EXHAUSTION OF INTELLECTUAL PROPERTY RIGHTS IN THE REALM OF FREE TRADE

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By

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Certificate

This is to certify that this thesis entitled **"Exhaustion of Intellectual property Rights in the Realm of Free Trade"**, submitted by Mr. Vishnu Sankar P. for the degree of Doctor of Philosophy, is, to the best of my knowledge, the record of bonafide research carried out under my guidance and supervision from 1st July, 2015, at the Inter University Centre for IPR Studies, Cochin University of Science and Technology. This thesis or any part thereof has not been submitted elsewhere for any other degree.

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This is to certify that the important research findings included in the thesis entitled **"Exhaustion of Intellectual Property Rights in the Realm of Free Trade",** have been presented in a research seminar at the Inter University Centre for IPR Studies, Cochin University of Science and Technology on 30th November 2017 and all the relevant corrections and modifications suggested have been incorporated in the thesis.

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Declaration

I declare that the thesis entitled **"Exhaustion of Intellectual Property Rights in the Realm of Free Trade,,** for the award of the degree of Doctor of Philosophy is the record of bonafide research carried out by me under the guidance and supervision of **PROF. (Dr.) T. G. AGITHA**, Professor, Inter University Centre for IPR Studies, CUSAT. I further declare that this work has not previously formed the basis of the award of any degree, diploma, associate-ship or any other title or recognition.

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Vishnu Sankar P.

CONTENTS

ABBREVIATIONS

1. AIR- All India Reporter.
2. Art. – Article.
3. Berkeley Tech. L.J. - Berkeley Technology Law Review.
4. Bom. C.R. - Bombay Cases Reporter.
5. CACM-Central American Common Market.
6. CMLR- Common Market Law Reports.
7. Co. - Company.
8. CULR- Cochin University Law Review.
9. DMCA – Digital Millennium Copyright Act.
10. EC Treaty – European Community.
11. ECR- European Court Reports.
12. edn.- Edition.
13. EFTA-European Free Trade Agreement.
14. EU- European Union.
15. F. Supp.- Federal Supplement
16. FTA- Free Trade Agreement.
17. GATT- General Agreement on Trade and Tariffs.
18. Geo. L.J.- Georgetown Law Journal.
19. i.e.- That is.
20. Inc.- Incorporated.
21. Indian J. Intell. Prop. L- Indian Journal of Intellectual Property Law.
22. IP – Intellectual Property.
23. J. Nat'l Ass'n Admin- Journal of National Association of Administrative Law.
24. JIPR- Journal of Intellectual Property Rights.
25. Mich. J. Int'l L- Michigan Journal Law International Law.
26. NAFTA- North American Free Trade Agreement.
27. NCAER- National Council for Applied Economic Research.
28. NUJS L. Rev.- National University of Juridical Science.

29. p- Page
30. PI- Parallel Imports.
31. pp. - pages.
32. PTC- Patent Trademark Cases.
33. Pvt. Ltd.- Private Limited.
34. R&D- Research and Development.
35. S.D.N.Y- Southern District of New York.
36. S.J.D- Doctor of Juridical Science.
37. SC- Supreme Court.
38. Sec. - Section.
39. Ss. - Sections.
40. TFEU- Treaty on the Functioning of European Union.
41. trans. – translation.
42. TRIPS- Trade Related Aspects of Intellectual Property Rights.
43. U. Chi. L. Rev. – University of Chicago Law Review.
44. U.S. - United States.
45. v. - Versus.
46. Vol.-Volume.
47. WCT- WIPO Copyright Treaty.
48. WIPO- World Intellectual Property Organisation.
49. WPPT- WIPO Performers and Phonograms Treaty.
50. WTO- World Trade Organisation.

Introduction

In the era of globalization international trade has taken a new form both in terms of economic and social welfare. The natural expectation of the countries who joined the process of globalization was that globalization of trade would promote free trade, which in turn would promote consumer welfare through enhanced access and affordability of goods. Intellectual property rights can affect this free movement of goods to an extent when knowledge intensive goods move across national boundaries.[1] The exclusive rights granted to the intellectual property holders often act as barriers to the cross border transfer of genuine goods. It is here that the doctrine of exhaustion becomes significant. Exhaustion is an inherent mechanism within the Intellectual Property system for facilitating free movement of goods even across national boundaries. The concept of exhaustion is one among the basic principles of intellectual property which limits the exclusive rights of an intellectual property owner and excludes the IP product from the coverage of IP protection. Under the doctrine, once the intellectual property owner sells an IP product in a market, his right to control the resale of the sold product gets exhausted. In other words, the purchaser who acquires title over the IP product through sale will be free to resell the product as per the doctrine, and the IP owner cannot control the further free movement of the sold product. Thus exhaustion protects the legitimate interests of the IP owner while protecting the free movement of goods

In this research work the researcher tries to explore the concept and evolution of the doctrine of exhaustion. While doing so, it is imperative to have a clear understanding of how and under what circumstances did the concept of exhaustion evolve. Exhaustion is a doctrine which hasevolved through the courts. Even though various theories exist regarding the evolution of the doctrine,[2]

[1] Carsten Fink and Carlos A. Primo Braga, "How Stronger Protection of Intellectual Property Rights Affects International Trade Flows", in Carsten Fink and Keith E. Maskus , *Intellectual Property and Development Lessons from Recent Economic Research*, World Bank and Oxford Publication, (2005), p. 19.

[2] The English Jurisprudence is often said to have developed the theory of exhaustion against the background of implied license theory under the contract law while the German jurist Joseph Kohler, who is considered to be the patron of the exhaustion theory has depended upon the theory of ' one time reward theory'. See, Christopher Heath, "Legal Concepts of Exhaustion and Parallel Imports",in Christopher Heath, *Parallel Imports In Asia,* Max

the researcher is trying to identify the most appropriate theoretical background of exhaustion through analysis of cases that laid down the founding principles of the doctrine. The purpose of the attempt to trace the evolution of exhaustion is to have a better understanding of the doctrine and its underlying principle which will help the researcher to identify the best mode of exhaustion befitting the free trade era. The researcher also takes the aid of the Hegelian and Kantian philosophies of property to have clarity on the philosophical moorings of the doctrine.

The doctrineof exhaustion is considered as an inherent mechanism within intellectual property regime to allow free movement of intellectual property goods while ensuring the protection of intellectual property so as to facilitate global welfare and to avoid undue protection of IP. It takes care of the interests of both the IP holder and the purchaser of an IP good. However, in the current global scenario there is no uniformity in this concept. Different nations follow different modes of exhaustion to suit their economic interests. There are basically three modes of exhaustion: national exhaustion, regional exhaustion, and international exhaustion. The objective of this study is to identify the best mode of exhaustion benefitting the free trade scenario ensuring global welfare. Interestingly, the Trade Related Aspects of Intellectual property Rights (TRIPs) which is the current international norm governing intellectual property as part of the WTO Agreements, do not specifically mandate any mode of exhaustion. This neutral position of the TRIPs Agreement makes this study on the best mode of exhaustion more significant. [3]

International exhaustion allows free movement of intellectual property goods. It is presumed that national and regional exhaustions, which limit the scope of exhaustion to the nation or region

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Plank Series on Asian Intellectual Property Law, Vol. 9, Kluwer Law International, Netherlands, (2004), pp.13-15. Another major theory put forward is the law of servitudes in property law. See, Glen O. Robinson, "Personal Property Servitudes", 71 U. Chi. L. Rev. 1449 (2004) available at
http://www.jstor.org/page/info/about/policies/terms.jsp, (accessed on 18/11/18).
Also see Yonatan Even, Property, Appropriability and The First Sale Doctrine, [Draft—Israel L&E--5/25/07].available at
http://portal.idc.ac.il/en/ilea/annualmeeting/documents/making%20sense%20of%20the%20first%20sale%20doctrine.pdf, (accessed on 4/11/2018).

[3] Vincent Chiappetta, "The Desirability of Agreeing to Disagree: The WTO, TRIPs, International IPR Exhaustion and A Few Other Things", Mich. J. Int'l L, [2000] , Vol.21, 333, at p. 335, available at:
http://repository.law.umich.edu/mjil/vol21/iss3/1, (accessed on 17/11/18).

respectively, run counter to the concept of free trade, which includes free movement of goods across the borders. On the contrary, international exhaustion, which extends the scope of exhaustion to an international level, appears to be the mode of exhaustion in consonance with the principles of free trade. Therefore it is also essential to understand the concept and evolution of free trade. A better understanding of the principles of free trade is essential to identify the best mode of exhaustion that promotes international free trade. This makes it essential to analyse the basic economic theories on which the concept of free trade has evolved. Thus, the economic, legal and judicial principles underlying free trade have to be analysed to identify the best mode of exhaustion that facilitates free trade.

In the era of TRIPs and globalisation, protection of intellectual property is expected to promote free trade, making available goods across the borders at cheaper rate. However, the different modes of exhaustion existing in different nations often act as a hindrance to the same. WTO operates on the idea that free movement of goods and services across the national boundaries would be beneficial to global economic welfare as it can encourage specializations and enhance efficiency in the production and distribution of goods resulting in an increased output of goods and services.[4] This is the theory of comparative advantage, on the basis of which the international trade functions.[5] Further, the WTO principle of free trade will be hindered the moment a genuine, legally sold, good is blocked from moving from one territory to another, on the simple reason that different nations follow different forms of exhaustion. Therefore it is imperative that the concept of parallel imports are analysed in the WTO framework, which works on the free trade principles, to identify the most favourable mode of exhaustion that promote free movement of goods.

For understanding the mandate of the TRIPS Agreement on exhaustion it is necessary to analyse the concept of exhaustion under the TRIPs framework. The TRIPs Agreement, being part of the

[4] Frederick M. Abbot, "First Report(Final) to the Committee on International Trade Law of the International Law Association on the Subject of Parallel Importation", Journal of International Economic Law, [1998], Vol. 1, No. 4, p.611, available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=915046, (accessed on 4/11/2018).

[5] David M Gould, "The Theory and Practice of Free Trade", Economic Review, [1993], Fourth Quarter, p.1, available at https://www.dallasfed.org/~/media/documents/research/er/1993/er9304a.pdf, (accessed on 4/11/2018). Also see; David Ricardo, *On The Principles of Political Economy and Taxation,* Batoche Books, Kitchener, (third edition, 2001), pp. 85-103.

WTO is also governed by the principles of free trade. Therefore it is required to examine if the concept of exhaustion under TRIPs would facilitate free movement of goods. The negotiating history of Article 6 is also required to be examined to understand how the current form of Article 6 came in to existence and if it is in agreement with the free trade concept.

Exhaustion is a doctrine having high economic significance. Therefore it is important to examine the economic impact of different modes of exhaustion to see if the TRIPS provision is capable of ensuring economic efficiency at a global level. The phenomenon of international exhaustion leads to parallel imports, which is import of genuine products sold once in any part of the world into any other country, by the purchaser of it. National or regional exhaustion prohibit this phenomenon of parallel imports. The incentive for parallel imports is the price differences that exist in different jurisdictions for the same product. The producer sells the same product at different prices due to various economic and non-economic factors. This is called differential pricing. A parallel importer obtains the goods from a place/country where it is sold at a lower price and resells it at another place/country where it is priced high, obtaining the price difference as the profit. This is how parallel import works in the global context. Different nations opt for different modes of exhaustion based on their respective economic and social interests. Such interests have crucial role in the decision whether to allow parallel imports. Therefore, the central question in the TRIPS negotiation in the context of the mode of exhaustion would have been whether parallel imports would enhance economic efficiency and consumer welfare. This is also because the legal regulation of parallel imports has a significant role in determining how successfully the producers can engage in price discrimination.[6] The main argument against parallel imports is that it could either end up in eliminating differential pricing or force the producer to resort to uniform pricing of products in all markets, or lead to the closing down of those markets that facilitate parallel imports. The ultimate result of both was expected to be the reduction in consumer welfare in developing and underdeveloped markets.[7] Another argument against parallel imports was that it would reduce the incentives of IP owners to invest in

[6] Krithpaka Boonfueng, "A Non-Harmonized Perspective on Parallel Imports: The Protection of Intellectual Property Rights and the Free Movement of Goods in International Trade", (S.J.D . dissertation, United States -- District of Columbia: American University, 2003), p.33, available at https://digitalcommons.wcl.american.edu/stu_sjd_abstracts/5/, (accessed on 4/11/2018).

[7] David A.Malueg and Marius Schwartz, "Parallel imports, demand dispersion, and international price discrimination", Journal of International Economics, [1994], Vol.37, pp.167–195.

R&D/creativity.[8] However, there exists an equally strong argument favouring parallel imports.[9] Therefore, an attempt is made in this thesis to determine the best, economically viable mode of exhaustion, and to understand the economics of parallel imports and its impact on consumer and global welfare.

The challenges posed by the digital technology to copyright and the diverse mechanisms used by the copyright owners in the digital world are another set of problems to be addressed while exploring the best mode of copyright exhaustion in the digital context . These challenges posed by the digital world are highly significant in the case of copyright as currently most works are created and disseminated in the digital medium. Digital technology has made creation and dissemination of works very easy. However, the IP owners do not enjoy the same control they enjoyed in the analogue context, over their copyrighted works in the digital context. The doctrine of exhaustion becomes much more challenging in the digital world when compared to the analogue world due to the easiness the digital medium provides for creation and dissemination of works. Once a copy of a work is purchased online, it is easy to reproduce and disseminate the same. To overcome this, IP owners either reject the application of exhaustion in the digital context, or resort to the following ways to circumvent the application of first sale doctrine in digital transfers:

(a) declaring the mode of transfer as licenses rather than sale;
(b) restricting distribution by expressly retaining title

[8] Gene M. Grossman and Edwin L.-C. Lai , "Parallel imports and price controls", RAND Journal of Economics, (2008), Vol. 39, No. 2, pp. 378–402, at p.380, available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=933106, (accessed on 16/11/2018). Also see, Patrick Rey, "The Impact of Parallel Imports on Prescription Medicines", Manuscript, University of Toulouse, [2003], available at http://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.493.1937&rep=rep1&type=pdf, (accessed on 1/12/2018). Also see; Barfield and Groombridge, "The Economic Case for Copyright Owner Control over Parallel Imports", Journal of World Intellectual Property, [1998], Vol. 1, pp. 903–939, available at https://onlinelibrary.wiley.com/doi/pdf/10.1111/j.1747-1796.1998.tb00041.x, (accessed on 22/12/2018) ; J.S Chard and C.J. Mellor, "Intellectual Property Rights and Parallel Imports", World Economy, [1989], Vol. 12, pp. 69–83 ; Patricia M. Danzon, and Adrian Towse, "Differential Pricing for Pharmaceuticals: Reconciling Access, R&D and Patents", International Journal of Health Care Finance and Economics, [2003], Vol.3 (3), pp.183-205, available at http://dx.doi.org/10.1023/A:1025384819575 , (accessed on 21/12/2018)

[9] Gene M. Grossman and Edwin L.-C. Lai, "Parallel imports and price controls", RAND Journal of Economics, [2008], Vol. 39, No. 2, pp. 378–402, available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=933106, (accessed on 4/11/2018).

(c) Attaching use restrictions to the copy itself[10]

It is at this juncture that the question whether sale is necessary to constitute exhaustion gains a lot more importance. Declaring transfers as licenses rather than sale appears to be the most rampant method adopted by the owners of intellectual property to prevent further distribution of the already sold work. The IP owner does not wish the purchaser to resell the purchased product.[11] Exhaustion can kick in only when the first authorised sale of a product takes place. This is circumvented by terming the transaction as license instead of sale. The impact and correctness of this is explored in this work.

Another significant issue often raised in the context of exhaustion is the impact of the secondary market on the right of the copyright owner. It is often argued that the secondary market facilitated by the exhaustion rule in the digital context significantly affect the interest of the copyright owner since the secondary market has more potential impact in the digital world than in the analogue context. Another serious aspect in the digital context is that every transfer of works in the digital world automatically results in the reproduction of works and therefore violates the reproduction right of the author. In order to address these challenges it is imperative to understand the nature of transaction occurring in the digital world.

The major problem in the Indian scenario is that the Indian statutes do not expressly define the exhaustion principle. This is confusing because a major flexibility like exhaustion provided under TRIPs is expected to be beneficial for a developing country like India. This attitude of India is still the more confusing since it argued for international exhaustion in various international negotiations including TRIPs. In fact India was instrumental for the TRIPs negotiating forum not opting for either national or regional exhaustion in the TRIPs agreement despite the strong demand for it from the developed world. Therefore it is pertinent to analyse

[10] John A. Rothchild, "The Incredible Shrinking First-Sale Rule: Are Software Resale Limits Lawful?",Rutgers Law Review , [2004], Vol. 57, Number 1, pp.44-45, available at: https://digitalcommons.wayne.edu/lawfrp/351, (accessed on 4/11/2018).

[11] Alice J. Won, "Exhausted? Video Game Companies and the Battle Against Allowing the Resale of Software Licenses", J. Nat'l Ass'n Admin. L. Judiciary , [2013] , Vol.33, Iss.1 pp.388-438, available at: http://digitalcommons.pepperdine.edu/naalj/vol33/iss1/10, accessed on 4/11/2018.

the Indian legal position,the mode of exhaustion followed by various Indian laws and the judicial responses to the disputes regarding those provisions.

The current confusion existing both in the international and national scenarios regarding the mode of exhaustion is the motivation behind this research. One serious issue having current significance is that even though Article 6 is termed as flexibility within the TRIPs Agreement allowing nations to adopt any mode of exhaustion, in actual practice even countries who have adopted international exhaustion are not in a position to implement that in the trade between them. This is because they are under constant threat of confiscation of IP goods in transit by a third country that has chosen either national or regional exhaustion. Another major issue in the digital context is that in the digital platform, which is the major platform of trade of copyright goods, serious challenge to access and affordability of digital goods is being made across the globe due to banning of parallel imports of copyright goods in digital format. This is against free trade philosophy envisaged under the WTO regime. Therefore it is strongly felt that it is important to have a study on the mode of exhaustion befitting the free trade era.

Chapter I

Historical Evolution and Theoretical Justifications of the Concept of Exhaustion

1. Concept of Exhaustion

Intellectual property refers to creations of the mind such as inventions, literary and artistic works, symbols, names and images used in commerce and industrial designs.[12] It vests the creators with certain bundle of rights which the creator of the concerned form of intellectual property can utilize to realize the fruits of his creation. It also acts as an incentive to the creator.[13] Thus, the creator is vested with special set of rights upon the creation of his mind. However, it is not as simple as it sounds. The rights that an IP holder exercises coexists with the rights attached to the physical property that encompasses the intellectual creation to give it a physical existence. Thus, two sets of rights come into play. Problem begins the moment these different rights come into conflict with each other, which happens when the physical property (IP good) is transferred to the consumer, say, on sale. Under the normal property jurisprudence, the purchaser becomes the absolute owner of the physical property, which contains IP. This implies that the purchaser can use the good to his liking, which includes reselling the same. However, then there arises conflict of interests, as the right of the purchaser of the IP product to resell the physical property comes in to conflict with the right of the IP holder "to sell or distribute".[14] When the purchaser resells the product containing IP, it is contended that, the consumer is violating the "right to sell/distribute" of the IP holder. If the IP owner could control the resale of the sold product through post-sale restrictions using intellectual property rights, those post-sale restrictions affect the rights of the owner of the physical product over his property. The necessary question to be raised here is whether the transfer of an object containing the intellectual property is subject to

[12] *What is intellectual Property*, World Intellectual Property Organisation, p.2, available at http://www.wipo.int/edocs/pubdocs/en/intproperty/450/wipo_pub_450.pdf , (accessed on 6/11/2018).

[13] Joseph L. Roth, "Exhaustion Cannot Stifle Innovation: A Limitation on the "First Sale" Doctrine, UC Irvine Law Review, [2015],Vol. 5, 1231, at p.1237, available at https://scholarship.law.uci.edu/cgi/viewcontent.cgi?article=1233&context=ucilr, (accessed on 15/12/2018).

