_e/thewto_e.htm (last visited Jan. 5, 2008).

²⁰⁴ Understanding the WTO - The case for open trade, http://www.wto.org/english/thewto_e/whatis_e/tif_e/fact3_e.htm (last visited Jan. 5, 2008).

²⁰⁵ See *Report on Parallel Importation*, *supra* note 45 (describing why the WTO is the best forum for drafting rules for parallel importation).

²⁰⁶ "The goal of the WTO is to encourage economic growth and expand the production of trade in goods and services in accordance with the objective of sustainable development." *Id.* at 620.

²⁰⁷ See JAY DRATLER, *INTELLECTUAL PROPERTY LAW: COMMERCIAL, CREATIVE, AND INDUSTRIAL PROPERTY* 1A-15 (1991); see also COLIN HINES, *GLOBAL LOOK TO THE LOCAL: REPLACING ECONOMIC GLOBALIZATION WITH DEMOCRATIC LOCALIZATION* 65 (2003).

faces economic sanctions (known as retaliation).²⁰⁸ These enforcement strategies would allow for effective enforcement and maintenance of an international exhaustion system.

The WTO's suitability for this task is buttressed by the fact that it administers the TRIPS agreement. Acceptance of TRIPS is mandatory for prospective WTO members.²⁰⁹ As one of the most significant multilateral agreement on intellectual property rights,²¹⁰ TRIPS has the attention of most of the nations of the world, especially the 151 WTO members. Furthermore, a standard that sets a floor or a bare minimum would conform to the rest of the TRIPS provisions.²¹¹ The WTO offers a multilateral solution that would avoid many of the problems associated with bilateral and regional agreements.²¹²

The other major international intellectual property forum, the WIPO, is not suited to the task of settling the issue of exhaustion. WIPO and its associated treaties lack the enforcement advantages of TRIPS and the WTO, giving no incentives for member nations to abide by their agreements.²¹³ Furthermore, most of the substantive law in the WIPO's treaties has been integrated by reference into TRIPS.²¹⁴ The WIPO thus offers no different legal advantages than the WTO, and lacks enforcement mechanisms.

²⁰⁸ DRATLER, *supra* note 207.

²⁰⁹ See JOHANNA GIBSON, COMMUNITY RESOURCES: INTELLECTUAL PROPERTY, INTERNATIONAL TRADE AND PROTECTION OF TRADITIONAL KNOWLEDGE 2 (2005) (noting acceptance of TRIPS is mandatory for any country wishing to join the WTO).

²¹⁰ See Keith Maskus, *The Role of Intellectual Property Rights in Encouraging Foreign Direct Investment and Technology Transfer*, 9 DUKE J. COMP. & INT'L L. 109, 109 (1998).

²¹¹ See KENNETH H. MAYER & HANK PIZER, THE AIDS PANDEMIC: IMPACT ON SCIENCE AND SOCIETY 335 (2005) ("[TRIPS] sets a floor of IPR protection for countries and connects IPR to several international trade agreements."); *contra* Drexl, *supra* note 92, at 725 ("Competition law argues against the minimum protection approach of the TRIPS agreement.").

²¹² See Jagdish Bhagwati & Arvind Panagariya, *The Theory of Preferential Trade Agreements: Historical Evolution and Current Trends*, 86 AMER. ECON. REV. 82-87 (1996) (noting that economically power countries employ "[the] simultaneous use of [bilateral free trade agreements] . . . alongside multilateralism . . . [is] a sequential bargaining strategy to divide the nonhegemonic governments and improve the final multilateral outcome in favor of its own demands . . ."); see generally JAGDISH N. BHAGWATI, IN DEFENSE OF GLOBALIZATION (2004).

²¹³ Notably the system for Dispute Settlement and retaliation. See DRATLER, *supra* note 207.

²¹⁴ "[T]he TRIPs Agreement has formed a WTO-WIPO marriage by integrating WIPO's substantive law into the WTO's trade regime." Susan A. Mort, *The WTO, WIPO & the Internet: Confounding the Borders of Copyright and Neighboring Rights*, 8 FORDHAM INTELL. PROP. MEDIA & ENT. L.J. 173, 177-78 (2006).

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Regional trade agreements, by their very nature, are also not suitable forums for creating an international consensus.²¹⁵ Regional trade agreements suffer from negotiation imbalances with emerging countries' interests being supplanted by economically stronger countries, or regional hegemons.²¹⁶ In the WTO, these countries would have a stronger representation on issues through the creation of coalitions with similarly situated countries worldwide.²¹⁷ Therefore, through pooling political resources in a global forum, economically weak countries can try to counter-act developed countries and achieve fairer results.²¹⁸

B. *Promoting International Devices and Discouraging Market Segmentation*

After the development of a legal foundation on exhaustion, much of the uncertainty concerning post-sale control would be alleviated. However, electronics companies that have already developed products with regionalizing features might not be persuaded to remove them immediately. Proponents of regionalization often rationalize their incorporation as a means to stop piracy.²¹⁹ However, these technologies have time and again been circumvented and rendered useless in combating piracy.²²⁰ Other anti-piracy

²¹⁵ For example: North American Free Trade Agreement, Mercado Común del Sur, Association of Southeast Asian Nations, etc.

²¹⁶ "Clearly the existence of a powerful hegemon within a region may undermine efforts to construct inclusive regional arrangements involving all or most of the states in a region." Andrew Hurrell, *Regionalism in Theoretical Perspective, in Regionalism, in WORLD POLITICS: REGIONAL ORGANIZATION AND INTERNATIONAL ORDER* 37, 50 (Louise L'Estrange Fawcett & Andrew Hurrell eds., 2003).

²¹⁷ See generally Sonia E. Rolland, *Developing Country Coalitions at the WTO: In Search of Legal Support*, 48 *HARV. INT'L L.J.* 483 (2007). 75% of the WTO consists of developing countries. *Id.*

²¹⁸ See DRAHOS & BRAITHWAITE, *supra* note 192, at 208-09 (discussing how developing countries are less vulnerable with regards to intellectual property in coalitions).

²¹⁹ "More than measures to protect against piracy, region coding has been one of the most controversial aspects of DVD." JASON WHITTAKER, *THE CYBERSPACE HANDBOOK* 139 (2004). "To keep a lid on piracy, the Blu-ray Disc Assn. has decided to use regional codes for film discs released in the format." Mark Schilling, *Blu-ray regional code to fight piracy: New system differs from one in place for standard DVDs*, *VARIETY*, Oct. 3, 2006, available at <http://www.variety.com/article/VR1117951183.html> (last visited Mar. 10, 2008).

²²⁰ "[T]he five-region plan failed to work, the search for ways to prevent casual copying of DVDs continued." KERRY SEGRAVE, *PIRACY IN THE MOTION PICTURE INDUSTRY* 128-29 (2003); "An anonymous computer programmer . . . [defeated] a scheme that both [HD-DVD and Blu-ray] use to protect digital content." John Markoff, *Studios' DVDs Face a Crack in Security*, *N.Y. TIMES*, Jan. 1, 2007, at C5; see also the Apple iPhone example, *supra* Part I.

technologies such as encryption and digital rights management, rather than regionalization could be more effective and efficient, without impeding free trade.

An additional response is needed to end electronic regionalization. There are many different avenues for providing incentives to electronics manufacturers who segment markets. The first option uses non-governmental actors to promote an international standard or to allow market forces to decide. The second option employs legislation and directs legal attention to the problem.