[14] See for eg; Sec.48 (b) of Indian Patent Act, 1970 and Sec.14 of the Indian Copyright Act, 1957 .

all the rules of transfer of normal real property. In other words, does the first transfer of the object containing IP extinguish the rights of the IP owner over the transferred object?

1.1. Historical Evolution of the Concept of Exhaustion

A minimum understanding of the real property jurisprudence is required to answer the question raised during the above discussion. In the real property context, the purchaser of a property becomes the absolute owner of it and thereby enjoys unhindered rights over his property, which includes the right to transfer it to another person. The question, therefore, is whether the jurisprudence can be different for IP goods. The right to sell conferred on the IP owner with respect to some forms of intellectual property, therefore, appears to be in conflict with the general property jurisprudence. It also appears to be in conflict with the rule against restraint on alienation under the common law. Property owners cannot, for instance, impose restraints that offend public policy by imposing restraint on alienation, or creating restraints on trade[15]. Is the same rule applicable to the IP products as well? Are post- sale restraints lawful for IP products? It is in this context that the concept of exhaustion gains importance.

1.1.1. Exhaustion and the Common Law Concept of Rule against Restraint on Alienation

The exhaustion doctrine in intellectual property law, it appears, has been introduced generally, to limit the rights of an IP owner to control the post-sale disposition of an IP good by its purchaser, once it has been sold by or under the authority of the IP Owner. In theory, this doctrine enables the IP owner to receive a fair reward for surrendering his right to withhold a product from the market. However, it permits the further sale of the good by its purchaser, thereby ensuring the freedom of movement of the IP good from one purchaser to another, and preventing IP rights from unduly disrupting the distribution system.[16] Thus, in simple terms, exhaustion of intellectual property rights takes place when the intellectual property owner or any person

[15] Glen O. Robinson, "Personal Property Servitudes",U. Chi. L. Rev. , [2004], Vol. 71 , 1449, at p.1450, available at .http://www.jstor.org/page/info/about/policies/terms.jsp, (accessed on 18/11/18).

[16]James B. Kobak,. "Exhaustion of Intellectual Property Rights and International Trade," Global Economy Journal, [2005], De Gruyter, Vol. 5(1), pp. 1-16, available at https://ideas.repec.org/a/bpj/glecon/v5y2005i1n5.html , (accessed on 22/12/2018).

authorised by him sells the product. In other words, upon the very first authorised sale, the right to control resale or distribution of the sold piece gets exhausted.[17] Hence the doctrine is also called the first sale doctrine. In the case of Copyright, the doctrine of first sale acts, in essence, as a limit on the copyright owner's right of distribution whereas in the case of other forms of IP it acts as a check on restraint on further sale, once it is sold by or under the instruction of the IP holder.

The legal basis of the concept springs from the distinction drawn between property rights of the IP holder and the purchaser of the IP good.[18] It is based on the logic that once an intellectual property owner has parted with the title to a particular copy or piece of product containing the invention or the work, successive possessors of the same should not be put into trouble of having to negotiate with the owner each time they contemplate a further sale or other forms of transfer of it.[19] This warrants the need to differentiate between the intellectual property rights and the general property rights over the physical object upon which the invention or the work is embedded. The tension arises due to the conflict of interests between the intellectual property owner and the purchaser of the physical product. The intellectual property owner claims that the sold physical object carries with it his intellectual creation, and therefore he demands for restriction on further sales of the physical object whereas the purchaser ascertains absolute ownership over it. Thus by putting restriction upon the rights over the intellectual creation, the owner of IP, in effect, restricts the transfer of the property – i.e., the physical object – owned by the purchaser. This is inconsistent with the common law principle of rule against restraint of alienation. The doctrine of exhaustion aims to reconcile this dispute and to bring the rule under

[17] Enrico Bonadio, "Parallel Imports in a Global Market: Should a Generalised International Exhaustion Be The Next Step?", European Intellectual Property Review, [2011], Vol.33(3), pp. 153-161, p.153, available at http://openaccess.city.ac.uk/4106/1/Parallel%20Imports%20in%20a%20Global%20Market.pdf, (accessed on 11/11/2018).

[18] PraneshPrakash, "Exhaustion: Imports, Exports and the Doctrine of First Sale in Indian Copyright Law", NUJS L.Rev. 635, [2012],Vol.5, p.637, available at http://docs.manupatra.in/newsline/articles/Upload/F62718B9-CDC7-4BDF-B224-434529EF9D14.pdf, (accessed on 11/11/2018).

[19] PraneshPrakash, "Exhaustion: Imports, Exports and the Doctrine of First Sale in Indian Copyright Law", NUJS L.Rev. 635, [2012],Vol.5, p.638, available at http://docs.manupatra.in/newsline/articles/Upload/F62718B9-CDC7-4BDF-B224-434529EF9D14.pdf, (accessed on 11/11/2018).

the intellectual property system in line with the common law jurisprudence. Therefore, the researcher believes that the doctrine of exhaustion has its roots in the common law rule against restraint on alienation.

Various other theories have also been proposed for justifying the doctrine of exhaustion. One such theory is the theory of implied license under the contract law has been used to explain the concept of exhaustion of IP.[20] The German jurist Joseph Kohler, has propounded the 'one time reward theory' as a justification for the doctrine of exhaustion.[21] Another branch of law which is being relied upon for justifying the doctrine of exhaustion is the law of servitudes.[22] However, almost all of these theories are based on shaky grounds for the inherent flaws in them. For example, implied license theory, if accepted, will allow the IP holder to impose additional restrictions in the license to avoid application of the concept of exhaustion. Even though the one time reward theory is justified by the incentive theory, it does not have any backing from the common law jurisprudence. Therefore, the analysis proceeds upon the assumption that the concept of exhaustion draws its roots from the common law concept of rule against restraint of alienation. It could be seen that the exhaustion doctrine developed in the USA also has its roots on the common law rule against restraint on alienation.[23]

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[20] English Common Law developed the doctrine of implied license making products protected under the intellectual property rights subject to the same rules as products protected under property rights. As per the theory the purchaser would be entitled to deal with these products as he saw fit unless the seller retained any rights. See; Christopher Heath, "Legal Concepts of Exhaustion and Parallel Imports",in Christopher Heath, *Parallel Imports In Asia,* Max Plank Series on Asian Intellectual Property Law, Vol. 9, Kluwer Law International, Netherlands, (2004), p. 14.

[21] Christopher Heath, "Legal Concepts of Exhaustion and Parallel Imports",in Christopher Heath, *Parallel Imports In Asia,* Max Plank Series on Asian Intellectual Property Law, Vol. 9, Kluwer Law International, Netherlands, (2004), pp.13-15.

[22] This theory bases the principle of exhaustion to be subject to the personal servitude law in real property context. The theory propounds that exhaustion works similar to the post-transfer restrictions in the servitude of real property law. See: Glen O. Robinson, "Personal Property Servitudes",U. Chi. L. Rev. 1449, (2004) , Vol.71, available at http://www.jstor.org/page/info/about/policies/terms.jsp, accessed on 18/11/2018.Also see;Christopher Heath, "Legal Concepts of Exhaustion and Parallel Imports", in Christopher Heath, *Parallel Imports In Asia,* Max Plank Series on Asian Intellectual Property Law, Vol. 9, Kluwer Law International, Netherlands, (2004), pp.13-23; Yonatan Even, "Property, Appropriability and The First Sale Doctrine", Draft—Israel L&E--5/25/07,available at http://portal.idc.ac.il/en/ilea/annualmeeting/documents/making%20sense%20of%20the%20first%20sale%20doctrine.pdf, (accessed on 14/11/2015).

[23] *DMCA Section 104 Report*, A Report of the Register of Copyrights Pursuant to §104 of the Digital Millennium Copyright Act, U.S. Copyright Office, 2001, p.20, available at

1.1.1.1. Rule against restraint on alienation

Rule against restraint on alienation is a concept evolved in the context of landed property. The concept should be understood in a qualified sense because the rule regarding alienation of landed property changed with the changes in the society and with the changes in public policy.[24] The differences in the application of the rule depended on the country and the relevant stage of the society and on the restraints and modifications suggested by the convenience of the society and dictated by the civil institutions.[25] It is now an accepted common law principle that any condition placing absolute restraints on further transfer of land or chattels by a transferor is illegal and void as the purchaser gets absolute ownership on the property on transfer.[26] The development of law has not been in favour of placing restraints and creating new forms of restraints on alienation, both in the case of landed properties and chattels.[27] However, the journey to the present position was indeed a rough one. Though family and ecclesiastical pride had been formidable obstacles to this movement, ultimately it became successful.

In the Anglo-Saxon period, when a body of invaders succeeded in conquering a portion of territory they settled down upon the land, which they have won, and the property belonged to the community and not the head. The land is public land, which was called the folkland.[28] However, from the initial time onwards private property concept was recognized at least in a limited sense with respect to folkland initially given as private property for housing purposes during this

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https://www.copyright.gov/reports/studies/dmca/sec-104-report-vol-1.pdf (accessed on 6/12/2018).

[24] See generally John ChipmanGray, *Restraints on the Alienation of Property,* Boston Book Company, Boston,(2nd edn, I895). Also see; Digby, *History of the Law of Real Property*, Clarendon Press Series, Macmillan and Co, Publishers to the University of Oxford, London, (4th edn, 1875), Sir William Holdsworth *, A History of English Law* (Vol.III)*,* Sweet andMaxwell, London, (2nd edn, 1941).

[25] Carl D. Stephan*,* "Conditions in Restraint of Alienation of Real Property"*,* Historical Thesis and Dissertations Collection, [1894],Paper 373, p.2, available at https://scholarship.law.cornell.edu/cgi/viewcontent.cgi?referer=https://www.google.com/&httpsredir=1&article=1378&context=historical_theses, (accessed on 20/11/218)

[26] See *Hood* v.*Oglander*34 Beav.513*, Re Bourkes Trusts* 27 L.R.I.R.573*, O' Callaghan* v*. Swan,* 13 Vict.L.R. 676*, Attwaterv. Attwater,* 18 Beav.330*.*

[27] John ChipmanGray, *Restraints on the Alienation of Property,* Boston Book Company*,* Boston,(2nd edn. I895), p.2.

[28] Digby, *History of the Law of Real Property*, Clarendon Press Series, Macmillan and Co, Publishers to the University of Oxford, London, (4th edn, 1875), Chapter 1.

period.[29] Still the agricultural land was not given as private property as the reversionary right vested with the community or its chief.[30] The concept of private ownership started evolving with the invasion of neighbouring lands by the Kings who ascertained something similar to ownership on the lands they conquered. Upon the King conquering a land, the land came out of the folkland concept and came under feudal governance. Even under the feudal governance it was considered perfectly in accordance with the public policy of the feudal society to keep restraints on alienation of any land. The feudal policy was to consider it repugnant to the interests of feudal lords to allow absolute freedom over alienation of land even to the family members.[31] The landed property was never meant to be alienated outside the family of the feudal lord for fear of the land going outside family circle. Therefore the feudal notion of ownership was different from the present day concept of ownership. The lands given to the men of high ranks in military services (vassals) for the services rendered to the King were also given with conditions attached to the transfer. The vassals[32] were not allowed to alienate the property without the consent of the Lord. The lands reverted to the Lord if the alienation was made without his consent. Even among the family, transfer of land could take place only with the consent of the chief of the family.[33] The

[29] See; Digby, *History of the Law of Real Property*, Clarendon Press Series, Macmillan and Co, Publishers to the University of Oxford, London, (4th edn,1875), Chapter 1, p.3: "Probably from the date of the earliest settlement some opposition to the idea of folcland must have been found in the proprietary rights over the house and its enclosure. It is reasonable to suppose that the house which the freeman had built, and the curtilage which he had enclosed, was regarded as his own property, apart from any ultimate or reversionary right residing in the community or its chief."

[30] Digby, *History of the Law of Real Property*, Clarendon Press Series, Macmillan and Co, Publishers to the University of Oxford, London, (4th edn, 1875), Chapter 1, p.3.

[31] Carl D. Stephan*,* "Conditions in Restraint of Alienation of Real Property"*,* Historical Thesis and Dissertations Collection, [1894],Paper 373, p.3, available at https://scholarship.law.cornell.edu/cgi/viewcontent.cgi?referer=https://www.google.com/&httpsredir=1&article=1378&context=historical_theses, (accessed on 20/11/218). Also see generally; Sir William Holdsworth*, A History of English Law* (Vol.III)*,* Sweet andMaxwell, London, (2nd edn, 1941).

[32] Vassal, in feudal society, one invested with a fief in return for services to an overlord. Some vassals did not have fiefs and lived at their lord's court as his household knights.Fief, in European feudal society, a vassal's source of income, held from his lord in exchange for services. See for details; Digby, *History of the Law of Real Property*, Clarendon Press Series, Macmillan and Co, Publishers to the University of Oxford, London, (4th edn,1875). Also see; Sir William Holdsworth*, A History of English Law* (Vol.III)*,* Sweet andMaxwell, London, (2nd edn, 1941).

[33] Carl D. Stephan*,* "Conditions in Restraint of Alienation of Real Property"*,* Historical Thesis and Dissertations Collection, [1894],Paper 373, p.3, available at https://scholarship.law.cornell.edu/cgi/viewcontent.cgi?referer=https://www.google.com/&httpsredir=1&article=1378&context=historical_theses, (accessed on 20/11/218). Also see Sir William Blackstone, *Commentaries on the Laws of England in Four Books,* J.B.Lippincott Company*,* Philadelphia, (vol*. 1*, Books I and II, 1893), available at

control exerted by the chief of the family over the land was with a view to prevent the legal heirs from alienating land to persons outside the family. Thus, free alienation of land and chattels was considered against public policy.[34] This creation of interests in the lands of the vassals by the lords later came to be known as the doctrine of feuds and was considered to be in tune with the then existing public policy demands.[35] This could be termed as a creation of undue monopoly and creation of dual ownership since though the land was owned by the feud the ultimate power over it vested with the Lord of the land. Thus the society was status based and alienation of land was also controlled by this status based relations.

There were two main reasons for the control exerted by the landlords over the land. The first reason for the curtailment of free movement of land in the feudal system by restraining its alienation was that the most valuable thing at that point of time was the land and such curtailment was required for the very existence of the feudal system.[36] Another important reason for the control was the concern over the ownership of the land produces.[37] During the feudal periods, as per the doctrine of feuds, soldiers were allowed to cultivate in the lands of the King who acted as lords of the land, as a reward for serving the King in military services causing dual ownership.[38] The land was tied up ultimately to the lord, in spite of the improvements made by the tenant. Lands were cultivated for the benefit of the King who is the Lord and it was to control the produces or to levy royalties that the feudal lords placed restrictions on alienation. Upon acquiring such lands the Kings, began to place conditions upon the people who lived in those lands, if they wanted to use the land for any purpose. They were obliged to enjoy the land under

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http://oll.libertyfund.org/title/2140, (accessed on 1/8/2019).

[34] Sir William Holdsworth*, A History of English Law* (Vol.III)*,* Sweet and Maxwell, London, (2nd edn, 1941), pp. 73-85.

[35] Carl D. Stephan*,* "Conditions in Restraint of Alienation of Real Property"*,* Historical Thesis and Dissertations Collection, [1894],Paper 373, p.3, available at https://scholarship.law.cornell.edu/cgi/viewcontent.cgi?referer=https://www.google.com/&httpsredir=1&article=1378&context=historical_theses, (accessed on 20/11/2018).

[36] Sir William Holdsworth*, A History of English Law* (Vol.III)*,* Sweet and Maxwell, London, (2nd edn,1941), pp. 73-86.

[37] Digby, *History of the Law of Real Property*, Clarendon Press Series, Macmillan and Co, Publishers to the University of Oxford, London, (4th edn,1875), p. 40.

[38] Digby, *History of the Law of Real Property*, Clarendon Press Series, Macmillan and Co, Publishers to the University of Oxford, London, (4th edn, 1875), p.40.Also see: Sir William Blackstone, *Commentaries on the Laws of England in Four Books,* J.B.Lippincott Company, Philadelphia, (vol. 1, Books I and II, 1893), available at http://oll.libertyfund.org/title/2140, (accessed on 1/8/2019).

those strict conditions. These people could never own these lands or any produces or improvements they made to these lands since ultimately they all reverted to the King. In simple terms, whatever be the improvements or additions one does to the land in which one lives, the ownership ultimately rested with the King, incapacitating the vassal from alienating the land.[39] This tying up of land to the lord and the restraint on alienation of it, led to economic stagnancy in the society. The status based relationship of the lord with that of the tenant and the familial ecclesiastical privileges controlled and restricted the free movement of landed property.

The later developments in property law saw a shift in the concept of inalienability of property, which was originally dictated by status, to alienability beyond the family as status no longer controlled property relations. The shift in the nature of the control given over the property and the nature of ownership of property came with the shift in the society from status based to contract based, as commerce became more rampant.[40] The land was used to pay off debts or as security in market exchanges. Land, therefore, slowly began to be treated as a commodity realising the commercial value of the land. For this transformation, the status based control over the land was to be avoided. The concept of property began to change from a status based to that of private ownership, aimed at breaking the chain of status control over the land.[41]

The right of alienation of land was conferred for the first time to the religious and ecclesiastical people who served the King in gratitude to the service, and they were allowed to own and alienate such land given to them by the King as gift.[42] Such land was called bocland,[43] which

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[39] Sir William Blackstone, *Commentaries on the Laws of England in Four Books,* J.B.Lippincott Company, Philadelphia, (vol. 1, Books I and II, 1893), p.329, available at http://oll.libertyfund.org/title/2140, (accessed on 1/8/2019). Also see; Digby, *History of the Law of Real Property*, Clarendon Press Series, Macmillan and Co, Publishers to the University of Oxford, London, (4th edn, 1875), p. 23.

[40] Sir Henry Sumner Maine*, Ancient Law: It's Connection with the Early History of Society and Its Relation to Modern Ideas,* John Murray, London, (1st edn, 1908), p.151, and pp.217-269. Also seeCarl D. Stephan*,* "Conditions in Restraint of Alienation of Real Property"*,* Historical Thesis and Dissertations Collection, (1894),Paper 373, , p.3, available at https://scholarship.law.cornell.edu/cgi/viewcontent.cgi?referer=https://www.google.com/&httpsredir=1&article=1378&context=historical_theses, (accessed on 20/11/2018). Also see: Sir William Holdsworth*, A History of English Law* (Vol.III)*,* Sweet and Maxwell, London, (2nd edn, 1941), pp. 77-79.

[41] Sir Henry Sumner Maine*, Ancient Law: Its Connection with the Early History of Society and Its Relation to Modern Ideas,* John Murray, London, (1st edn, 1908), p.242.

[42] Digby, *History of the Law of Real Property*, Clarendon Press Series, Macmillan and Co, Publishers to the

was free from all burdens and had the right to alienate attached to it.[44] The persons to whom the land was gifted by the King were under no obligation to the grantor of the land and were free from all burdens, except for the duties like military services to the King, to which they were obliged even otherwise.[45] It was also generally expressed in the Charter which granted the land to the boclands holder that the grantee of the land was to be entitled to grant the land away, in his lifetime, to whomsoever he pleased, or to leave it by his last will, and that if not disposed of, it was to descend to his representatives. These powers, however, seem to have depended upon the form of the gift as expressed in the charter; the power of alienation seems to have been restricted in such a way that the land could not be granted away from the kindred; or in other words, the descent of the land was confined to lineal descendants, male or female.[46] Along with the bocland concept arose the alodial land concept, which meant that one is to hold the land free from all burdens.[47] It could be disposed off to anyone whom the grantee pleases.[48] However, the Feudal Lords enjoyed the privilege to place express restrictions on alienation even on the boclands and

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University of Oxford, London, (4th edn, 1875), p.30. Also see; Sir William Holdsworth*, A History of English Law* (Vol.III)*,* Sweet andMaxwell, London, (2nd edn, 1941), pp. 86-88.