1. *Using an International Standard*

A standard should be established to promote electronics that function internationally, rather than regionally. Standards are useful to: create market growth for new and emerging technologies, reduce development times and costs, promote sound engineering practices, decrease trading costs and lower trade barriers, increase product quality and safety, reduce market risks, and protect against obsolescence.²²¹ A standard creation group would have to be non-governmental, have a history of successful standards and be interested in social welfare.²²² Two predominant choices are available: the International Electro-technical Commission (IEC) and the International Organization for Standardization (ISO).²²³

Inaugurated in 1906,²²⁴ the IEC is a non-governmental international standards organization whose membership is composed of 69 national committees.²²⁵ The IEC has promulgated important international standards of units of measurement, such as the gauss, hertz, weber, and the first system of standards, the *Système Inter-*

²²¹ IEEE Association Standards, <http://ieee.org/web/standards/home/index.html> (last visited Jan. 26, 2008).

²²² Using a non-governmental entity would avoid some competing national interests.

²²³ NAT'L RESEARCH COUNCIL, STANDARDS, CONFORMITY ASSESSMENT, AND TRADE INTO THE 21ST CENTURY 46 (1995). "The most notable institutions at the international level are the International Standards Organization (ISO) and the International Electro-technical Commission (IEC)" Walter Mattli, *International Governance for Voluntary Standards: A Game-theoretic Perspective*, in TRANSATLANTIC REGULATORY COOPERATION: LEGAL PROBLEMS AND POLITICAL PROSPECTS 337, 337 (George A. Bermann et al. eds., 2004).

²²⁴ Mark Frary, IEC History: In the Beginning, the Founding of the IEC, http://www.iec.ch/about/history/articles/founding_iec.htm (last visited Feb. 10, 2008).

²²⁵ IEC in Action: The IEC in Figures, http://www.iec.ch/news_centre/iec_figures/ (last visited Feb. 10, 2008).

national d'unités (International System of Units).²²⁶ As part of its mission, the IEC is dedicated to an efficient global market, improved human health and safety, and the protection of the environment.²²⁷ The IEC's standards are especially noteworthy since they are the core of the WTO's Agreement on Technical Barriers to Trade (TBT).²²⁸ Further support is drawn from the fact that:

[T]he IEC is one of the bodies recognized by the . . . WTO and entrusted by it for monitoring the national and regional organizations agreeing to use the IEC's international standards as the basis for national or regional standards as part of the WTO's Technical Barriers to Trade Agreement.²²⁹

ISO founded in 1947, is also an especially good choice for creating an international standard for electronics that do not segment markets.²³⁰ ISO is the largest non-governmental standards organization,²³¹ but has no authority to impose standards.²³² Like the IEC, ISO is linked directly with the international legal and political community, through the TBT,²³³ and communicate with the European Committee for Standardization (CEN) through the Lisbon Agreement of 1989,²³⁴ and Vienna Agreement of 1991.²³⁵ These agreements have been instrumental in promoting international

²²⁶ JOHN J. ROCHE, *THE MATHEMATICS OF MEASUREMENT: A CRITICAL HISTORY* 184-85 (1998); see also IEC History: In the Beginning, Giovanni Giorgi, http://www.iec.ch/about/history/articles/giovanni_giorgi.htm (last visited Feb. 10, 2008).

²²⁷ About the IEC: Mission and Objectives, <http://www.iec.ch/about/mission-e.htm> (last visited Feb. 10, 2008).

²²⁸ *Id.*

²²⁹ About the IEC: Types of IEC Publications, <http://www.iec.ch/ourwork/iecpub-e.htm> (last visited Feb. 10, 2008).

²³⁰ See The ISO Story, http://www.iso.org/iso/about/the_iso_story.htm (last visited Feb. 10, 2008).

²³¹ *Id.*

²³² See JOSEPH CASCIO ET AL., *ISO 14000 GUIDE: THE NEW INTERNATIONAL ENVIRONMENTAL MANAGEMENT STANDARDS* 7 (1996).

²³³ "ISO has taken the commitment and implemented all the necessary measures to ensure that ISO's International Standards are fully compliant with the requirements set by the Agreement on Technical Barriers to Trade of the WTO." The ISO Story: The Establishment of the GATT Standards Code, http://www.iso.org/iso/about/the_iso_story/iso_story_gatt_standards_code.htm (last visited Jan. 26, 2008).