[43] Also known as 'bookland'. See Digby, *History of the Law of Real Property*, Clarendon Press Series, Macmillan and Co, Publishers to the University of Oxford, London, (4th edn, 1875), p.13. Also see Sir William Holdsworth*, A History of English Law* (Vol.III)*,* Sweet andMaxwell, London, (2nd edn, 1941), p. 73.

[44] See, Digby, *History of the Law of Real Property*, Clarendon Press Series, Macmillan and Co, Publishers to the University of Oxford, London, (4th edn, 1875), p.13. From very early times it was common to grant away portions of the public land to religious bodies or to individuals, so that the land ceased to be public land and became what we should style corporate or private property. The grants were affected by the king as the chief of the community, by and with the assent of his witan, by means usually of a ' book ' or charter. Land thus granted was said to be 'booked' to the grantee and was called boclands or bookland. Thus bookland as opposed to folkland comes to mean land owned by private persons or churches; who or whose predecessors are, or at least are supposed to have been, grantees of the community.

[45] Digby, *History of the Law of Real Property*, Clarendon Press Series, Macmillan and Co, Publishers to the University of Oxford, London, (4th edn, 1875), p. 14.

[46] Digby, *History of the Law of Real Property*, Clarendon Press Series, Macmillan and Co, Publishers to the University of Oxford, London, (4th edn, 1875), pp.14-15.

[47] The term 'alodial' originally had no necessary reference to the mode in which the ownership of land had been conferred ; it simply meant land held in absolute ownership, not in dependence upon any other body or person in whom the proprietary rights were supposed to reside, or to whom the possessor of the land was bound to render service. See Digby, *History of the Law of Real Property*, Clarendon Press Series, Macmillan and Co, Publishers to the University of Oxford, London, (4th edn, 1875), pp. 13 - 14.

[48] Digby, *History of the Law of Real Property*, Clarendon Press Series, Macmillan and Co, Publishers to the University of Oxford, London, (4th edn, 1875), p.5.

the alodial lands.[49] The terms alodial and boclands is often used interchangeably. However, the recognition of boclands and alodial land could be treated as the first stage in the process of recognition of private ownership.

With the beginning of the private property concept, the policy of automatic reversion of landed property to the lord on attempt for alienation of the property by the tenant started fading away. The main reason for the same was the discomfort felt by the public and the courts regarding the automatic transfer of ownership on the improvements and produces made on the land by the tenants to the landlords and the Kings, who had no role in making such improvements or produces. The philosophy of individual freedom penetrated the society and the people began to rebel against the unfair restrictions on alienability of their lands.[50] Vassals began to abstain from producing in the land or making improvements on them, which, in turn, resulted in the reduction of the commercial value of the land, leading to economic stagnation. The vassals began to realise the commercial value of the land and the importance of ownership in economic terms. This compelled the State to act in response to the discomfort, changing public policy.[51]

The first step to do away with the restraints on the land generally, extending its coverage even to the land owned by general public, was taken during the time of Henry I who initiated subinfeudation.[52] This allowed the vassals to alienate their land. Thus in cities and burrows, land began to be circulated. Later Henry I further relaxed the rule by extending the right of alienation to all purchasers of lands. However, the restriction on the inherited property continued to exist.[53]

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[49] See generally, Digby, *History of the Law of Real Property*, Clarendon Press Series, Macmillan and Co, Publishers to the University of Oxford, London, (4th edn, 1875).

[50] See Sir William Blackstone, *Commentaries on the Laws of England in Four Books,* J.B.Lippincott Company, Philadelphia, (Vol. 1, Books I and II, 1893), pp.149- 349, available at http://oll.libertyfund.org/title/2140, (accessed on 1/8/2019).

[51] Carl D. Stephan, "Conditions in Restraint of Alienation of Real Property", Historical Thesis and Dissertations Collection, [1894],Paper 373, p.3, available at https://scholarship.law.cornell.edu/cgi/viewcontent.cgi?referer=https://www.google.com/&httpsredir=1&article=1378&context=historical_theses, (accessed on 20/11/2018)

[52] Subinfeudation is the practice by which tenants, holding land under the king or other superior lord, carved out new and distinct tenures in their turn by sub-letting or alienating a part of their lands.

[53] Carl D. Stephan, *Conditions in Restraint of Alienation of Real Property*, Historical Thesis and Dissertations Collection, [1894],Paper 373, p.5, available at https://scholarship.law.cornell.edu/cgi/viewcontent.cgi?referer=https://www.google.com/&httpsredir=1&article=1378&context=historical_theses, (accessed on 20/11/2018).

Simultaneously, fee simple estate, which enabled transfer of landed property without any restrictions, was created. The landlords were unhappy about it. This was evident from the enactment of the Magna Carta which was reissued in 1215, which was a compromise achieved in order to pacify the land lords. The Magna Carta enabled the landlords to impose fines on the transfers of lands made without their consent.[54] As response to the practice of fee simple lands, feudal lords began to put conditions of fees if the land was alienated without their consent.[55]. After the same came the Statute of Westm. II,[56] which allowed the land to be used as security for the payment of debts.[57] Thus the land began to be treated as a tradable commodity. Finally, the Statue of Quia Emptores by Edward I, which established the free right of alienation, swept away this practice of fine on lands for alienation without permission.[58] It also did away with the sub-infeudation policy.[59] This triggered the development of the concept of absolute ownership, right to alienation forming part or incidental to it, resulting in the new concept of fee simple.[60] Thus, creation of the freedom of absolute ownership concept over the land put an end to the feudal policy of reversion back and the control of resale of the land. Thus, finally, the practice of

[54] Digby, *History of the Law of Real Property*, Clarendon Press Series, Macmillan and Co, Publishers to the University of Oxford, London, (4th edn, 1875), p.113. Also see; Sir William Holdsworth *, A History of English Law* (Vol.III)*,* Sweet and Maxwell, London, (2nd edn, 1941), pp-77-81,Sir William Blackstone, *Commentaries on the Laws of England in Four Books,* J.B.Lippincott Company*,* Philadelphia, (*vol. 1*, Books I and II, 1893), p.345, available at http://oll.libertyfund.org/title/2140, (accessed on 1/8/2019).

[55] Digby, *History of the Law of Real Property*, Clarendon Press Series, Macmillan and Co, Publishers to the University of Oxford, London, (4th edn,1875), p.113. Also see; Sir William Holdsworth *, A History of English Law* (Vol.III)*,* Sweet and Maxwell, London, (2nd edn,1941), pp-77-81,Sir William Blackstone, *Commentaries on the Laws of England in Four Books,* J.B.Lippincott Company*,* Philadelphia, (*vol. 1*, Books I and II, 1893), p.345, available at http://oll.libertyfund.org/title/2140, (accessed on 1/8/2019).

[56] Digby, *History of the Law of Real Property*, Clarendon Press Series, Macmillan and Co, Publishers to the University of Oxford, London, (4th edn, 1875), pp.162-165.

[57]Sir William Blackstone, *Commentaries on the Laws of England in Four Books,* J.B.Lippincott Company*,* Philadelphia,(*vol. 1*, Books I and II, 1893), pp.324-325, available at http://oll.libertyfund.org/title/2140, (accessed on 1/8/2019).

[58] Digby, *History of the Law of Real Property*, Clarendon Press Series, Macmillan and Co, Publishers to the University of Oxford, London, (4th edn, 1875), pp.162-166. Also see; Sir William Holdsworth *, A History of English Law* (Vol.III)*,* Sweet and Maxwell, London, (2nd edn, 1941).

[59] Sir William Holdsworth *, A History of English Law,* Sweet *and* Maxwell, London, (Vol.III, 2nd edn, 1941), p. 81. Also see; John ChipmanGray, *Restraints on the Alienation of Property,* Boston Book Company*,* Boston*,* (2nd edn, I895).

[60] Tenant in fee-simple (or, as he is frequently styled, tenant in fee) is be that hath lands, tenements, or hereditaments, to hold to him and his heirs forever ; generally, absolutely, and simply; without mentioning *what* heirs, but referring that to his own pleasure, or to the disposition of the law. See; Sir William Holdsworth *, A History of English Law* (Vol.III)*,* Sweet and Maxwell, London, (2nd edn, 1941), p.365.

placing restraints on alienation came to an end with the recognition of land as a property and the recognition of ownership and other rights incidental to it as part of it.

Realising the commercial value of the land and the improvements made on it, people began to use land and land produces for paying off debts.[61] Thus the public policy on land underwent a complete change.[62] Restrictions on enjoyment of land over which one had a rightful possession came to be considered as repugnant to the interest of the purchaser created by the transfer of land. This made land transferrable through will and later through free exchange under different forms of contracts. Thus, right to transfer the land replaced the reversion back policy. The transition from inalienability to alienability of land led to interesting changes in two factors: (i) the commercial value of the property (ii) the notion of ownership of property. The commercial value increased considerably and the notion of ownership attained more clarity. Transferability of land became a most important characteristic of ownership.

The judiciary, while reflecting on this wave of change that took place in the approach of the society and the legal response to it, began to give more emphasis to transferability of land which led to the evolution of the rule against restraint on alienation. In every case of an alleged attempt to put restraints upon alienation, two questions were frequently asked: (1) what restraint was intended to be imposed; (ii) was the intended restraint lawful an in accordance with the notion of ownership over property? The courts began to declare that once an absolute ownership over the land got transferred to a purchaser upon receiving adequate consideration, no restraint, which hampered the interest of absolute ownership, could be placed upon the purchaser.[63] This was commonly called the theory of repugnancy.[64] The theory was based on the principle that right to

[61] Claire Priest, "Creating an American Property Law: Alienability and Its Limits in American History", Harvard Law Review, [2006], Vol.120. p.388, available at https://harvardlawreview.org/wp-content/uploads/pdfs/priest.pdf , (accessed on 18/12/2018).

[62] Carl D. Stephan, "Conditions in Restraint of Alienation of Real Property, Historical Thesis and Dissertations Collection, [1894],Paper 373, p.3, available at https://scholarship.law.cornell.edu/cgi/viewcontent.cgi?referer=https://www.google.com/&httpsredir=1&article=1378&context=historical_theses, (accessed on 20/11/2018).

[63] *Attwater* v.*Attwater* (1853) 18 Beav. 330

[64] *Bonnell* v. *McLaughlin*, I73 Cal. 2I3, I59 Pac. 590 (igi6); *Walton* v. *Warming-ton*, 89 Colo. 355, 2 P.(2d) io88 (1931); *Department of Public Works* v. *Porter*, 327 Ill. 28, I58 N. E. 366 (I927), *McCleary*v. *Ellis*, 54 Iowa 3Ii, 6 N. W. 57I (I880), *Durand* v. *Higgins*, 67 Kan. IIO, 72 Pac. 567 (1903), *Northwest Real Estate Co.* v.*Serio*, I56 Md. 229, I44 Atl. 245 (I929), *Hause*v. *O'Leary*, I36 Minn. I26, i6i N. W. 392 (I9I7), *Kessner*v. *Phillips*, I89 Mo. 5I5, 88 S. W. 66

alienation, being incidental to the absolute ownership, could not be restricted as it clashed with the right to the full enjoyment of the ownership over the transferred property.[65] Thus, ownership began to presuppose right to alienation. The notion of absolute ownership began to ensure guarantee full enjoyment of the property owned.[66] This was also based on the notion of public policy, as it would not be in the public interest to allow restricted transfers of the land.[67]

The court began to assert that one could not make an absolute gift or other dispositions, particularly an estate in simple fee and at the same time impose restrictions and limitations upon its use and enjoyment in the same transaction in such a way as to defeat the objective of the gift itself and that right to transfer is incidental to the ownership.[68] Any restraints which completely took away the right to alienate (disabling restraints) were declared void by the courts.[69] A restraint on alienation began to be treated as complete and perfect once it became reasonably certain that no person, after understanding the restraint placed, would buy the property.[70] The court held that one could not restrict the right to alienate, in a contract for transfer of ownership, as it was incidental to the concept of ownership and one could not restrict through a contract what law has provided.[71] Even when partial restraints were recognised by the courts, those partial

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(1905); *Loosing* v.*Loosing*, 85 Neb. 66, I22 N. W. 707 (i9o9), *Battin*v.*Battin*, 94 N. J. Eq. 497, I20 Atl. 5I9 (I922), *Grems*v. *Parsons*, I49 N. Y. Supp. 577 (Sup. Ct. I9I4), *Combs* v. *Paul*, I9I N. C. 789, I33 S. E. 93 (I926), *Anderson* v. *Cary*, 36 Ohio St. 5o6 (i88i), *Palma-teer*v. *Reid*, I2I Ore. I79, 254 Pac. 359 (I927), *Pattin*v. *Scott*, 270 Pa. 49, II2 Atl. 9II (I92I), *Gaffe* v.*Karanyianopoulos*, 53 R. I. 3I3,i66 Atl. 547 (I933), *Sandford*v.*Sandford*, io6 S. C. 304, 9I S. E. 294 (I9I7), *Tschern*ev. *Crane-Johnson Co*., 56 S. D. IOI, 227 N. W. 479 (I929), *Gladstone Mt. Mining Co.* v.*Tweedell*, I32 Wash. 44I, 232 Pac. 306 (I925); *Zillmer* v.*Landguth*, 94 Wis. 607, 69 N. W. 568 (I896).

[65] *In re Estate of Schilling*, I02 Mich. 612, 6I7, 6i N. W. 62, 63 (I894), *Camp* v. *Cleary*, 76 Va. I40, I43 (I882), *In re McNaul's Estate*, [1902] i Ir. R. II4.

[66] Richard E. Manning, "The Development of Restraints on Alienation Since Gray", Harvard Law Review, [1935], Vol. 48, No. 3, pp. 373-406.

[67] *Title Guar. & Trust Co.* v.*Garrott*, 42 Cal. App. 152, 183 Pac. 470 (I9I9), *Wright* v. *Hill*, 140 Ga. 554, 79 S. E. 546 (1913), *Davis* v. *Hutchinson*, 282 Ill. 523, ii8 N. E. 72I (I9I8), *Chappell* v. *Frick Co*., i66 Ky. 3II, I79 S. W. 203 (I9I5); *Gischell*v.*Ballman*, I3I Md. 260, IOI Atl. 698 (I9I7), *Morse* v. *Blood*, 68 Minn. 442, 7I N. W. 682 (I897), *Minor* v. *Shipley*, 2I Ohio App. 236, I52 N. E. 768 (I923), *Friswold* v. *United States Nat. Bank*, I22 Ore. 246, 257 Pac. 8i8 (I927), *Kerns* v. *Carr*, 82 W. Va. 78,95 S. E. 6o6 (I9I8).

[68] *Potter* v.*Couch*(1891),141 U.S. 296.

[69] *Hood* v.*Oglander* 34 Beav. 513. Also see Sir William Holdsworth*, A History of English Law* (Vol.III)*,* Sweet and Maxwell, London, (2nd edn, 1941), p. 85.

[70] *Smith* v. *Harrington,* 14 Allen*,* 566 (Mass. 1862).

[71] ". . one of the essential features of an estate in fee is the right to convey, and when a testator attempts to attach a restriction on such right to convey such restraint is void as repugnant to the nature of the estate." See *In re Estate of Schilling*, I02 Mich. 612, 6I7, 6i N. W. 62, 63 (I894). Also see; *Camp* v. *Cleary*, 76 Va. I40, I43 (I882), In

restraints that took away the right of alienation completely were considered complete restraints and were held to be void. A complete restraint was considered to keep the land away from commercial transactions and circulations[72] as this ultimately led to tying up of property in perpetuity, leading to economic stagnation.[73] The situation was considered graver when it came to chattels as it practically hampered trade when restrictions were placed on alienation of chattels by the producers in order to increase their monopoly. This led to trade restraints and anti-trust issues. Thus, the courts began to realise the extent of trade restrictions that restraints on alienation were causing. This was the reason behind the evolution of the rule against restraint on alienation. Thus, it becomes clear that with the evolution of the concept of ownership the rule against the restraint also got evolved to resist the creation of monopoly by the feudal lords.

To summarise the reasons and rationale for the Rule against restraint on alienation, one may take a look into the guidelines provided by the courts. From the analysis done above, five main reasons had been identified by courts for justifying the rule against restraint on alienation. They were:

(a) Theory of repugnancy – the theory of repugnancy even though developed as a theory through courts, the historical evolution of rule against restraint on alienation analysed above too has been having its base in the theory of repugnancy. The principle establishing that any restriction on alienation which hampered the full enjoyment of the property was repugnant to the concept of ownership, and hence null and void.[74] The historical accounts

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Cowell v. Springs Co., Ioo U. S. 55, 57 (I879): " Repugnant conditions are those which tend to the utter subversion of the estate, such as prohibit entirely the alienation or use of the property. Conditions which prohibit its alienation to particular persons or for a limited period, or its subjection to particular uses, are not subversive of the estate. ...".

[72] See *Morse* v. *Blood*, 68 Minn. 422, 443, 7I N. W. 682 (1897). "When the restraint unreasonably impedes the economic development of the community by taking the property out of commerce an unreasonable length of time, and thus un-reasonably injures the public welfare, it becomes an unreasonable restraint on alienation in consequence of the social loss it causes. . . ." in *Colonial Trust Co. v. Brown*, IO0 Conn. 26I, 295, I35 Atl. 555, 567 (I926). Also see; *Chappell* v. *Frick Co*., i66 Ky. 3II, 315, I79 S. W. 203, 204 (19I). Also see Sir Henry Sumner Maine*, Ancient Law: Its Connection with the Early History of Society and Its Relation to Modern Ideas,* John Murray, London, (1st edn, 1908). Richard E. Manning, "The Development of Restraints on Alienation Since Gray", Harvard Law Review, [1935], Vol. 48, No. 3, pp. 373-406.

[73] Richard E. Manning, "The Development of Restraints on Alienation Since Gray", Harvard Law Review, [1935], Vol. 48, No. 3, pp. 373-406.

[74] *Bonnell* v. *McLaughlin*, I73 Cal. 2I3, I59 Pac. 590 (igi6); *Walton* v. *Warming-ton*, 89 Colo. 355, 2 P.(2d) io88

also threw light into the fact that with evolution of the concept of ownership restraints on alienation were felt as repugnant to the interests of the owner even by the vassals and the rulers.

(b) Restraint on trade and against general public policy – The tying up of property keeps the land away from commerce leading to freezing of capital and trade deficit. The effect of the same is more seen in the case of chattels. This hampers the public interest as competition is suppressed.[75]

(c) Social Utility – Right to alienate grants individual freedom and social utility. It avoids creation of double monopoly by creating just a single absolute owner.

(d) Puts restraints on transfer of property – Restraint makes exchange of goods impossible.

(e) Helps monopolization – Restraints also result in unnatural increase in market value, again due to monopoly.

These rationales were later on extended by the courts to intellectual property goods as well, with a view to prevent restraint on resale of intellectual property goods.

1.2. Evolution of the doctrine of exhaustion

The earliest case laws regarding exhaustion attempted at resolving the issues relating to post sale restrictions placed on the IP goods by the owners of IP in favour of the purchasers' interests. The effort of the court was to protect public interest by protecting the interests of the purchasers or users who, according to courts, were the primary or even the ultimate beneficiaries of the

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(1931); *Department of Public Works* v. *Porter*, 327 Ill. 28, I58 N. E. 366 (I927), *McCleary*v. *Ellis*, 54 Iowa 3Ii, 6 N. W. 57I (I880), *Durand* v. *Higgins*, 67 Kan. IIO, 72 Pac. 567 (1903), *Northwest Real Estate Co.* v.*Serio*, I56 Md. 229, I44 Atl. 245 (I929), *Hause* v. *O'Leary*, I36 Minn. I26, i6i N. W. 392 (I9I7), *Kessner v. Phillips*, I89 Mo. 5I5, 88 S. W. 66 (1905); *Loosing* v.*Loosing*, 85 Neb. 66, I22 N. W. 707 (i9o9), *Battin* v.*Battin*, 94 N. J. Eq. 497, I20 Atl. 5I9 (I922), *Grems* v. *Parsons*, I49 N. Y. Supp. 577 (Sup. Ct. I9I4), *Combs v. Paul*, I9I N. C. 789, I33 S. E. 93 (I926), *Anderson* v. *Cary*, 36 Ohio St. 5o6 (i88i), *Palma-teer*v. *Reid*, I2I Ore. I79, 254 Pac. 359 (I927), *Pattin*v. *Scott*, 270 Pa. 49, II2 Atl. 9II (I92I), *Gaffe* v.*Karanyianopoulos*, 53 R. I. 3I3,i66 Atl. 547 (I933), *Sandford* v.*Sandford*, io6 S. C. 304, 9I S. E. 294 (I9I7), *Tschern*ev. *Crane-Johnson Co*., 56 S. D. IOI, 227 N. W. 479 (I929), *Gladstone Mt. Mining Co.* v.*Tweedell*, I32 Wash. 44I, 232 Pac. 306 (I925); *Zillmer* v. *Landguth*, 94 Wis. 607, 69 N. W. 568 (I896).

[75] *Morse* v. *Blood*, 68 Minn. 422, 443, 7I N. W. 682 (1897), *Trust Co.* v. *Brown*, IO0 Conn. 26I, 295, I35 Atl. 555, 567 (I926), *Chappell* v. *Frick Co*., i66 Ky. 3II, 315, I79 S. W. 203, 204 (19I). Also see; Sir Henry Sumner Maine*, Ancient Law: It's Connection with the Early History of Society and Its Relation to Modern Ideas,* John Murray, London, (1st edn, 1908).

intellectual property system.[76] The effort, thus, was to limit the monopoly granted to the IP owners, an analogous situation to that of the landed property and chattels. They were the same problems enumerated above, in the context of the rule against restraint on alienation of landed property and chattels. The IP owners placed restrictions upon the use and transfer of the sold article in the guise of protection of intellectual property rights.[77] The court also came down heavily upon the practice of placing geographical restrictions regarding the sale and use of products by the owners of IP.[78] The courts achieved this by separating intellectual property from the property in the IP product.

It is very interesting to note that the courts, while evolving the jurisprudence of exhaustion, has never used the word exhaustion during these days. In one of the earliest cases pertaining to development of exhaustion, *Wilson* v. *Rousou*[79], the court tried to explore the nature of property rights asserted by the IP owner. The court differentiated the rights granted to the owner of IP from the right of the purchaser of an IP product. For example, the right to vend, the right to make and the right to use are covered under the patent protection of an invention.[80] However, the right to use the product conferred to the patent holder, as construed by the court, must not deprive the user the simple right to use the machine for daily uses. Therefore when the patented product is sold, the purchaser has the sole right to unrestricted use of the product and it cannot be curtailed. The reasoning was that if otherwise construed, it would put the purchaser in to trouble.[81] The

[76] *Wilson* v. *Rousseau 45 U.S. 646.*

[77] *Wilson* v. *Rousseau 45 U.S. 646.*

[78] *Adams* v. *Burke 84 U.S. 453 (1873).*

[79] In the present case the issue related to whether the benefit of the extension of patent extended to the original patentee or the assignees of the patent. The issue also related to whether the seller is prohibited from using the product upon further extension s the original patent period has expired.

[80] *Wilson* v.*Rosou*, 45 U. S. 683: "*The patented machine is frequently used as equivalent for the "thing patented," as well as for the invention or discovery, and no doubt, when found in connection with the exclusive right to make and vend, always means the* right of property in the invention, the monopoly. But when in connection with the simple right to use, the exclusive right to make and vend being in another, the right to use the thing patented necessarily results in a right to use the machine and nothing more."

[81] In Wilson v. Rosou, 45 U. S. 684: "*Obviously to guard against the injustice which might otherwise occur to a person who had gone to the expense of procuring the patented article, or changed his business upon the faith of using or dealing with it after the monopoly had expired, which would be arrested by the operation of the new grant. To avoid this consequence, it is provided that the extension must take place before the expiration of the patent if at all. Now it would be somewhat remarkable if Congress should have been thus careful of a class of persons who had merely gone to the expense of providing themselves with the patented article for use or as a*

court, however, did not analyse whether the purchaser could resell the product probably because it was not an issue raised in the case. However, the opinion of the court that the statutory rights of the patent holder are different from the ownership rights of the purchaser signifies that the patent holder does not have any right over the sold product.[82]

Even though in the above case there is no express mention regarding resale, it laid the foundation of the trend to separate ownership in private property, which the consumer purchased from that of the intellectual property of the IP owner. The next case that followed, *Bloomer v. Mcqueen*,[83] attempted to properly ascertain the grounds for exhaustion.[84] The court, while deciding whether it constituted infringement to use the machine after the expiration of the original patent period, distinguished between an assignee and an ordinary purchaser of a patent machine. It found that the franchise holder or the assignee of a patent stands in a different footing from that of the ordinary purchaser who has purchased the good for using it in the ordinary pursuits of life. The franchise holder who acquired his rights from the patent holder gets a portion of the patent rights granted by the statute i.e. he acquires the statutory rights to make, use and sell the product which will be terminated when the statutory right of the patentee ends. While the normal purchaser does not purchase any statutory rights and only purchases the product, he does not gather any statutory monopoly rights from the patentee. In using the product, he exercises no rights created by the

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matter of trade, after the monopoly had ceased, and would be disappointed and exposed to loss if it was again renewed, and at the same time had overlooked the class who in addition to this expense and change of business had bought the right from the patentee, and were in the use and enjoyment of the machine, or whatever it might be, at the time of the renewal. These provisions are in juxtaposition, and we think are but parts of the same policy, looking to the protection of individual citizens from any special wrong and injustice on account of the operation of the new grant."

[82] The court has however tried to protect the interest of the inventor and went on to say that after the extension of the patent term, the inventor receives the right to use, make and vend the further products encompassing invention excepting the previous purchasers who bought for using it in the ordinary business life.

[83] 55 U.S. 539 (1852).

[84] The appeal was filed by Bloomer who was an assignee of the administrator of the original patent holder to whom the right to construct and use and to vend to others the right to construct and use was given during the extended period of the patent. Mcquewan claimed through a license granted during the original term of the patent the right to construct and use the patent machine. McQuewan acquired this right from one Barnet who had received the right from the Collin and smith who did not have the right to construct and use themselves and could only license to Barnet. The defendants purchased right use the machine from the Barnet along with the right to construct and use certain number of machines. The defendants continued to use the machine even during the extended patent period. The plaintiffs challenged that the defendants did not have the right to use the machine during the extended period of patent since they had acquired right only to use it during the original patent period.

intellectual property law, nor does he derive title to it by virtue of the franchise or exclusive privilege granted to the patentee. The Court held:

> *"*The inventor might lawfully sell it to him, whether he had a patent or not, if no other patentee stood in his way. And when the machine passes to the hands of the purchaser, it is no longer within the limits of the monopoly. It passes outside of it, and is no longer under the protection of the act of Congress*"*.[85]

The court found that the property so sold by the patentee became the private individual property of the purchaser. Thus, it clearly differentiated between the intellectual property rights of the IP holder and property rights of the lawful purchaser of the IP product. Court held that if the rights of the IP holder were so construed that it could deprive a legitimate purchaser who purchased the IP product from using it as he wishes, it would be an inappropriate interpretation of the law. The implication of this language of the court is that using intellectual property rights one cannot restrict the ownership of a legitimate purchaser.[86] It is in fact a reflection or reiteration of theory of repugnancy evolved by the common law courts, according to which, no interest shall be created by private persons contravening the rights guaranteed by law as it is repugnant to the very concepts of property and ownership. It is also against the public policy.

In *Adams v. Burke,*[87] the issue was whether the use of a coffin lid outside a definite territory violated the patent right of the patentee.[88] The court explained the rationale behind the findings of courts in different cases wherein the courts have held that the right to use by the purchaser

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[85] *Bloomer* v. *McQuewan,* 55 U.S. 549 (549).

[86] Similar decision was followed in *Mitchell* v. *Hawley* 83 U.S. (16 Wall.) 544.The court however found the case against the respondents since the intermediate licensee, had only the right to construct and use only during the time of patent period and he could not transfer a better title than what he possessed and thus the respondents obtained only the right to use and construct during the original period of patent.

[87] 84 U.S. 453 (1873).

[88] Letters patent were granted to Merrill & Horner for a certain improvement in coffin lids, giving to them the exclusive right of making, using, and vending to others to be used, the said improvement .Merrill& Horner, the patentees, by an assignment duly executed and recorded, assigned to Lockhart & Seelye, of Cambridge, in Middlesex County, Massachusetts, all the right, title, and interest which the said patentees had in the invention described in the said letters patent, for, to, and in a circle whose radius is ten miles, having the city of Boston as a centre. They subsequently assigned the patent, or what right they retained in it, to one Adams. Burke was an undertaker who had purchased the said coffins from the Adams and used it outside the limits assigned for Adams to use. Hence Adams filed a suit against Burke for patent infringement.

does not get extinguished upon the expiry of patent. The rationale, as the court has opined, was that "the sale by a person who has the full right to make, sell, and use such a machine carries with it the right to the use of that machine to the full extent to which it can be used in point of time."[89] Therefore the court examined the meaning and extent of the word "use to the fullest extent". The court opined that in the case of products such as coffin the sole value of the product lies in the use of it and therefore once the patent owner has sold the same to a lawful purchaser and received the value of the same, the patentee cannot restrict the use of the product and the purchaser can use it as he wishes.[90] In this specific case the purchaser could use the coffin only by selling it to others and use and sale in the instant case mergers. Therefore the use extends to sale too. Therefore the territorial limitation in the contract for sale and use of the coffin was held void. Thus, the courts categorically stated that the sale by the authorised person, after receiving the money for the same, transfers the right to use the sold object to the fullest extent possible which includes resale. The court thus has recognised the absolute ownership of the purchaser along with the incentive theory.

The position in the case *Adams v. Burke* was further clarified in *Keeler v. Standard Folding-Bed Co.*[91] The court in this case recognised the right of the purchaser of an article from the patentee to dispose of the same as he wishes.[92] The court stated as below:

> "Where the patentee has not parted, by assignment, with any of his original rights, but chooses himself to make and vend a patented article of manufacture, it is obvious that a purchaser can use the article in any part of the United States, and, unless restrained by contract with the patentee, can sell or dispose of the same. It

[89] 84 U.S. 455 (1873).

[90] "*That is to say the patentee or his assignee having in the act of sale received all the royalty or consideration which he claims for the use of his invention in that particular machine or instrument, it is open to the use of the purchaser without further restriction on account of the monopoly of the patentees*." *Adams* v. *Burke* 84 U.S. 453, 456.

[91] 157 U.S. 659 (1895)

[92] In this case the complainants were the Standard Folding – Bed Co who were the assignees of the patentee of a improvement in the wardrobe bed steads, for the area of Massachusetts. The company of the patentee holds the patent rights for the area of Michigan. The defendant that is Keeler purchased a car load of beds from Michigan and sold at Massachusetts and also in Boston which is the principal place of business of the defendants.

has passed outside of the monopoly, and is no longer under the peculiar protection granted to patented rights.*"*[93]

The court first enquired whether a purchaser who has bought a product from the patentee under a contract to the effect that it could be used and sold only within a particular area, has the right to use and vend the same in any part of the country. The court was addressing the issue of territorial division or geographical discrimination strategy used by the patentee. It also examined whether a purchaser of an article from an assignee of patentee in a territory should pay to the local assignee for the privilege of using and selling his property. In order to address these questions the court relied on all the cases stated above, especially *Adams v. Burke*. It finally came to the conclusion that these cases were authorities for the position that the purchaser of a patented product had absolute right to use the product until the product gets worn out. The court also relied on the case of *Bloomer v. Mcqueen*as an authority for the proposition that the purchaser of a patented machine has not only the right to continue the use of the machine as long as it exists, but also has the right to sell such machine[94]. The court also relied on *Adams v. Burke*[95] for concluding that in certain instances the use and sale of a patented product gets merged and the right to use accompanies the right to sell[96]. The court finally opined that, "when the royalty had once been paid to a party entitled to receive it, the patented article then becomes the absolute, unrestricted property of the purchaser, with the right to sell it as an essential incident of such ownership*"*.[97] The court concluded by saying those cases clearly indicated that one who bought patented articles of manufacture from an authorized seller got an absolute property right in such articles, unrestricted both in time and place.[98]

Turning to the copyright cases, the one which stands out among them is *Bobbs-Merrill Co. v. Strauss*[99]. The court in this case addressed the extent of the right to vend guaranteed by the

[93] 157 U.S. 659 (1895) at 662.
[94] Ibid at 662.
[95] 84 U.S. 453 (1873).
[96] 157 U.S. 659 (1895) at 664.
[97] 157 U.S. 659 (1895) at 667.
[98] 157 U.S. 659 (1895).
[99] 210 U.S. 339 (1908).

copyright law.[100] The court opined that the purchaser of the product from an authorised seller may sell it gain.[101] The court examined the meaning of the phrase 'the sole right of vending the same' in the statute to see if it conferred on the copyright owner the right to restrict further alienation. It stated:

> "What does the statute mean in granting 'the sole right of vending the same'? Was it intended to create a right which would permit the holder of the copyright to fasten, by notice in a book or upon one of the articles mentioned within the statute, a restriction upon the subsequent alienation of the subject-matter of copyright after the owner had parted with the title to one who had acquired full dominion over it and had given a satisfactory price for it? It is not denied that one who has sold a copyrighted article, without restriction, has parted with all right to control the sale of it. The purchaser of a book, once sold by authority of the owner of the copyright, may sell it again, although he could not publish a new edition of it."[102]

The court was of the opinion that the right to make copies was the main right guaranteed under the copyright statute and vending right was to facilitate the same and does not allow creating a right to prevent alienation by attaching a notice to the copyrighted work.[103] The copyright owners had argued that the rights created by the statute were their absolute ownership and therefore they could decide up to which length they need to part their rights and also could reserve certain rights to themselves when they a sell a product. The court, in order to nullify this argument, analysed the nature of copyright and the rights guaranteed under the same. Quoting another case for the same court it opined:

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[100] Bobbs Merrill was the copyright owner of a book named castaway. They have attached a notice in the book stating that the price of the book and that no dealer should sell the book below that price. The defendants purchased the book from an a wholesale dealer and sold it below the prescribed price. Plaintiffs sued for copyright infringement.

[101] "It is not denied that one who has sold a copyrighted article, without restriction, has parted with all right to control the sale of it. The purchaser of a book, once sold by authority of the owner of the copyright, may sell it again, although he could not publish a new edition of it." See *Bobbs Merrill* v. *Strauss,* 210 U.S. 339 (1908).

[102] 210 U.S. 339 (1908) at 350.

[103] "The copyright statutes, while protecting the owner of the copyright in his right to multiply and sell his production, do not create the right to impose, by notice, such as is disclosed in this case, a limitation at which the book shall be sold at retail by future purchasers".

> "The copyright is an exclusive right to the multiplication of the copies, for the benefit of the author or his assigns, disconnected from the plate, or any other physical existence. It is an incorporeal right to print and publish."[104]

This was a clear attempt to delineate between intellectual property and intellectual property containing material. The court, therefore, concluded that the copyright owner could not restrict the purchasers of a copyrighted material by fastening a notice to it as such a right is not granted under the statute. And also in the instant case the defendant purchased the book from wholesale dealers who did not undertake to sell the book at the stipulated price in the notice even though they were aware of the notice and hence all the more not liable.[105]

From the above analysis it is clear that the concept of exhaustion developed mainly as a response to the undesirable extension of the monopoly rights by the intellectual property owner to the IP product. The courts' aim was to restrict the owner of the intellectual creations from restraining a legitimate purchaser of a property from enjoying his property who has a legitimate expectation of enjoying the same. The courts therefore have taken refuge under the general property laws having roots in the common law to do the same. The effort of the judiciary to split the intangible element and the tangible element in a product containing intellectual property and to apply the principles of ownership and alienation right sheds light in this direction. It is in effect the theory of repugnancy evolved by the common law courts, which rests on the principle of enjoyment of property possessed under a title, which is indirectly hinted by the courts. The language used by the courts to say that the product goes out of the monopoly power of the IP holder and thus, cannot be further controlled, hints two things. The first implication is that the upon a legal sale , the sold property gets subjected to the normal property rules and the second implication being that private persons or the IP holders cannot go beyond any rights what law has conferred. Thus it is clear that it is the rule against restraint of alienation which has been adopted by the courts to substantiate exhaustion principles.

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[104] *Stephens* v. *Cady, 14 How.528, 55 U. S. 530.*

[105] "In our view, the copyright statutes, while protecting the owner of the copyright in his right to multiply and sell his production, do not create the right to impose, by notice, such as is disclosed in this case, a limitation at which the book shall be sold at retail by future purchasers, with whom there is no privity of contract." See; *Bobbs Merrill* v. *Strauss,* 210 U.S. 339 (1908).

1.3. Philosophy of Exhaustion

It is sometimes stated that 'property' refers to both the bundle of rights and to the objects over which rights are exercised.[106] Ownership by itself is a right, and is commonly understood as the phenomenon through which rights and duties between the owner and the general public, in relation to the property, are established. From this initial concept, property has branched out to various levels and one of the most controversial of all was the emergence of the intellectual property is a public good and therefore, non-rivalrous and non excludable by nature. Not many jurists of the traditional schools of jurisprudence have analysed this special branch of property law. Unlike the tangible property context the ownership over the intellectual products are rendered not to exclude from others the fruits of the outcome of the property but to facilitate access to the same. Ownership in a sense being monopoly need to be checked so that welfare of the large population should not be compromised and one of the mechanisms ensuring this public responsibility is the exhaustion doctrine. As seen in the earlier section, the evolution of ownership concept and alienation of property is closely attached to the object owned by a person. Therefore, it is imperative to understand the nature of property and ownership and the alienation as a right at a philosophical level.

Two major theories relied upon for justifying intellectual property are the personality theory of Georg Frederich Hegel and the theory of Immanuel Kant. Therefore an attempt is made here to seek the help of their philosophy to justify the doctrine of exhaustion by establishing that resale of IP protected product by the buyer does not violate the rights of the IP owner. This conclusion is drawn from the philosophy on property of both the above mentioned philosophers in general and their treatment of the intellectual property system in particular. This discussion is divided into three parts. The first part deals with the Kantian philosophy of property, intellectual property and his observations on limiting the rights of the IP owner. The second part approaches the same issues in similar lines in the context of Hegelian philosophy. Both Kant and Hegel have interestingly dealt with the property concept both in the tangible and intangible context. Both of them have strived hard to demarcate the intangible rights and tangible rights residing within an

[106] Geoffrey M. Hodgson, "Editorial introduction to 'Ownership' by A. M. Honor´e", Journal of Institutional Economics , [1961] , Vol. 9, Issue 02 , pp. 223-255, p. 224, available at https://doi.org/10.1017/S174413741200032X, (accessed on 25/11/2016).

intellectual property goods. And the last section deals with the analysis of case laws which are considered to be the cradle of the exhaustion doctrine to find out whether the ratio of these decisions falls within the framework of the personality theory, basically of that of the Hegel, his being the strongest.

1.3.1. Kantian Theory of Property

Kant's property concept is basically grounded upon possession, free will and acquisition of property. Kant is of the opinion that a property can be acquired by any person by first taking possession of it, then subsequently exercising his free will upon it and later bringing it under his control.[107] One can see that excess importance is being attributed by Kant to the process of bringing the object under the control of a person in order to establish his true ownership. It is only by taking full control that one gets full ownership.[108] And a person is linked through his rights to the property/object he owns. Kant is of the view that "private property arises from the concept of right which is the sum of conditions under which the choice of one can be united with the choice of another in accordance with a universal law of freedom".[109] In other words, in the property context the rights of many persons need to coexist in harmony.