²³⁴ "[T]he Lisbon Agreement, approved in 1989 . . . provided for full and mutual exchange of information between ISO and CEN [the European Committee for Standardization] on their respective activities." The ISO Story: The Vienna Agreement, http://www.iso.org/iso/about/the_iso_story/iso_story_vienna_agreement.htm (last visited Jan. 26, 2008). See also James L. Dixon & Ian Brodie, *The New ISO Standards for Ice Hocket Helmets and Face Protectors: Moving Toward International Standards Harmonization and Conformity*, in *SAFETY IN ICE HOCKEY*, 192, 207 (Cosmo R. Castaldi et al. eds., 2004) (discussing the success and history of the Lisbon Agreement and ISO).

standard harmonization, coordination, and promulgation.²³⁶ These agreements help eliminate competing standards and efforts, the existence of which would derail widespread adoption of an international standard.²³⁷ ISO has previously created and promoted a vast number of standards,²³⁸ and also has been a prominent group for forming international consensuses – aiding the UN when asked.²³⁹ Lastly, ISO supports international standardization in the hopes that it will “facilitate trade between countries and make it fairer” and “safeguard consumers, and users in general, of products and services.”²⁴⁰

Both the IEC and ISO are excellent bodies for creating an international standard for electronics that will not segment markets. Each has a long history of successful and important standards,²⁴¹ and each is connected at the international level with the WTO, as well as nationally with individual countries. Most appealing, each endeavors to promote consumer welfare and support free trade by way of furthering standardization.²⁴²

²³⁵ See ISO Standards Development Procedures: Cooperation with CEN, http://www.iso.org/iso/standards_development/processes_and_procedures/cooperation_with_cen.htm (last visited Jan. 26, 2008).

²³⁶ Mattli, *supra* note 223, at 351 (discussing the success of the Vienna Agreement and Dresden Agreement in international standardization). R

²³⁷ “The adoption of standards can be slowed by proliferation of multiple, competing standards.” Sushil Vachani, *Introduction*, in TRANSFORMATIONS IN GLOBAL GOVERNANCE: IMPLICATIONS FOR MULTINATIONALS AND OTHER STAKEHOLDERS 1, 14 (Sushil Vachani ed., 2006). See also Carelton A. Sperati, *Introducing the United States to the ISO Committee on Terminology (Principles and Coordination)*, in STANDARDIZING TERMINOLOGY FOR BETTER COMMUNICATION: PRACTICE, APPLIED THEORY, AND RESULTS 54, 57 (Richard Alan Strehlow & Sue Ellen Wright eds., 1993).

²³⁸ ISO Standards, http://www.iso.org/iso/iso_catalogue (last visited Feb 10, 2008) (“ISO has developed over 17000 International Standards on a variety of subjects and 1100 new ISO standards are published every year.”).

²³⁹ See CASCIO ET AL., *supra* note 232, at 9 (The UN asked ISO to help create a consensus on environmental issues). R

²⁴⁰ Discover ISO: What Standards Do, http://www.iso.org/iso/about/discover-iso_what-standards-do.htm (last visited Feb. 10, 2008).

²⁴¹ ISO has developed over 17,000 standards. ISO Standards, *supra* note 238. The IEC has published 5,213 International Standards. IEC in Action: The IEC in Figures, *supra* note 225. R

²⁴² See Discover ISO: Who Standards Benefits, http://www.iso.org/iso/about/discovers-iso_who-standards-benefits.htm (last visited Mar. 10, 2008) (detailing who ISO standards benefit). For IEC’s dedication to increased welfare see About the IEC: Mission and Objectives, *supra* note 227. R

2. *Relying on Market Forces*

While reliance on market forces to deter market segmentation would require the least effort, but it also offers no guarantee of change. The costs to segment markets do not come cheaply, and the costs of enforcing segmentation may be even higher.²⁴³ Using segmentation technology, such as regionalization, raises manufacturing costs and is nonetheless ineffective due to ambitious individuals who can circumvent them. However, competition in the market-place helps deter segmentation. For instance, China is developing a high definition multimedia disc standard to compete with the DVD, HD-DVD,²⁴⁴ and Blu-ray standards.²⁴⁵ Most importantly, this new format will be region-free and therefore will not lead to market segmentation like regionalized DVDs.²⁴⁶ Product competition could eventually result in de-regionalization of electronics and ultimately benefit the consumer in the form of lower prices.