This phenomenon of unification of rights observed by Kant takes place in trade or exchange of objects. So when a purchaser buys an intellectual product, the right over the "tangible product" transfers to him while the intangible property may not move completely. It amplifies the factor that rights determine the relation of a seller and a purchaser of a property. As per Kant, an external object is one's private property if the use of the same by others wrongs him. An object of a person's choice is that which he has the physical capacity to use and have absolute power over use. This is the situation even in the vending of the IP product. The buyer brings under his control the good he has purchased completely making it his property. This means that the IP owner loses control over the tangible good sold to another as he does not have the control over the tangible product. This view is supported by Kant himself as he clearly differentiates the

[107]Immanuel Kant, *Metaphysics of morals*, trans. Mary Gregor, Cambridge University Press, Cambridge, (1st edn, 1991),pp.80-81.

[108] Immanuel Kant, *Metaphysics of morals*, trans. Mary Gregor, Cambridge University Press, Cambridge, (1st edn, 1991),pp. 88-89.

[109] Immanuel Kant*, Metaphysics of morals*, trans. Mary Gregor ,Cambridge University Press, Cambridge, (1st edn, 1991), p. 56.

intangible and tangible nature in an intellectual creation, which will be dealt in detail in the next part. An action is right, if right, which is one's freedom, co-exists with freedom of others. Otherwise freedom would be depriving himself of the use of its choice with regard to an object of choice by putting usable objects beyond any possibility of being used.[110] This observation by Kant is important in the discussion of the exhaustion since the control over resale exercised by the owner of intellectual property cannot coexist with the freedom of enjoyment of individual property as the freedom enjoyed by every purchaser for resale or alienation of the purchased property is an incident of ownership and any restriction over it is prohibited under the Kantian system of property rights; and the resale restriction will also result in making the property stagnant in one's hand depriving the further resale which might be the choice of use of the purchaser, an prohibited act under Kantian system. [111]As per Hegel, property right is not merely a right over a thing, but a sum of all the principles having to do with things being mine or yours[112], which are the incidents of ownership including resale. As per Kant, if property right co-exists with the right of others, whoever hinders the owner does him wrong. The ownership rights conferred on the purchaser of the IP product does not conflict with any of the IP owner's rights as the purchaser does not exercise the monopoly rights conferred by IP protection. Therefore any attempt by the IP owner to place restrictions on the rights of enjoyment of the IP product by its purchaser is unlawful.

1.3.1.1. Kant on intellectual property and exhaustion

Kant talks about IP in the sense of intelligible possession,[113] i.e., possession without actually holding something. Kant argues that whoever wants to assert that he owns a thing must be in possession that object since otherwise he would not be wronged when another uses it without his consent. Right itself means intelligible possession as per Kant. Kant also says that it is not appropriate to speak of possessing a right to intelligible possession of an object but rather of

[110] Immanuel Kant, *Metaphysics of morals*, trans. Mary Gregor , Cambridge University Press, Cambridge, (1st edn, 1991), p.69.

[111] Immanuel Kant, *Metaphysics of morals*, trans. Mary Gregor , Cambridge University Press, Cambridge, (1st edn, 1991), p.69.

[112] Immanuel Kant, *Metaphysics of morals*, trans. Mary Gregor , Cambridge University Press, Cambridge, (1st edn, 1991), p.82.

[113] Immanuel Kant, *Metaphysics of morals*, trans. Mary Gregor , Cambridge University Press, Cambridge, (1st edn, 1991), p.76, p.88.

possessing it merely rightfully, for a right is already an intellectual possession of an object and it would make no sense to speak of possessing a possession.[114] Extending this observation by Kant to products of creativity guarantees that the intellectual property owner exercises merely an intelligible possession of the IP product even at the creation of the intellectual propertyand upon sale of the product the purchaser brings under control the product and thus ends the possession of the IP owner and he cannot further possess any rights**.**

Kant further attempts to justify the reproduction right of the author in his work. He opines that book is not the immediate sign of a concept; rather it is a discourse to the public.[115] Kant is of the opinion that even though one may feel, prima facie, that unauthorized publishing, i.e., reproduction of a work as unjust, it can be justified since the book itself is a corporeal thing, whose legitimate possession entitles a person to make copies of it as part of ownership over the same.[116] This, Kant says, is due to the fact that what an author possesses is the right over the intellectual thought and appropriation of the tangible property or copy of the book does not affect the intellectual property of the author and therefore cannot control the right of the purchaser from reproducing the copy he legitimately possess, let alone resale, through reservation.[117] Thus he tries to differentiate between the tangible and intangible nature of a product created out of intellect. This is clearly an attempt by Kant to demonstrate that the property possessed by the IP owner should be limited so as not to restrict the legitimate enjoyment of the purchaser. But the same limitation of the author is negated by Kant stating his definition of literary work as a discourse to the public which the author alone can perform. The publisher merely speaks through publishing to the public in the name of the author and on behalf of him. Kant opines that since publication is an act a publisher can do only in the name of the author with his consent as it's his prerogative to communicate to the public, purchaser cannot exercise the same. As per Kant only

[114] Immanuel Kant, *Metaphysics of morals*, trans. Mary Gregor , Cambridge University Press, Cambridge, (1st edn, 1991), p.71.

[115] Immanuel Kant, *Metaphysics of morals*, trans. Mary Gregor, Cambridge University Press, Cambridge, (1st edn, 1991), p.106.

[116] Immanuel Kant, *Metaphysics of morals*, trans. Mary Gregor, Cambridge University Press, Cambridge, (1st edn, 1991), p.107.

[117] Immanuel Kant, *Metaphysics of morals*, trans. Mary Gregor, Cambridge University Press, Cambridge, (1st edn, 1991), p.107.

those acts which one can do in his own constitutes a legitimate act.[118] Further Kant restricts only the reproduction of the copy while he approves other acts of incidental to the ownership and Kant says:

> "… it does not matter to whom the copy of the speech belongs, whether it is in the author's handwriting or the print, to make use of it for oneself or to carry on trade with it is still an affair that every owner of it can carry on his own, name and at his discretion. However, to let someone speak publicly, to bring his speech as such to the public … is undoubtedly an affair that someone can execute only in another's name".[119]

Thus from the above statement Kant establishes that resale of a product of IP by the purchaser is lawful thus exhaustion is established. He needs to be only a legitimate purchaser. Kant also states that it would be against the will of the author to communicate to the public his speech without his consent while in resale nothing of the sort takes place. He continues his justification of reproduction right of the author and says that reproduction right is a positive right and positive right cannot be inferred from complete ownership.[120] Right to alienate certainly attaches itself to the incidents of the ownership other than like right of reproduction. We see upon analysis of the work of Kant that the only concern he expresses over unauthorized use of a work is interfering with the right of communication to the public that the author possess and if that is not disturbed by a purchaser then no act of the purchaser wrongs the author. Kant specifically states that the right of the author and the right of the person owning a copy is different and that the author does not possess a right over the copy published and delivered but only in preventing others from reciting it in public. Kant says to acquire a full right over a thing or property; one must be able to do whatever one want in "one's own name "with that property.[121] This is the essence of ownership. He negates right to publish i.e. reproduction from giving into the hands of the owner

[118] Immanuel Kant, *Metaphysics of morals*, trans. Mary Gregor, Cambridge University Press, Cambridge, (1st edn, 1991), pp.106-107

[119] Immanuel Kant, *Metaphysics of morals*, trans. Mary Gregor, Cambridge University Press, Cambridge, (1st edn, 1991), pp.106-107

[120] Immanuel Kant, *Metaphysics of morals*, trans. Mary Gregor, Cambridge University Press, Cambridge, (1st edn, 1991), pp.106-107

[121] Immanuel Kant, *Metaphysics of morals*, trans. Mary Gregor, Cambridge University Press, Cambridge, (1st edn, 1991), pp.106-107

of a copy. Since it is an activity which can be done only in the name of the author and not by purchaser's name as the intellectual property still remains the property of the author.

Reselling the tangible property which the purchaser had bought from the IP owner is a perfectly legal act which can be done by the purchaser in his own name. He does not allow the passing off of the books of the author as his own creation but rather that he sells it as his tangible property as he rightfully is. This logic of the Kantian philosophy goes in tune with the philosophy of rule against restraint on alienation as enjoyment of ownership under ones possession is the underlying philosophy of both. Thus exhaustion can be a valuable exception to the monopoly right granted which is justified under the Kantian philosophy of property.

1.3.2 Hegelian Philosophy of property

Hegel's theory is alternatively acknowledged as the personality theory for the approved reason that he bases his philosophy on the personality of a person. His theory propounds that property is the reflection of the personality of the person owning it. Property provides a unique or especially suitable mechanism for self-actualization, for personal expression and for dignity and recognition as an individual person.[122] Hegel's concept revolves around three main concepts, which are Free will, freedom and abstract right. As a general proposition, ownership over a property brings along with it certain rights attached incidental to the ownership, which itself is a right. And the origin of this right, as per personality theory is the free will.[123] Freedom is the essential character of a will and will without freedom is nullity as spirit in oneself spreads its wings to the fullest possible extend through this free will. [124] Will as per Hegel is a special way of thinking which translates the thoughts into reality.[125] This free will is true substance of property concept of Hegel.

Man possess or owns only which he wills or wishes to possess as no one need to possess something they do not will to possess. This inner spirit, is at the first instance intelligence which

[122] Justin Hughes, "The Philosophy of Intellectual Property", Geo. L.J. 287, [1998], Vol.77, p.28, available at http://www.justinhughes.net/docs/a-ip01.pdf. (accessed on 21/12/2018).

[123] Georg Frederich Hegel, *Philosophy of Right*, trans. S.W Dyde ,Batoche Books, Kitchener ,(2001), p.28.

[124] Georg Frederich Hegel, *Philosophy of Right*, trans. S.W Dyde ,Batoche Books, Kitchener ,(2001), p.28.

[125] Georg Frederich Hegel, *Philosophy of Right*, trans. S.W Dyde ,Batoche Books, Kitchener ,(2001), p.28.

develops itself to the form of the will. Hegel considers this inner spirit/freedom to an idea. Moreover, a person must give to his freedom an external sphere in order to reach the completeness of his idea. It is through the exercise of this free will, which is the development of the inner spirit that a person acquires property. This completely free will, when it is conceived abstractedly is in a condition of self-involved simplicity,[126] which in the context of intellectual property constitutes the idea of a person. This abstract right, which is free, gets more concrete existence, as it is in need of it, when they are expressed on a property. Thus abstract right gets a tangible shape when it acquires property. This property in Hegelian terms is the external world. Thus the free will internalizes the external world. A person's personality and his free will are the same in the initial stage. Moreover, the property over which he acquires ownership is external and opposite of him. It is the merger of these two opposites that take place upon acquiring property. Therefore it is through personality I acquire property and thus it reflects my personality. This personality is the capacity to possess rights and constitutes basis of abstract right.[127] This abstract right is then transferred to the first possible conversion of the right i.e. possession. Possession according to Hegel is the crux of ownership. It is the first mere possibility of owning something.[128] Nevertheless, it is not the perfect right but certainly provides some authority. Property ownership is established as per Hegel through three levels of development of this abstract right:- possession, use of it and the relinquishment of the same.

The property becomes the expression of the will and a part of the personality and it creates ambience for further free action. As per Hegel, the value of the property lies not in satisfying our needs but superseding and replacing the personality reflected in the object.[129] Then how can one replace the personality in an object? Trading would be the obvious manner. In other words Hegel believes that it is trading characteristic that makes property valuable for a person. This confirms to the free movement of the goods which 'was' one of the objectives of the intellectual property. Therefore restricting the reselling of the product by the intellectual property, which was legitimately purchased, goes against the purpose of the property both in Hegelian terms and as per the object of the intellectual property law. Statute renders the right to vend to the IP owner

[126] Georg Frederich Hegel, *Philosophy of Right*, trans. S.W Dyde ,Batoche Books Kitchener ,(2001), p.51.
[127] Georg Frederich Hegel, *Philosophy of Right*, trans. S.W Dyde ,Batoche Books Kitchener ,(2001), p.51-53.
[128] Georg Frederich Hegel, *Philosophy of Right*, trans. S.W Dyde ,Batoche Books Kitchener ,(2001), p.55.
[129] Georg Frederich Hegel, *Philosophy of Right*, trans. S.W Dyde ,Batoche Books Kitchener ,(2001), p.55.

realizing the incentive it can provide to the IP owner but to what extend? It would be against rationale to think statute would intend to allow perpetual control over the product sold which might create stagnancy in value of the property.

Hegel considers person as natural property and considers that he as a person has certain inalienable qualities of personality. This provides according to Hegel the ultimate substance to the person that is the inner personality. Alienation of such part of personality thus is prohibited under the Hegelian system and only those forming part of the personality attached to the object owned that is the external property becomes alienable. It is from this premise one may start the analysis of the treatment of intellectual property by Hegel.

1.3.2.1. Hegelian concept of intellectual property

As per Hegel a person has certain features of personality with which he is directly endowed and which one acquires through expression of his personality. This he calls as mental endowments which includes invention, art, science, etc, which he considers as objects of exchange, which are things to be bought and sold.[130] They, however, he argues contains a spiritual side which is the inner spirit residing inside the person. How can then one possess the same? Hegel points out the difficulty in considering these mental treasures as properties of exchange stems from the issue of incapability of possessing the same i.e. being intangible. How can then they be propertised? Hegel answers it as – through relinquishment. Through relinquishment of one's inner spirit, one can give an external appearance to the same turning it into tangible property which one can possess.[131] Hegel admits that at the first glance mental endowments may appear to be property but the spirit lowers its inner side to the level of the directly external. Hence it becomes external property. The importance of this observation is that giving mental endowment a tangible existence makes all the laws applicable to the product created out of intellectual property which is of vital importance to the current discussion. The implication of the same is that the moment an innovative idea or knowledge gets transformed into a copyright subject matter (work) or patentable invention, the intellectual property of the owner ends and the normal property rights begins. Such a conclusion would mean not even the reproduction right may be retained by the

[130] Georg Frederich Hegel, *Philosophy of Right*, trans. S.W Dyde ,Batoche Books Kitchener ,(2001), p.56.
[131] Georg Frederich Hegel, *Philosophy of Right*, trans. S.W Dyde ,Batoche Books Kitchener ,(2001), p.56.

intellectual property owner but Hegel has an answer for this problem too which would be discussed at a later stage. Relinquishment of the mental possession takes place as it passes to the external world. Therefore in the case of exhaustion, when the restriction is placed by the intellectual property owner on the intellectual property rights that he "possess" and prohibiting a legitimate purchaser from reselling it does not find justification under the Hegelian analysis as IP ends upon externalization.

Now as stated above, as per the Hegelian conceptualisation of property, absolute ownership is established through acquiring, using and relinquishing a thing. Analysing the position of the purchaser in a Hegelian framework, one acquires property using personality of the purchaser which comes under the complete ownership of the purchaser. Hegel states that when a property which is under the obligation of a complete ownership of a person's personality, it would be unjustified to control his personality by another person subduing the purchasers complete enjoyment. The purchaser's act of purchasing replaces the personality of the IP owner with that of the purchaser. Thus according to Hegel the purchasers even possess the right to reproduce the IP product since reproduction of a person's personality is the right of the personality. What property of external sphere does is giving visible existence to my will and hence property.

The next stage is the use of a property. Hegel says that use is the realization of one's want through the change, destruction or consumption of object, which in this way reveals that it has no self and fulfils its nature.[132] When a purchaser is admitted to the fullest use of a thing, as per Hegel, the ownership of the purchaser completed. Thus nothing is left for the other to appropriate. When one comes in possession of a thing not only what is directly laid upon is his, but what is connected with it also is his.[133] A person cannot have the total use of a thing when the abstract right to property rests with somebody else. These observations of Hegel leads to a safe conclusion that a person who purchases a product might have a desire to resell the same which is a desire that cannot be placed under restriction by any one as he is admitted to the fullest use of it as the owner of the object. Hegel negatives the proposition that an object can be

[132] Georg Frederich Hegel, *Philosophy of Right*, trans. S.W Dyde ,Batoche Books Kitchener ,(2001), p.67.
[133] Georg Frederich Hegel, *Philosophy of Right*, trans. S.W Dyde ,Batoche Books Kitchener ,(2001), p.68.

someone's while the same is the property of the other i.e., in intellectual property terms he is against creation of unrestricted monopoly. [134]

Another feature of ownership is the right to relinquish a property. It is in the context of the right to relinquish that Hegel talks more about IP. When a person takes into possession a thing, a right to relinquish too gets attached with the property. However, certain part of the personality of the owner cannot be alienated. An owner's desire to alienate a piece of property is connected to the recognition that the property is either not or soon will not be an expression of him.[135] This means that through alienation, one relinquishes his personality with the knowledge that from that moment the purchaser expresses his personality in a manner he chooses, it obviously and necessarily includes the right of further alienation. When a person relinquishes his property he returns to his self personality, by establishing himself as idea or complete legal or moral person and does away with the old relation. What is peculiar to a mental production is that it can be externalized for others to produce.[136] Hegel argues that a literary work or an invention constitutes not just the idea of an author or an inventor as it also includes the "mechanical genius" of making it[137]; i.e., publishing in the case of literary work, or industrial production in the case of invention which maybe internalised by the purchaser and thereby exercise the same in the similar manner of that of the creator.[138] This means that the new owner comes into possession of the general powers to express himself in the same way as the IP owner and it even includes the power of reproduction.[139] Reproduction of a book is merely a mechanical labour and therefore no personality is involved. Hegel also expressly states as below:

> "Since the purchaser of such a product of mental skill possesses the full use and value of his single copy, he is complete and free owner of that one single copy, although the author of the work or inventor of the apparatus remains the owner of the general method of multiplying such products. The author or inventor has not

[134] *"The object would be wholly penetrated by my will and yet contain something impenetrable namely the empty will of another*." See Georg Frederich Hegel, *Philosophy of Right*, trans. S.W Dyde ,Batoche Books, Kitchener ,(2001), p.68.

[135] Georg Frederich Hegel, *Philosophy of Right*, trans. S.W Dyde, Batoche Books Kitchener ,(2001), pp.71-73.

[136] Georg Frederich Hegel, *Philosophy of Right*, trans. S.W Dyde, Batoche Books Kitchener ,(2001), p.73.

[137] Georg Frederich Hegel, *Philosophy of Right*, trans. S.W Dyde, Batoche Books Kitchener ,(2001), p.73.

[138] Georg Frederich Hegel, *Philosophy of Right*, trans. S.W Dyde, Batoche Books Kitchener ,(2001), p.73.

[139] Georg Frederich Hegel, *Philosophy of Right*, trans. S.W Dyde, Batoche Books Kitchener ,(2001), p.73.

disposed directly of the general method, but may reserve it for his private utterance."[140]

This is nothing but the doctrine of exhaustion. Hegel has ingeniously recognized the importance of the right of reproduction of the author which is "the general method of multiplying" which, in the words of Hegel, could be retained by the author of the work or the inventor. The retention of this right of reproduction is justified since it is the only mode in which the author could express his work to the world[141] without which the author may not be motivated to create more of the works.[142] But that does not prohibit, as per Hegel, the purchaser from making copies of the purchased tangible property that he owns.[143]

Hence Hegel finds that some limitation needs to be imposed on the monopoly conferred by the statute on the IP owner for his creation to allow the purchaser to the unhindered use of the IP product and therefore, except for the mode of recreating the product, i.e., reproduction or making, all other rights of the intellectual owner need not be protected further. This is because his property, being the intellect, is already safeguarded through protecting the reproduction right and he possesses no other rights over the copy vended. Thus approach of Hegel clearly indicates that he supports the doctrine of international exhaustion.

1.4. Analysis of initial case laws of Exhaustion using Hegelian and Kantian system of property

This section aims at analyzing the initial case laws, which paved the way for the development, and shaping of the doctrine of exhaustion. Exhaustion doctrine is a judge made doctrine rather than a creation of statute. The aim of this section is to exhibit that the courts relied on in deciding the cases falls in line with the Hegelian theory even though the courts have not expressly referred to him.

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[140] Georg Frederich Hegel, *Philosophy of Right*, trans. S.W Dyde, Batoche Books Kitchener ,(2001), p.74.

[141] "*The alienation of a single copy of a work need not entail the right to produce facsimiles because such reproduction is one of the universal ways and means of expression which belong to the author."* Justin Hughes, "The Philosophy of Intellectual Property", Geo. L.J. 287, [1998], Vol.77, p.34, available at http://www.justinhughes.net/docs/a-ip01.pdf. (accessed on 21/12/2018).

[142] Georg Frederich Hegel, *Philosophy of Right*, trans. S.W Dyde, Batoche Books Kitchener ,(2001), p.71.

[143] Georg Frederich Hegel, *Philosophy of Right*, trans. S.W Dyde, Batoche Books Kitchener , (2001), pp.71-73.

As mentioned before, the first case decided recognizing exhaustion was *Bloomer v. Mcqueen.*[144] The court tried to limit the extent of rights of the intellectual property owner in the present case. The Court stated:

> "When the machine passes into the hands of the owner it comes outside the protection of the monopoly granted by the statute. The machine becomes his absolute private property".

This means that IP ends as the sale of the object takes place wherein normal property rights begins. The court further held that it would be hardly the intention of the legislature to deprive the legitimate purchaser of the benefits of the ownership by protecting intellectual property. The reasonable understanding from this ratio of the court is that court identified the property of the IP owner as the intellectual substance and the same when converted into the tangible form and purchased by the buyer, exists merely as tangible product which is under the ownership of the purchaser.

In *Mitchell v. Hawley*,[145] the court considered the license agreement set about by the intellectual property owner. In the case the court held that if the patentee had delivered the patented good for use to the purchaser, then the purchaser may continue to use it as long as he wish to use it. This means that the ownership is completed by the transfer of the object to the purchaser even for use. Hegelian system too confirms that use of a thing concretes ownership of a thing. The court further held that upon resale, the patentee is believed to have been parted with the intellectual property and further quoted the above ratio of *Bloomer v. Mcqueen*. Similar line of judgement was followed in *Adams v. Burke*[146], wherein court held that "...the sale by a person who has the full right to make, sell, and use such a machine carries with it the right to use of that machine to the full extent to which it can be used...''. The court explained that in the present case use amounted to further resale and that it was lawful to do so as he was the absolute owner of the coffin.

[144] 55 U.S. 539 (1852).
[145] 83 U.S. (16 Wall.) 544.
[146] 84 U.S. 455 (1873).

In *Keeler v. Standard Folding Co*[147] the court held that if a patentee has sold his products restricting the use of the same within a territory, the purchaser has the freedom to use, sell or dispose the same anywhere in the country provided they are rewarded once for their creation. The reward theory too confirms the Hegelian theory since once you relinquish your property through which you relinquish your personality which allows you to get reward only once. It stated"

> " .. 'Having manufactured the material and sold it for a satisfactory compensation, whether as material or in the form of a manufactured article, the patentee, so far as that product of his invention is concerned, has enjoyed all the rights secured to him by his letters patent, and the manufactured article and the material of which it is composed go to the purchaser for a valuable consideration, discharged of all the rights of the patentee previously attached to it or impressed upon it by the act of congress under which the patent was granted."[148]

Thus court expressly declared that the intellectual property did not pass to the purchaser as it got ended upon the sale and the mere tangible property rights begin. Court addressed the question whether a purchaser who bought the patented article from a lawful seller should again pay him to resell it. Quoting *Adams v. Burke*[149], court explained that a person who bought a product from a person lawful to sell has the right resell the same as it has become the absolute unrestricted property of the purchaser.

Thus it is sufficiently clear that the court has decided these cases within the Hegelian philosophy pertaining to property demarcating and through separating the rights of the IP owner and the purchaser upon the selling of the product. The ratio of these decisions falls within the framework of ownership concept of property by Hegel enunciating his principles of use and alienation theory of Hegel. The limitation of these judgements however should be pointed out. The court has allowed the freedom to the monopolist to restrict the purchaser through contracts. But this yet again is against the Hegelian perspective since personality cannot move from one person to

[147] 157 U.S. 659 (1895).
[148] 157 U.S. 659 (1895).
[149] 84 U.S. 455 (1873).

another if reasonable characteristics of the personality is restricted through contract and hence the exchange of objects cannot take place, negating the space for contractual restriction.

The above analysis of philosophy of exhaustion, history of evolution of exhaustion and evolution of common law principle of restraint of alienation of exhaustion, one may draw many similarities and conclusions from them. The philosophical perspective makes it clear that once a product is sold to a person to a lawful purchaser, ownership transfers to the purchaser wherein the incidental right to alienate to is transferred. This is consistent with the jurisprudence evolved by courts in rule against restraint of alienation and in exhaustion. Further Hegelian and Kantian principles are in tune with public policy concerns of common law courts as well as American courts (in the case of exhaustion), stressing that it is necessary to find a balance between rights granted to IP holder and legitimate interests of the public.[150] Therefore, free movement of IP goods and the enjoyment of the good is the ultimate aim of exhaustion and private persons, using a statute conferred right, can in no way, be restricted. The recent controversies and division even within the judiciary both at international and national level exists because there is no consensus as to the mode of exhaustion to be recognized. Various jurisdictions recognize different modes of exhaustion, national, international or regional exhaustion. In addition, countries even follow different exhaustion regimes depending on the nature of IP. Nevertheless, this does not get justified within the philosophy of property justifying intellectual property. The above discussion has given needful clarity as to the drivel of classifying the exhaustion regimes as to national, international and regional. The above discussion has pointed to the fact that there cannot be differentiation in adopting the exhaustion by different countries, as there can only be international exhaustion as the IP protected property losses its protection of intellectual statutes upon the selling of the product wherever in the world it be. The same conclusion is drawn based on the property characteristic of intellectual property thus further supporting the universal nature of the doctrine.

[150] Georg Frederich Hegel, *Philosophy of Right*, trans. S.W Dyde, Batoche Books Kitchener,(2001), p.74. Also see : Immanuel Kant, *Metaphysics of morals*, trans. Mary Gregor, Cambridge University Press, Cambridge, (1st edn, 1991), pp.106-107.

1.5. Does the Concept of Exhaustion differ with the form of property?

The above analysis of the historical evolution of the common law principle of rule against restraint on alienation and the philosophy of exhaustion reveals that such concepts are the necessary fall out of the concept of ownership. Ownership implies the full and unrestricted enjoyment of the property by the owner and the right to alienate or transfer property is a necessary incident of ownership. Whatever is the nature of property – whether tangible or intangible –this underlying principle will not alter. Therefore, the rule against restraint on alienation is applicable in full vigour even in the case of intellectual property and to the modern technological context where the transfer of property takes place in the digital rather than the tangible form. Different methods have been employed to restrict the application of exhaustion to the tangible medium and to exclude digital medium from its purview. One of the basic arguments raised in support of this move is that exhaustion applies only to tangible medium and not to digital medium.[151] As already stated the justification of the concept of exhaustion has nothing to do with the nature of property and it rests absolutely on the concept of ownership and its necessary concomitant viz., enjoyment of property. Different methods are being used for restricting online transfer of materials and transfer of digital works. They include contracts, technological protection measures etc. The major allegation against the application of exhaustion to the digital context is the reproduction of works happening in the course of transferring the works. However, no such excuses are conceptually acceptable since ownership of intellectual property and ownership in the digital works are clearly distinguishable. Therefore, restrictions on movement and circulation of objects cannot be sustained even in digital context and exhaustion is applicable irrespective of the medium.

1.6. Conclusion

The historical evolution of the exhaustion doctrine reveals that the doctrine has its roots in the common law principle of rule against restraint on alienation. The rule against restraint on alienation was originally intended to the resolve the conflicting interest of a seller and a purchaser of land and chattels. The courts relied on the logic behind this rule to resolve the conflicting interests of the intellectual property owner and the purchaser of an IP good without

[151] *Capitol Records, LLC* v.*ReDigi Inc*., 934 F. Supp. 2d 640, 648 (S.D.N.Y. 2013).

specifically mentioning it. They identified the conflicting interests and opted for a harmonious construction giving due respect to the rights each parties were actually deserving. This logic ultimately led to the evolution of the concept of exhaustion which ensured the unrestricted enjoyment of the right of the purchaser of an IP good while ensuring that the rights of the IP owner is not detrimentally affected by it. Since the IP owner has secured his reasonable interests on the specific piece or good on the first sale of it he has no right to interfere with the right of the purchaser of it to enjoy the use of it to his fullest satisfaction. While evolving this principle the courts tried to differentiate between the tangible and intangible elements within the intellectual property and the IP product so as to allow the consumers to enjoy their absolute ownership over the product. The courts also relied on the contractual principle of illegality of conditional sales to establish that the intellectual property holders are not entitled to place restraints on the sold product. The courts were concerned on the effect of these restrictions on the consumer welfare.

The practice resorted by the courts to resolve the conflicting interests of the owner of IP and purchaser of IP good either by using the logic of the contractual principles or the common law principles are supported by the property jurisprudence put forward by both Kant and Hegel. The common thread running through all the three legal principles viz., rule against restraint on alienation, the contractual principle of illegality of conditional sale and the exhaustion doctrine and the philosophical justifications of Hegel and Kant is that once the absolute ownership over the product is vested with the purchaser of it as a result of sale, the seller cannot control its enjoyment of it by the purchaser, which includes its further sale. Thus the free movement of goods once sold is ensured under all these principles or philosophy. The underlying objective of all these judicial and philosophical logic, therefore, was to enable free movement of goods in the market. Our next objective is to trace the relation between exhaustion and free trade in the modern context of trade globalization.

Chapter II

WTO, Free Trade and Parallel Imports

2.1 Introduction

The term free trade refers generally to the free movement of goods, services, labour, and capital across national borders without the interference of government-imposed economic or regulatory barriers. Free movement of goods is an integral element of free trade and one of the bedrocks of the common market.[152] Free movement of goods brings about free trade by minimising border restrictions between countries. Free trade is a system in which the trade of goods between or within countries is unhindered by government-imposed restrictions and interventions.[153] It aims at bringing about non-tariff, non-obstructive movement of goods between nations.[154] The main objective of World Trade Organisation (WTO) is to achieve global free trade by mandating its member countries to bring down trade barriers and to facilitate free movement of goods across borders. The concept of free trade has been built on various theories propounded by renowned economists. Many economists have put forward theories based on various parameters upon which free trade should work in an international scenario. However, Adam Smith and David Ricardo are the major proponents of the free trade theory, especially during a period where nations where preaching a closed economy to bring about internal development.[155] The theories

[152] Damian Chalmers, "Free Movement of Goods within the European Community: An Unhealthy Addiction to Scotch Whisky?", The International and Comparative Law Quarterly, [1993], Vol. 42, No. 2, p. 269, available at http://www.jstor.org/stable/761100, (accessed on 20/11/2018).

[153] Regine Adele NgonoFouda, "Protectionism and Free Trade: A Country's Glory or Doom?", International Journal of Trade, Economics and Finance, [2012], Vol. 3, No. 5, p.351, available at http://www.ijtef.org/papers/226-CF312.pdf, (accessed on 20/11/2018).

[154] Wolfgang Ernst *et. al*, "The Free Movement of Goods and Services Within the European Economic Community in the Context of the World Economy", Journal of Institutional and Theoretical Economics, vol. 137, no. 3, [1981], pp. 556, available at www.jstor.org/stable/40750375, (accessed on 22/12/2018).

[155] Regine Adele NgonoFouda, "Protectionism and Free Trade: A Country's Glory or Doom?", International Journal of Trade, Economics and Finance, [2012], Vol. 3, No. 5, p.351, available at http://www.ijtef.org/papers/226-CF312.pdf, (accessed on 20/11/2018). Also see; Jagdish Bhagwati, *Termites in the trading system: How preferential agreements undermine free trade*, Oxford University Press, New York, (2008).

of Adam Smith and David Ricardo changed the trading pattern across the globe.[156] Therefore the chapter begins by examining the theories of Adam Smith and David Ricardo on free trade.

Even though GATT was in place by 1947, an enforceable legal framework, or in fact a practical application of the free trade notion and free movement of goods began and evolved to its current stature in the European Union, during 1950's. European Union, thus, presents an excellent example for the application and evolution of free movement of goods principles. Therefore, the second part of the chapter attempts to analyse the concept of free movement of goods as perceived by European Union. The researcher takes the aid not only of the legal framework on free movement of goods but also of the judicial decisions, which expanded the notion of free movement of goods in the European jurisdiction. The third part of the chapter analyses the interplay between free movement of goods, intellectual property rights and exhaustion. This part aims to find out whether exhaustion can bring about free movement of intellectual property goods. In the fourth part of the chapter the concept of free movement of the goods as reflected in the WTO frame work is examined. This section also analyses the link between WTO free trade principles and exhaustion.

2.1 The theory of free trade

Economists of the free trade era favour unrestricted international trade nearly unanimously.[157] In the most general sense, free trade is trade that would take place if there were no government policies that would restrict movement of goods across the borders as if there were no national

[156] Krithpaka Boonfueng, "A Non-Harmonized Perspective on Parallel Imports: The Protection of Intellectual Property Rights and the Free Movement of Goods in International Trade", (S.J.D . dissertation, United States -- District of Columbia: American University, 2003), P.9, available at https://digitalcommons.wcl.american.edu/cgi/viewcontent.cgi?article=1005&context=stu_sjd_abstracts, (accessed on 26/11/2018).

[157] Reinhard Schumacher, "Deconstructing the Theory of Comparative Advantage", World Economic Review, [2013], Vol.2, 83-105, at p.83, available at http://wer.worldeconomicsassociation.org/files/WEA-WER2-Schumacher.pdf, (accessed on 21/12/2018). Also see; Eithne Murphy, "The Evolution of Trade Theory: An Exercise in the Construction of Surrogate or Substitute Worlds?" (Thesis submitted for the degree of Ph.D, Department of Economics SOAS, University of London, 2013), available at https://eprints.soas.ac.uk/18066/1/Murphy_3557.pdf, (accessed on 26/11/2018).

boundaries.[158] This means, at a minimum, no tariffs or quotas on the import side and no subsidies or other policies designed to increase exports.[159] Free trade conceptually enables goods, services, capital, companies and people to reach almost any part of the globe rapidly and easily.[160] After 1950's many nations were prepared to do away with protectionist measures so as to embrace free trade regime believing that free trade would bring about more economic benefits.[161] Thus, one of the objectives of the formation of WTO in 1994 was adoption of free trade globally. The whole WTO process of trade liberalization is based on the assumption that the best way to raise global living standards is to promote free trade to the maximum extent.[162]

Two major theories led to the development of free trade as an international mechanism – Adam Smith's theory of absolute advantage[163] and David Ricardo's theory of Comparative advantage.[164] The aim of analysing the theory is to understand how free trade benefits the international community as a whole and how international exhaustion of IP rights can further the same. Exhaustion of rights facilitates free movement of IP goods. However, different jurisdictions recognize different modes of exhaustion which suits their economies, and which brings forth free movement of goods within their internal markets. Free trade, in today's world, exists both in regional as well as international context. In the observation of the researcher, the

[158] Regine Adele NgonoFouda, "Protectionism and Free Trade: A Country's Glory or Doom?", International Journal of Trade, Economics and Finance, [2012], Vol. 3, No. 5, p.351, available at http://www.ijtef.org/papers/226-CF312.pdf, (accessed on 20/11/2018).

[159] Russell Trenholme, "Free Trade and Comparative Advantage: Why Most Economists are Wrong", pp.4-18, available at http://freetradeexposed.homestead.com/files/FreeTrade.pdf, (accessed on 12/12/2018).

[160] Damian Chalmers, "Free Movement of Goods within the European Community: An Unhealthy Addiction to Scotch Whisky?" The International and Comparative Law Quarterly, [1993], Vol. 42, No. 2, p. 269, http://www.jstor.org/stable/761100, accessed on 20/11/2018.Also see**;** Santiago BarónEscámez, *"*Restrictions to the free movement of goods : The protection of the environment as a mandatory requirement in the ECJ case law"*,* (Master thesis, Faculty of Law , University of Lund, 2006), p.4, available at http://lup.lub.lu.se/luur/download?func=downloadFile&recordOId=1555204&fileOId=1563581, (accessed on 26/11/2018).

[161] ShujiroUrata, "Globalization and the Growth in Free Trade Agreements", Asia-Pacific Review, [2002], Vol. 9, No. 1, pp.1-2, available at http://www.wright.edu/~tdung/Globalization_and_FTA.pdf, (accessed on 21/12/2018).

[162] Reinhard Schumacher, "Free Trade and Absolute and Comparative Advantage : A Critical Comparison of Two Major Theories of International Trade", [2012], Band 16, p.10, available at https://publishup.uni-potsdam.de/opus4-ubp/frontdoor/deliver/index/docId/6086/file/wtthesis16.pdf, (accessed on 22/12/2018).

[163] Adam Smith, *The Wealth of Nations*, available at https://political-economy.com/wealth-of-nations-adam-smith/, (accessed on 8/12/2018).

[164] David Ricardo, *On The Principles of Taxation and Political Economy*, Batoche Books, Kitchener, (3rd edn, 1821), available at https://socialsciences.mcmaster.ca/econ/ugcm/3ll3/ricardo/Principles.pdf, (accessed on 21/12/2018).

recognition of the mode of exhaustion has been influenced by the nature of free trade that exists in a market. Therefore, the endeavour of the researcher here is to analyze the underlying philosophy of international free trade and the benefits arising out of it so as to identify the best mode of exhaustion capable of enhancing the benefits of international free trade. It is argued here that allowing different modes of exhaustion to be practiced in the international scenario will be tantamount to permitting non-tariff barrier across frontiers, which will ultimately hinder international free trade.[165]

2.1.1 Adam Smith's view on free trade

Adam Smith regarded free trade as a necessary condition for achieving national and global welfare.[166] As per Smith, trade is the consequence of the human propensity to truck, barter, and exchange one thing for another.[167] Whenever people trade with each other, they pursue their own interests, not some noble ones.[168] They must benefit from trade; otherwise they would not pursue it.[169] Therefore Smith proposed international free trade based on division of labour, as the solution to global welfare. The division of labour leads to increased specializations.[170] In other

[165] Krithpaka Boonfueng, "A Non-Harmonized Perspective on Parallel Imports: The Protection of Intellectual Property Rights and the Free Movement of Goods in International Trade", (S.J.D . dissertation, United States -- District of Columbia: American University, 2003), P.9, available at https://digitalcommons.wcl.american.edu/cgi/viewcontent.cgi?article=1005&context=stu_sjd_abstracts, (accessed on 26/11/2018). Also see; *The Impact of Parallel Imports of Books, Films / Music and Software on the Indian Economy with Special Reference to Students*, NCAER, 2014, p.85, available at http://copyright.gov.in/documents/parallel_imports_report.pdf, (accessed on 26/11/2018).

[166] Adam Smith, *The Wealth of Nations*, pp.752-788, available at https://political-economy.com/wealth-of-nations-adam-smith/, (accessed on 8/12/2018).Also see; Douglas A. Irwin, *Against the Tide: An Intellectual History of Free Trade*, Princeton University Press, Princeton, (1996), p.217.

[167] Adam Smith, *The Wealth of Nations*, p.22, available at https://political-economy.com/wealth-of-nations-adam-smith/, (accessed on 8/12/2018).

[168] Reinhard Schumacher, "Free Trade and Absolute and Comparative Advantage : A Critical Comparison of Two Major Theories of International Trade", [2012], Band 16, p.15, available at https://publishup.uni-potsdam.de/opus4-ubp/frontdoor/deliver/index/docId/6086/file/wtthesis16.pdf, (accessed on 22/12/2018).