3. *Deferring to Governmental Action*

National governments could combat the problem of manufacturers segmenting markets by passing laws that discourage these practices. Areas of domestic law that involve competition and monopoly could readily be adapted to ensure that rights holders do not continue to embed regionalizing features in their products.²⁴⁷ These laws would ideally parallel the international standards on exhaustion.²⁴⁸ Governments typically employ competition law to “[avoid] market dominating [behavior] of businesses through, inter alia, price fixing or market-sharing cartels, abuses by leading firms

²⁴³ See *supra* note 28 for factors required to have a market segmented.

²⁴⁴ Now defunct, see Press Release, Toshiba, Toshiba Announces Discontinuation of HD DVD Businesses, (Feb. 19, 2008), http://www.toshiba.co.jp/about/press/2008_02/pr1903.htm.

²⁴⁵ China to develop DVD format, <http://www.msnbc.msn.com/id/9618578/> (last visited Jan. 26, 2008).

²⁴⁶ *Id.*; see also Brian Lam, *Format War: CH-DVD Like HD DVD For China*, GIZMODO, Sept. 10, 2007, <http://gizmodo.com/gadgets/format-war/ch+vd-like-hd-dvd-for-china-298376.php> (last visited Jan. 26, 2008) (explaining that CH-DVD is based off of HD-DVD, which is region free).

²⁴⁷ See generally Nancy T. Gallini & Michael J. Trebilcock, *Competition Policy and Intellectual Property Rights: A Framework for the Analysis of Economic and Legal Issues*, in *COMPETITION POLICY AND INTELLECTUAL PROPERTY RIGHTS IN THE KNOWLEDGE-BASED ECONOMY* 17, 17 (Robert D. Anderson & Nancy Theresa Gallini eds., 1998).

²⁴⁸ Anderson et al., *supra* note 36 at, 426-27.

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and undue concentration.”²⁴⁹ The United Nations Conference on Trade and Development Model Law on Competition provides that the main objectives of national competition law and policy are:

[T]o control or eliminate restrictive agreements or arrangements among enterprises, or mergers and acquisitions or abuse of dominant positions of market power, which limit access to markets or otherwise unduly restrain competition, adversely affecting domestic or international trade or economic development.²⁵⁰

Thus the principles of competition law appear to run contrary to that of market segmentation and product regionalization.

The European Commission’s antitrust probe into iTunes, Apple’s online music store, is an illustration of these principals.²⁵¹ The probe resulted from a complaint from a watch-dog organization that alleged that the price differentials between European Union member countries “violated the treaty rules prohibiting restrictive business practices.”²⁵² After some negotiations, Apple eliminated the price differentials to the satisfaction of the European Commission.²⁵³ However, European iTunes customers can only purchase songs through their national stores, which all offer different songs.²⁵⁴ Generally, the European Union Commission has been aggressive in determining if there has been discrimination or anti-competitive behavior in the internal market.²⁵⁵

Regionalization features run contrary to policies that form the basis of competition law. These practices stifle trade, restrain com-

²⁴⁹ Objectives of Competition Law and Policy: Towards a coherent strategy for promoting competition and development, 2 UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT, available at [http://www.ifc.org/ifcext/fias.nsf/AttachmentsByTitle/Conferences_CompetitionPolicyTanz_Hassan+Qaqaya.prn.pdf/\\$FILE/Conferences_CompetitionPolicyTanz_Hassan+Qaqaya.prn.pdf](http://www.ifc.org/ifcext/fias.nsf/AttachmentsByTitle/Conferences_CompetitionPolicyTanz_Hassan+Qaqaya.prn.pdf/$FILE/Conferences_CompetitionPolicyTanz_Hassan+Qaqaya.prn.pdf) (last visited Feb. 18, 2008).

²⁵⁰ *Id.* at 1.

²⁵¹ See Tobias Buck et al., *Brussels to Target Apple’s iTunes Site*, FINANCIAL TIMES, Apr. 2, 2007, available at http://www.ft.com/cms/s/0/216031bc-e131-11db-bd73-000b5df10621.html?ncklick_check=1 (last visited Mar. 7, 2008).

²⁵² *Id.*

²⁵³ See Leigh Phillips, *EU Deal Prompts Apple iTunes Price Cut*, BUSINESS WEEK, Jan. 9, 2008, available at http://www.businessweek.com/print/globalbiz/content/jan2008/gb2008019_323239.htm (last visited Mar. 7, 2008).

²⁵⁴ *Id.*

²⁵⁵ See, e.g., Natali Helberger, *Refusal to Serve Consumers because of their Nationality or Residence - Distortions in the Internal Market for E-commerce Transactions?*, Policy Department Economic and Scientific Policy, IP/A/IMCO/IC/2006-207 11 (2007); see also Joint Answer to Written Questions E-1509/00 and E-1510/00 given by Mr. Monti on behalf of the Commission, 2000 O.J. (C53E) 157-59 (Feb 20, 2001) (addressing European Union competition concerns about country coding of DVD players).

petition, and are abuses of dominant industry positions. Existing national laws should be updated and new laws implemented to target regionalization practices, opening up markets and encouraging the free movement of goods.

IV. CONCLUSION

The uncertainty surrounding the exhaustion of intellectual property rights internationally has prompted electronics companies to take matters into their own hands. With a strong interest in controlling their products and price thereof, even after sale, electronics manufacturers and rights holders have developed technologies which they embed into their products. This is done to ensure that the international market remains segmented. Because segmentation allows manufacturers to charge different prices for the same product in different markets, rights holders have an incentive to keep these markets segmented and to dissuade importers from introducing cheaper versions bought in other markets. However, parallel importation through gray markets offers consumers greater options and reflects the principles of globalization and free trade.

Nations that have a national exhaustion regime enable rights holders to utilize price discrimination in multiple markets, since the regime only affects domestic rights. Although community exhaustion builds upon the concept of national exhaustion, it allows for exhaustion only within the community. Parallel importation between community members is acceptable, but between non-members and members it is not. Unlike the other methods, international exhaustion removes the rights and subsequent control regardless of where the initial sale occurred, and so is the most beneficial to parallel importers. Traditionally every country takes a different stance with respect to these regimes.

The United States favors national exhaustion, whereas the European Union employs community exhaustion due to its need for barrier-free internal markets. Japan and Australia, support parallel importation, and have instituted international exhaustion regimes. However, the major international agreements and treaties currently available have failed to effectively address the issue of exhaustion. The TRIPS agreement has taken a hands-off approach with regards to exhaustion that reflects the inability of the member states to come to an agreement.

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To stop electronics companies from implanting segmentation technologies, a consensus on exhaustion should be reached. The international standard on rights exhaustion should be limited to electronics to avoid disagreements that paralyzed the TRIPS negotiations and garner the willing support of more countries. An international exhaustion regime set through the WTO, would help to sway the European Union, promote free trade, and encourage lower prices with wider product-availability for consumers.

Other parts of the solution are promotion of international-wide devices through standardization and allowance for market forces, which are critical to ensuring that the promotion of electronics takes place on an international level, rather than one of independent regions. Without international exhaustion and parallel importation consumers will not have access to international goods, especially at reasonable low prices. Without any further progress, technology will continue to be used to artificially divide markets and rights holders will do all they can to stop parallel importers.