[169]Adam Smith, *The Wealth of Nations*, p.24, available at https://political-economy.com/wealth-of-nations-adam-smith/, (accessed on 8/12/2018).

[170] The base of the theory of Adam Smith is division of labour. For him, it is the division of labour that leads to "the greatest improvement in the productive powers of labour". Division of labour occurs due to the need for trade. As a result of a more advanced division of labour, more output can be produced with the same amount of labour. When output increases consumer welfare increases through increased access of products to the consumers and that too at a cheaper rate. As per Smith, "the more specialization, the more growth". Smith opines that capital will not be employed to its greatest advantage when it is directed towards an object which it can buy

words, a country must specialize in the production of goods which is cheaper for it to produce and trade in international market. Smith opines that international free trade, by opening up large markets, increases production and wealth of nations and society as whole.[171] It naturally increases the number of goods that can be exchanged between countries.[172]

Smith further explained it as below:

> "If a foreign country can supply us with a commodity cheaper than we ourselves can make it, better buy it of them with some part of the produce of our own industry employed in a way in which we have some advantage".[173]

If free trade is operative, consumers will buy a good from those who sell it at the lowest price. The nation (or producer) with the lowest production costs is able to sell it cheaper than every other producer and is able to undersell its competitors. Therefore, every nation will produce those commodities which it can produce more cheaply than other countries. This is the basis of his division of labour theory. As specialization leads to increased production, goods will be available to consumers at a cheaper rate. Smith opines that capital will not be employed to its greatest advantage when it is directed towards an object which it can buy cheaper than it can make.[174] This means that when output is increased, technological development is stimulated, and workers' skills and productivity are enhanced. This facilitates better access to cheaper goods. Smith explains that consumers are the main beneficiaries of international free trade. Therefore, according to him, access to cheaper goods for consumers is the main advantage of free trade. It

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cheaper than it can make. This means that output is increased, technological development is stimulated, and workers' skills and productivity are enhanced. See generally; Adam Smith, *The Wealth of Nations*, available at https://political-economy.com/wealth-of-nations-adam-smith/, (accessed on 8/12/2018).

[171] Adam Smith, An Inquiry into the Nature and Causes of the Wealth of Nations, Edited by Adler, Mortimer J., Great Books of the Western World, (4th edn, Vol. 36, 1776), p.286.

[172] Adam Smith, An Inquiry into the Nature and Causes of the Wealth of Nations, Edited by Adler, Mortimer J., Great Books of the Western World, (4th edn, Vol. 36, 1776), p.234.

[173] Adam Smith, *The Wealth of Nations*, p.760, available at https://political-economy.com/wealth-of-nations-adam-smith/, (accessed on 8/12/2018).

[174] Adam Smith, *The Wealth of Nations*, p.760, available at https://political-economy.com/wealth-of-nations-adam-smith/, (accessed on 8/12/2018).

can also be understood that for furthering such an objective it is necessary to reduce the import taxes, tariffs and other prohibitions and encourage free movement of goods.[175]

Smith further states that international free trade leads to innovation through specialization as technology too will keep improving as a result of free trade.[176] Merchants engage in commerce internationally because they earn profits by it.[177] Smith attempts to show that not only single merchants, but also the society as a whole, benefits from international trade.[178] Benefit of society is the central theme of the theory of Adam Smith, and it calls for international free trade.[179] The goods which can be bought cheaper from another country should be purchased from that country rather than making them in country where it is costlier to produce. Smith categorically states, as mentioned above, that the main beneficiary of such exchange are the consumers as they get cheaper goods.

2.1.2 Ricardo's Theory of Comparative advantage

David Ricardo's notion of free trade is the theory of comparative advantage, which follows the same line as that of Adam Smith, but is more elaborate in its perspective. It attempts to show why free trade is beneficial for all nations and even for the world as a whole, and how free trade automatically leads to the realization of those benefits.[180] The comparative advantage theory propounds that each country must specialise in the production of goods that is less costly for the

[175] Sarah R. Wasserman Rajec, "Free Trade in Patented Goods: International Exhaustion for Patents", Berkeley Tech. L.J., [2014], Vol.29, pp.328-329, available at https://scholarship.law.berkeley.edu/cgi/viewcontent.cgi?referer=https://www.google.com/&httpsredir=1&article=2023&context=btlj, (accessed on 26/11/2018).

[176] H Myint, 'Adam Smith's Theory of International Trade in the Perspective of Economic Development' Economica New Series, [1977], Vol. 44, No. 175, pp.231–48, available at https://www.jstor.org/stable/2553648, (accessed on 1/9/2019).

[177] Adam Smith, *The Wealth of Nations*, p.24, available at https://political-economy.com/wealth-of-nations-adam-smith/, (accessed on 8/12/2018).

[178] Adam Smith, *The Wealth of Nations*, pp.760-770, available at https://political-economy.com/wealth-of-nations-adam-smith/, (accessed on 8/12/2018).

[179] Adam Smith, *The Wealth of Nations*, pp.760-770, available at https://political-economy.com/wealth-of-nations-adam-smith/, (accessed on 8/12/2018).

[180] See generally Reinhard Schumacher, "Deconstructing the Theory of Comparative Advantage", World Economic Review, [2013], Vol.2, 83-105, available at http://wer.worldeconomicsassociation.org/files/WEA-WER2-Schumacher.pdf, (accessed on 21/12/2018).

country to produce, and thus export it to other countries where it is costly to produce.[181] The comparative advantage of a country in producing a good is determined by different factors of production such as natural differences that exists between nations due to climatic differences etc., and the technological differences that exists in the economies.[182] A country has a comparative advantage in producing a good if the opportunity cost of producing that good in terms of other goods is lower in that country than it is in other countries.[183] This difference varies from products to products and from nation to nation. Therefore, different countries trade different goods bringing participation of all the nations in a global platform. The theory in question argues that, put simply, it is better for a country which is inefficient in producing a good or service to specialise in the production of that good it is least inefficient at, when compared with producing other goods.[184] Ricardo observes that international trade based on comparative advantage will benefit all countries when there is difference in cost ratio between countries and if one country specialises in one product and trades on it.[185] Difference in comparative production costs is 'the essential and also the sufficient condition' for the existence of international trade.[186] Poor countries will benefit in the same way as rich countries as free trade enables developing countries also to make use of their comparative advantages. The theory thus bases its functioning

[181] David Ricardo, *On The Principles of Taxation and Political Economy*, Batoche Books, Kitchener, (3rd edn, 1821), pp.85-89, available at https://socialsciences.mcmaster.ca/econ/ugcm/3ll3/ricardo/Principles.pdf, (accessed on 21/12/2018).

[182] Reinhard Schumacher, "Free Trade and Absolute and Comparative Advantage: A Critical Comparison of Two Major Theories of International Trade", [2012], Band 16, pp.25-29, available at https://publishup.uni-potsdam.de/opus4-ubp/frontdoor/deliver/index/docId/6086/file/wtthesis16.pdf, (accessed on 22/12/2018).

[183] Enrico Bonadio, "Parallel imports in a global market: should a generalised international exhaustion be the next step?", European Intellectual Property Review, [2011], Vol.33(3), pp. 153-161, available at http://openaccess.city.ac.uk/4106/1/Parallel%20Imports%20in%20a%20Global%20Market.pdf, (accessed on 11/11/2018).

[184] Enrico Bonadio, "Parallel imports in a global market: should a generalised international exhaustion be the next step?", European Intellectual Property Review, [2011], Vol.33(3), pp. 153-161, available at http://openaccess.city.ac.uk/4106/1/Parallel%20Imports%20in%20a%20Global%20Market.pdf, (accessed on 11/11/2018).

[185] Reinhard Schumacher, "Deconstructing the Theory of Comparative Advantage", World Economic Review, [2013], Vol.2, 83-105, p.85, available at http://wer.worldeconomicsassociation.org/files/WEA-WER2-Schumacher.pdf, (accessed on 21/12/2018).

[186] Reinhard Schumacher, "Deconstructing the Theory of Comparative Advantage", World Economic Review, [2013], Vol.2, 83-105, p.85, available at http://wer.worldeconomicsassociation.org/files/WEA-WER2-Schumacher.pdf, (accessed on 21/12/2018).

on the price mechanism.[187] Countries specialized in efficient production of certain product tend to export this product to areas where the good is more expensive to produce.

Ricardo has stated that international trade based on comparative advantage is beneficial to all trading nations. International trade is beneficial to the trading countries, because it leads to an increase in the amount of production and the variety of the objects on which revenue may be expended and thus increases the sum of enjoyments.[188] He is of the view that due to the more efficient employment of labour and capital, "the amount and variety of the objects on which revenue may be expended"[189] and "the sum of enjoyments"[190] increase. When the production in a country increases, it is exported to another country where it is expensive to produce[191]. The whole population in the form of consumers get benefited because goods become cheaper and available in a larger quantity which in simple terms is affordable access. The consumers of both trading nations benefits by enabling an increase in revenue of the exporting country and ensuring availability of cheaper goods to the consumers in the importing nation. Ricardo stressed the point that ultimately consumers should be the beneficiaries of the international trade as goods should be made available at their cheapest rate.[192] He opined that money saved by purchasing cheaper goods through imports should be utilised in production of those goods which the country has comparative advantage in producing. In this manner, the capital of the nation could be used in the production of those goods, which is advantageous for the nation to make, and the profit made

[187] See David Ricardo, *On The Principles of Taxation and Political Economy*, Batoche Books, Kitchener, (3rd edn, 1821), pp.85-103, available at https://socialsciences.mcmaster.ca/econ/ugcm/3ll3/ricardo/Principles.pdf, (accessed on 21/12/2018).

[188] David Ricardo, *On The Principles of Taxation and Political Economy*, Batoche Books, Kitchener, (3rd edn, 1821), pp.85-89, available at https://socialsciences.mcmaster.ca/econ/ugcm/3ll3/ricardo/Principles.pdf, (accessed on 21/12/2018).

[189] David Ricardo, *On The Principles of Taxation and Political Economy*, Batoche Books, Kitchener, (3rd edn, 1821), p.89, available at https://socialsciences.mcmaster.ca/econ/ugcm/3ll3/ricardo/Principles.pdf, (accessed on 21/12/2018).

[190] David Ricardo, *On The Principles of Taxation and Political Economy*, Batoche Books, Kitchener, (3rd edn, 1821), p.85, available at https://socialsciences.mcmaster.ca/econ/ugcm/3ll3/ricardo/Principles.pdf, (accessed on 21/12/2018).

[191] Reinhard Schumacher, "Deconstructing the Theory of Comparative Advantage", World Economic Review, [2013], Vol.2, 83-105, at p.41, available at http://wer.worldeconomicsassociation.org/files/WEA-WER2-Schumacher.pdf, (accessed on 21/12/2018).

[192] David Ricardo, *On The Principles of Taxation and Political Economy*, Batoche Books, Kitchener, (3rd edn, 1821), p.88, available at https://socialsciences.mcmaster.ca/econ/ugcm/3ll3/ricardo/Principles.pdf, (accessed on 21/12/2018).

out of the same may be used in importing those goods, which are costlier to make and is also available to be imported at a cheaper rate.[193] The income of the consumers' could also be spent profitably as consumers normally prefer to buy from those sellers who sell cheaply. This would also benefit consumers by facilitating cheaper access to goods internationally. For these benefits to take place, there should be free trade between nations i.e., free movement of cheap priced goods. Thus, it is for the benefit of consumers who could receive cheap goods, and for the benefit of each nation participating in international trade who could gain comparative advantage of such trade that Ricardo propounded free trade.

The theory of comparative advantage expects that nations participating in the free trading process should necessarily encourage import activities so as to get cheaper products to increase consumer welfare. Once the tariffs are low and the cost of importation also is low, foreign goods which are made cheaper can be easily imported resulting in the increase of total welfare.[194] Therefore, the blockage of parallel imports, which are genuine cheap imported goods, produced in countries where they are cheaper to produce, amounts to non-tariff barriers as it impedes access to cheap foreign goods stifling development and competition.[195] It brings in higher cost effects to goods and consumers and therefore runs counter to the free trade theory as propounded both by Ricardo and by the WTO.[196]

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[193] David Ricardo, *On The Principles of Taxation and Political Economy*, Batoche Books, Kitchener, (3rd edn, 1821), p.88, available at https://socialsciences.mcmaster.ca/econ/ugcm/3ll3/ricardo/Principles.pdf, (accessed on 21/12/2018).

[194] Paul Krugman et.al. (Eds.), *International Economics: Theory and Policy*, Addison – Wesley, Boston, (9th edn, 2012,), p. 24, pp.33-35, pp.221-222 . Also see; Alan Sykes, "Comparative Advantage and the Normative Economics of International Trade Policy", Journal of International Economic Law, [1998], Vol. 1, Issue 1, pp. 49-82, available at SSRN: https://ssrn.com/abstract=805036 (accessed on 26/11/2018).

[195] *The Impact of Parallel Imports of Books, Films / Music and Software on the Indian Economy with Special Reference to Students*, NCAER, 2014, p.85, available at http://copyright.gov.in/documents/parallel_imports_report.pdf (accessed on 26/11/2018).

[196] Sarah R. Wasserman Rajec, "Free Trade in Patented Goods: International Exhaustion for Patents", Berkeley Tech. L.J., [2014], Vol. 29, p.330, available at https://scholarship.law.berkeley.edu/cgi/viewcontent.cgi?referer=https://www.google.com/&httpsredir=1&article=2023&context=btlj, (accessed on 26/11/2018). According to the author, this theory of lowering barriers to trade so as to maximize the benefits of international trade has been the philosophy behind the formation of GATT and WTO.

2.1.3. Theoretical gains expected from International free trade

Theories of Adam Smith and Ricardo essentially concentrate on free movement of goods between nations so that consumers and nations benefit from the same. The undisputed and most important positive aspect attributed to international free trade is the increase in the production of goods and availability of the goods at a cheaper rate. As stated above, the comparative advantage of nations, it is suggested, will automatically make the productions of the goods cheaper. This will lead to an increased demand in other markets for the cheaper products. Further, to meet the increased demand in the producing country, the producing country needs to increase the production; this will ultimately lead to increased revenue for the nation and benefits the consumers of both nations. Thus, division of labour and specialisation automatically leads to increased output. Specialisation in producing a good automatically encourages the importation of goods which are costlier to produce in the country of importation. Thus free movement of goods is essential for encouraging importation. The consumers will naturally opt for goods which are cheaper to get, and for the same free movement of goods and importation should be increased. However, it must be noted that the encouragement of importation is to facilitate welfare for the consumers.

The other main gains attributed to free trade by the supporters of free trade/free movement of goods are the following:

(a) Better allocation of resources- by relocating the capital from producing those goods which are costlier to produce towards producing those goods which that nation have comparative advantage, the resources of the nation are used up in the best manner.[197] The money of the consumer also is better allocated as consumers need not spent more money when a product could be cheaply imported.
(b) Increases wealth of the nation.
(c) Increases competition in the market- Adam Smith argues the free competition may not be often beneficial for traders but certainly will benefit consumers through increased produce at lower prices.

[197] James Langenfeld and James Nieberding, "The Benefits of Free Trade to U.S. Consumers :Quantitative Confirmation Of Theoretical Expectation", Business Economics, [2005] ,p.43, available at http://courses.wcupa.edu/rbove/eco338/050trade-debt/freetr/050700benefits.pdf, (accessed on 27/11/2018).

(d) Competition spurs innovation - Even though international theories does not talk much about dynamic efficiencies, innovations could be brought in through the pressure of competition that occurs in the market through international trade.[198]

(e) Technology transfer can also lead to increased innovation and development. Free movement of goods can promote dynamic efficiency through facilitating international knowledge spill over, reducing research redundancy and providing access to a wider range and cheaper intermediate and capital goods.

(f) Free movement of goods reduces producers cost by reducing cost of inputs through imports.

(g) Openness to trade enables the products to be sold at a larger market which increases the profits of the producers.

Thus even though dynamic efficiency is promoted in a smaller scale by the international free trade, gains that result from international trade are mainly static gains in the form of more goods being produced. Consumption is increased and the needs of the population are satisfied to a higher degree. This can be achieved because international trade leads to a more efficient use of the existing resources. It is the argument of the author that the phenomenon of parallel imports too works towards promoting the same.

2.2 Development of International legal framework on principles on free movement of goods

The theoretical framework on free trade enunciated by David Ricardo using comparative advantage practically found application when after the Second World War the global nations decided to adopt free trade as a global trading pattern for recovering from the economic crisis they were in. The countries believed that the welfare effects to the consumers mentioned in the comparative advantage theory also can be fully achieved only through no- borders legal scenario. For the same, a General Agreement on Trade and Tariffs (GATT), 1947, was framed with an aim to reduce tariffs and import quotas and any impediments to international trade and to disregard

[198] James Langenfeld and James Nieberding, The Benefits of Free Trade to U.S. Consumers :Quantitative Confirmation Of Theoretical Expectation", Business Economics, [2005] ,p.43, available at http://courses.wcupa.edu/rbove/eco338/050trade-debt/freetr/050700benefits.pdf, (accessed on 27/11/2018).

protectionist measures.[199] The GATT text of 1947 contained provisions for bringing about international free trade.[200] Even though GATT, in its early stages, could bring down the tariffs and import quotas, it could not completely bring about the free trade globally in its later stages.[201] The GATT 1947 provisions, was later incorporated into WTO in the year 1994, with almost similar provisions. Therefore, the next portion analyses the GATT, 1994 provisions in detail.

2.2.1. WTO Principles on Free Trade.

WTO, established in 1994 institutionalizing GATT, as we know, is an international organization with common agreements binding its members to establish international free trade.[202] The theory of free trade in the international arena arose after the failure of protective market strategies prohibiting exchange of goods between nations, which were in vogue prior to the Second World War.[203] This protective market strategy was believed to be the cause of international economic

[199] Regine Adele NgonoFouda, "Protectionism and Free Trade: A Country's Glory or Doom?", International Journal of Trade, Economics and Finance, [2012], Vol. 3, No. 5, p.351, available at http://www.ijtef.org/papers/226-CF312.pdf, (accessed on 20/11/2018). Also see; K. Bagwell and R. W. Staiger, "Multilateral Tariff Cooperation during the Formation of Regional Free Trade Areas", International economic Review, [1997], Vol. 38, pp.291-319, available at www.jstor.org/stable/2527376, (accessed on 22/12/2018).

[200] See for eg: Art. XI of GATT, 1994, Art.III of GATT, 1994, Art.V of GATT, 1994. It should be noted that the GATT 1994 document contained almost the same provisions as contained in the 1947 GATT document. There were only minute changes made to the document which is not significant for analysis under this chapter.

[201] Manfred A. Dauses, "The System of the Free Movement of Goods in the European Community", The American Journal of Comparative Law, [1985], Vol.33, p.209, available at https://opus4.kobv.de/opus4-bamberg/frontdoor/deliver/index/docId/6796/file/Free_MovementOCRseA2.pdf., (accessed on 16/12/2018).

[202] See generally; Thomas Cottier and Matthias Oesch, *Direct and Indirect Discrimination in WTO Law and EU Law*, NCCR Trade Working Paper No. 2011/16, [2011], available at http://www.nccr-trade.org/fileadmin/user_upload/nccr-trade.ch/hi/CottierOeschNCCRWP16.pdf, (accessed on 30/12/2018). Also see ; Tamara Perišin, "Balancing Sovereignty With The Free Movement Of Goods In The Eu And The WTO- Non-Pecuniary Restrictions on the Free Movement of Goods", Croatian Yearbook of European Law and Policy, [2005], Vol. 1(1), available at https://www.researchgate.net/publication/27205267_Balancing_Sovereignty_with_the_Free_Movement_of_Goods_in_the_EU_and_the_WTO_-_Non-Pecuniary_Restrictions_on_the_Free_Movement_of_Goods, (accessed on 27/11/2018).

[203] Andrew G. Terborgh, *The Post-War Rise of World Trade: Does the Bretton Woods System Deserve Credit?* Working Paper No. 78/03, (2003), p.1, available at http://eprints.lse.ac.uk/22351/1/wp78.pdf, (accessed on 12/12/2018). Also see ; Pedro A. Perichart, "Free Movement of Goods: a Comparative Analysis of the European Community Treaty and the North American Free Trade Agreement" (LLM Theses and Essays, University of Georgia, Paper 42, 2005), P.1, available at http://digitalcommons.law.uga.edu/stu_llm/42, (accessed on 27/11/2018);

recession during that period. The WTO framework on free trade was, therefore, structured on the Ricardian theory of comparative advantage.[204] Modern international law sought to increase global welfare by lowering barriers to trade and by encouraging competition.[205] The first step towards this was instituted through the GATT agreement 1947, which attempted at lowering trade barriers to facilitate free trade, and subsequently in 1994, WTO was established with GATT agreement forming a part of it, along with many other agreements constituting the WTO.

This section of the chapter aims at analysing the free trade principles enshrined under WTO framework and to understand how the concept of international exhaustion becomes the perfect choice under these principles.[206] It tries to establish that the practice of following different modes of exhaustion has created barriers to free trade and that the concept of regional and national exhaustion prohibits free movement of goods beyond certain territories. Thus, it is attempted here to establish that such practices of national or regional exhaustion go against the principles of free trade propagated by the WTO regime, in which TRIPs forms part of.

Even though many literatures are available on WTO principles on free trade, the author found it interesting that the analysis of the WTO articles on free trade was limited. Among various agreements on free trade under WTO, the GATT, 1994, deals with the free movement of goods. Therefore, the author here attempts to bring out the philosophy of WTO on free movement of goods by examining various provisions of GATT Agreement 1994.

Arnold Collery, "A Full Employment, Keynesian Theory of International Trade", The Quarterly Journal of Economics, [1963], Vol. 77, No. 3, pp. 438-458, available at https://academic.oup.com/qje/article-abstract/77/3/438/1845370?redirectedFrom=fulltext, (accessed on 10/12/2018)

[204] Sarah R. Wasserman Rajec, "Free Trade in Patented Goods: International Exhaustion for Patents", Berkeley Tech. L.J. [2014], Vol. 29, p.328, available at https://scholarship.law.berkeley.edu/cgi/viewcontent.cgi?referer=https://www.google.com/&httpsredir=1&article=2023&context=btlj, (accessed on 26/11/2018).

[205] Sarah R. Wasserman Rajec, "Free Trade in Patented Goods: International Exhaustion for Patents", Berkeley Tech. L.J. [2014], Vol. 29, p.328, available at https://scholarship.law.berkeley.edu/cgi/viewcontent.cgi?referer=https://www.google.com/&httpsredir=1&article=2023&context=btlj, (accessed on 26/11/2018).

[206] Basically countries have recognised three modes of exhaustion namely- national, regional and international. The classification of exhaustion has taken place, practically, to suit the economies of each country. For more information read Lazaros G. Grigoriadis, *Trade Marks and Free Trade – A Global Analysis*, Springer International Publishing, Switzerland, (2014).

2.2.2. GATT 1994 and the principles of Free Trade

2.2.2.1. General free trade principle:

Much of the discussion of the WTO principles on free trade circles around Article XI of the GATT principle of WTO[207] which is commonly called as the free trade principle of WTO.[208] Article XI which talks about elimination of quantitative restrictions,[209] states that "no prohibitions on imports shall be placed by any member country other than duties, taxes or other charges, made effective through import or export licenses or other measures". Article XI calls for prohibition of import and export quotas or other like measures.[210] In other words, it stipulates that restriction on free movement of goods should be minimal. Therefore, it is evident from these Articles that free movement of goods across the borders has been given due importance in the

[207] Art. XI of GATT 1994 reads: "No prohibitions or restrictions other than duties, taxes or other charges, whether made effective through quotas, import or export licences or other measures, shall be instituted or maintained by any contracting party on the importation of any product of the territory of any other contracting party or on the exportation or sale for export of any product destined for the territory of any other contracting party."

[208] There are also other provisions in the GATT which further substantiates the free trade principle under Article XI and also gives an idea of the nature of free trade envisioned under GATT. The other relevant provisions of the GATT which calls upon reduction in trade barriers such as Article VIII(Fees and formalities), Article VIII (c)(minimized formality for imports) and ban on imports in emergency situations sheds light into the nature of restrictions that the GATT aims to have on importation of products. There is also the principle of Most Favoured Nation Article 1 of the GATT deals with most favoured nation treatment. With respect to customs duties and charges of any kind imposed on or in connection with importation or exportation or imposed on the international transfer of payments for imports or exports, and with respect to the method of levying such duties and charges, and with respect to all rules and formalities in connection with importation and exportation, and with respect to all matters referred to in paragraphs 2 and 4 of Article III any advantage, favour, privilege or immunity granted by any contracting party to any product originating in or destined for any other country shall be accorded immediately and unconditionally to the like product originating in or destined for the territories of all other contracting parties. The restrictions imposed under most favoured nation are of the like duties, charges, formalities and rules. It's a trace towards the kind of restrictions that the GATT encompasses on importation of goods. MFN principle has several benefits like encourages international trade like minimising distortions in the market, allows nations to get goods from neighbouring nations at a low price making it cost efficient. MFN basically aims at reducing trade distortions on the basis of origin of goods. MFN thus expects and encourages the importation of goods to take place in any economy.

[209] Art. XI: 1 of GATT 1994, reads: "No prohibitions or restrictions other than duties, taxes or other charges, whether made effective through quotas, import or export licences *or other measures*, shall be instituted or maintained by any contracting party on the importation of any product of the territory of any other contracting party or on the exportation or sale for export of any product destined for the territory of any other contracting party".

[210] See Raj Bhala and Kevin Kennedy, *World Trade Law: The GATT-WTO System, Regional Agreements, and U.S. Law*, Lexis Law Publishing, Virginia, 1998, pp.105-106.

GATT agreement and only restrictions like duties, taxes charges etc. can be the limitation on the imports. Article XI applies to all measures instituted or maintained by a contracting party prohibiting or restricting the importation, exportation or sale for export of products other than measures that take the form of duties, taxes or other charges.[211] Any measure which leads to nullification or impairment of the benefits that is due from the GATT agreement constitutes a violation of Article XI of GATT[212]. Further import restrictions are generally not permissible under Article XI of GATT. The existence of quantitative restrictions, as we see from the discussion below, is sufficient to attract Article XI, regardless of whether they impede trade or not.[213]

The U.S. Manufacturing Clause[214]case,[215] where the U.S. prohibition of importation of books made outside U.S. or Canada was challenged under Article XI of GATT. The Panel in that case discussed GATT provisions in the context of parallel import itself, speaks regarding the international approach to the issue. The U.S. banned the importation and distribution of books into the country which were printed outside U.S. under section 6 of Title 17 of U.S. code. The European Communities challenged the Manufacturing Clause on the ground that it was contrary to Articles XI and XIII of the GATT. It is interesting to note that the U.S. did not contest the position of EC. The Panel accepted the EC position that such a clause violated Art. XI of GATT,

[211] Report of the GATT Panel on "Japan - Trade in Semi-conductors", (L/6309 - 35S/116), adopted on 4 May 1988.

[212] Report of the GATT Panel, "Uruguayan Recourse to Article XXIII" (3L/1923-11S/95), adopted on 16 November 1962.

[213] Report of the GATT Panel, "EEC- Payments and Subsidies Paid to Processors and Producers of Oilseeds and Related Animal Feed Proteins", (L/6627 - 37S/86), adopted on 25 January 1990. Also see; Raj Bhala and Kevin Kennedy, *World Trade Law: The GATT-WTO System, Regional Agreements, and U.S. Law*, Lexis Law Publishing, Virginia,1998, p.106.

[214] § 601 of the U.S. Copyright Act read: "Manufacture, importation, and public distribution of certain copies: (b): (a) Prior to 1 July 1982, and except as provided by subsection (b), the importation into or public distribution in the United States of copies of a work consisting preponderantly of non-dramatic literary material that is in the English language and is protected under this title is prohibited unless the portions consisting of such material have been manufactured in the United States or Canada." Here the provision directly violates Article XI of GATT by expressly differentiating and banning products from importation into the U.S. if they are made outside the territory of U.S. or Canada."

[215] Report of the GATT Panel, "The United States Manufacturing Clause", (L/5609 - 31S/74),adopted on 15/16 May 1984.

which specifically forbids import prohibitions or restrictions.[216] Thus it is pretty clear that ban on imports merely because it was manufactured outside the country will be violative of Article XI. The general philosophy of GATT aims at reducing restrictions on importations. In another Panel report on U.S. "Restrictions on import on Tuna",[217] also it was held that prohibition on imports of fish from Mexico violated Article XI.[218]

The ambit of Article XI was further analysed in Report of the GATT Panel in Japan Semiconductors case[219] wherein it was observed that the unlike other GATT provisions, Article XI:1 does not refer solely to laws or regulations, but extends more broadly to "other measures".[220] Therefore any measure maintained by a member country that effectively restricts exports is prohibited under Article XI:1.[221] In other words, restriction on importation based on the origin of the goods or of lack of consent from the local licensee or owner of the relevant intellectual property contradicts with Article XI of GATT. Therefore, the prohibition of genuine parallel imported goods which are banned purely based on the fact that the goods were produced outside the national boundary of the importing country is squarely violating Article XI of the GATT, 1994.

2.2.2.2. *Freedom of transit:*

Article V of the GATT mandates that upon entry of the goods after importation into a territory of a party, except for the non-compliance of customs laws and duties, no goods shall be unduly detained by a contracting party.[222] Freedom of transit: "… includes protection from unnecessary

[216] Report of GATT the Panel, "The United States Manufacturing Clause", (L/5609 - 31S/74), adopted on 15/16 May 1984.

[217] Report of the WTO Panel, "United States – Measures Concerning The Importation, Marketing and Sale of Tuna and Tuna Products" (WT/DS381/R 15), 15 September 2011.

[218] Report of the WTO Panel, "United States – Measures Concerning The Importation, Marketing and Sale of Tuna and Tuna Products" (WT/DS381/R 15), 15 September 2011,

[219] Report of the GATT Panel, "Japan - Trade in Semi-conductors", (L/6309 - 35S/116), adopted on 4 May 1988.

[220] Report of the GATT Panel, "Japan - Trade in Semi-conductors", (L/6309 - 35S/116), adopted on 4 May 1988, Also see; Raj Bhala and Kevin Kennedy, *World Trade Law: The GATT-WTO System, Regional Agreements, and U.S. Law*, Lexis Law Publishing, Virginia,1998, p.106.

[221] Raj Bhala and Kevin Kennedy, *World Trade Law: The GATT-WTO System, Regional Agreements, and U.S. Law*, Lexis Law Publishing, Virginia,1998, p.106.

[222] Art. V of GATT, 1994, reads "*Freedom of Transit: Goods (including baggage), and also vessels and other means of transport, shall be deemed to be in transit across the territory of a contracting party when the passage across*

restrictions, such as limitations on freedom of transit, or unreasonable charges or delays, and the extension of Most Favoured-Nation (MFN) treatment to Members' goods which are "traffic in transit" or "have been in transit".[223] Even though this freedom is guaranteed under WTO, it is often seen that the parallel imported goods in transit are detained by the countries on request of IP owners. This is inconsistent with the freedom of transit provided under Art V of the GATT, 1994. Most IP exporting countries point to increasing trade in counterfeits and fake goods as the primary factor for such seizures.[224] This, they argue, destroys international trade in IP protected goods.[225] However, under the guise of preventing counterfeit goods they are blocking parallel import. This contradicts with the philosophy of free trade generally, and Article V specifically. The goods so ceased are genuine goods and they are destined for another country. The freedom of movement of goods gets full application only when the goods are allowed free transit between nations. The confiscation of the same hinders free trade.

2.2.2.3 Creation of Customs Union:

Article XX IV (4) of GATT provides for creation of customs union,[226] which aims at creating regional trade blocs as to further free trade between these nations. This, however, does not aim to

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such territory, with or without trans-shipment, warehousing, breaking bulk, or change in the mode of transport, is only a portion of a complete journey beginning and terminating beyond the frontier of the contracting party across whose territory the traffic passes. Traffic of this nature is termed in this article "traffic in transit"'.

[223] Report of the WTO Panel, "Colombia – Indicative Prices and Restrictions on Ports of Entry", (WT/DS366/R) 27 April 2009.

[224] Several cases of seizures by EU of generic drugs originating in Brazil and India have been disputed at WTO. See for eg; "European Union and A Member State – Seizure of Generic Drugs in Transit, Request for Consultations by India", WT/DS408/1 G/L/921 IP/D/28, 19 May 2010.

[225] Henning Grosse Ruse – Khan, "A Trade Agreement Creating Barriers to International Trade?: ACTA Border Measures and Goods in Transit", American University International Law Review, [2011], Vol.26, Issue 3, pp. 645-726, available at https://digitalcommons.wcl.american.edu/cgi/viewcontent.cgi?article=1711&context=auilr, (accessed on 22/12/2018).

[226] Art. XXIV:8(a) states that "a customs union shall be understood to mean the substitution of a single customs territory for two or more customs territories. Although this provision has not been interpreted by the Appellate Body, the negotiating history offers some indication. The original text contained in Article 33 of the United States Draft Charter (1946) reads as follows: "a union of customs territories for customs purposes shall be understood to mean the substitution of a single customs territory for two or more customs territories, so that all tariffs and other restrictive regulations of commerce as between the territories of members of the union are substantially eliminated and the same tariffs and other regulations of commerce are applied by each of the members of the union to the trade of territories not included in the union". For details read Reference contained in Article XXIV and the General Agreement, Note by the Secretariat, MTN.GNG/NG7/W/13/Add.1, 10 August 1988, (2).

create trade barriers with other nations outside the union. The goal of the exception was trade creating and not to trade diverting.[227] This provision might be one of the reasons for recognising regional exhaustion but as mentioned earlier, the creation of customs union should not hinder free trade globally.[228]

2.2.2.4. National treatment principle:

National treatment principle is enshrined in Article III of the WTO agreement[229]. The Article aims to provide equal treatment to goods of domestic and foreign origin.[230] For that it mandates that taxes, laws and regulations etc., which affects the internal sale or transportation of goods shall not be applied differently to similar goods irrespective of domestic or foreign origin.[231] Within the context of GATT, National treatment principle requires that internal taxes, charges, laws and regulations must not be applied in a manner that treats imported products less favourably than domestic ones. The national treatment obligations of Article III of the General Agreement do not apply to foreign persons or firms but to imported products.[232] It aims at avoiding discrimination of goods on the basis of origin of products. Once imported into a member and have cleared customs, they have to be treated no less favourably than like products originating in that member.[233] Therefore, differentiation based on territorial division is narrowed through national treatment principle.[234] Thus the principle of national treatment makes

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[227] John H. Jackson, *The Jurisprudence of the GATT and the WTO*, Cambridge University Press, Cambridge, (2nd edn, 2007), p. 102. Also see; GATT "Working Party Report – US-Canada Free Trade Agreement," GATT , (L/6927), 12 November 1991.

[228] Raj Bhala and Kevin Kennedy, *World Trade Law: The GATT-WTO System, Regional Agreements, and U.S. Law*, Lexis Law Publishing, Virginia,1998, p.165.

[229] Art. III of GATT agreement, 1994: National Treatment on Internal Taxation and Regulation.

[230] Art. III of GATT, 1994.

[231] Art. III:1 of GATT, 1994 reads :-"The contracting parties recognize that internal taxes and other internal charges, and *laws, regulations* and requirements affecting the internal sale, offering for sale, purchase, transportation, distribution or use of products, and internal quantitative regulations requiring the mixture, processing or use of products in specified amounts or proportions, should not be applied to imported or domestic products *so as to afford protection to domestic production"*

[232] Report of the GATT Panel, "Canada - Administration of the Foreign Investment Review Act"- *(L/5504- 30 S/ 140)* adopted on 7 February, 1984.

[233] National treatment applies to goods which have been cleared by the customs to enter into the market of the importing country. Goods cannot be blocked under the border measure rule unless it falls under the prohibited category under WTO rules.

[234] Art. III of GATT, 1994.

it is clear that measures could not be adopted against imported products for protecting domestic market.[235] This provision read along with Article XI of GATT calls for no prohibition of genuine products. Article XI pre-empts nations from adopting border measures to block free movement of genuine goods and once inside the territory of the nation then Article III prohibits the differentiation of goods based on origin of goods. Similarly, Article III: 4 mandates for equal treatment of products of foreign origin imported into another territory[236] with that of like domestic product. Further the provision aims at avoiding protectionism and protection to domestic industries and producers.[237] It serves to protect the interests of producers and exporters established on the territory of any contracting party.[238]

National treatment provisions are mainly invoked when a member's internal measure explicitly discriminates against products with regard to their origin.[239] Where a measure bans both the import and sale of a product, the whole measure should be examined under the scrutiny of national treatment.[240] The National treatment provisions also obligate the parties to create a competitive condition between domestic and foreign products within their national markets.[241] The rationale of the Article III and Article XI (free trade provision) of GATT are the same,

[235]Raj Bhala and Kevin Kennedy, *World Trade Law: The GATT-WTO System, Regional Agreements, and U.S. Law*, Lexis Law Publishing, Virginia, 1998, p.98.

[236] Import restrictions may be placed on goods of foreign origin only under the following categories apart from the restrictions mentioned above: Article XI (2): Import prohibitions on the basis of not meeting standards or regulations, Article XII: Import restrictions to safeguard balance of payments, Article XVIII: - Governmental Assistance to Economic Development, Article XX: General Exceptions. None of these conditions is applicable for banning parallel imports. Article XX is the only provision which could be relied on for banning parallel imports about which will be dealt in detail in the following sections.

[237] Report of WTO Panel, "Japan - Taxes on Alcoholic Beverages, Complaints by the European Communities, Canada, and the United States", (WT/DS8, DS10, DS11), 11 July, 1996. Also see; Report of the WTO Appellate Body, "European Communities – Measures Affecting Asbestos and Asbestos-Containing Products", WT/DS135/AB/R, 12 March 2001 , p.43, the panel opined that the that in endeavouring to ensure equality of competitive conditions, the general principle in Article III seeks to prevent Members from applying internal taxes and regulations in a manner which affects the competitive relationship, in the market place, between the domestic and imported products involved , so as to afford protection to domestic production.

[238] GATT Panel Report."Canada - Administration of the Foreign Investment Review Act"(L/5504- 30 S/ 140),adopted on 7 February, 1984.

[239] Art. III of GATT agreement, 1994.

[240]Report of WTO Panel,"European Communities – Measures Affecting Asbestos and Asbestos-Containing Products", (WT/DS135/R), adopted on 18 September, 2000.

[241]Report of the Panel "United States - Taxes on Petroleum and Certain Imported Substances", (L/6175 - 34S/136) adopted on 17 June 1987.

namely to create a competitive condition between foreign and domestic products.[242] The GATT panel, thus, has clearly equated the national treatment provisions with that of free trade provisions making it an inseparable part of free trade.

As stated earlier, Article III: 4 mandates for equal treatment of products of foreign origin imported into another territory[243] with that of like domestic product.[244] Therefore in order to attract Article III, there must be a law or regulation or requirement which affects the internal sale or offer for sale etc., of the imported and domestic product, wherein the imported and domestic product are like products and the imported products are accorded less favourable treatment than the domestic product.[245]

Therefore, the WTO framework on free trade does not prohibit the movement of genuine goods between borders and as seen encourages importation of goods from countries. This is to facilitate free international trade. Further, merely on the ground of originating in another country, the importation cannot be blocked. This is important in view of parallel imports. The overall philosophy of WTO, as one understands, means to discourage unlawful goods and encourage competition in the world market.

2.2.3.Free Trade Experimentation by EC

Countries began to implement free trade principles within their legal frameworks and the European Community were the forerunners in this process. They were the initial group of nations to have tried to practically implement free movement of goods between the member countries.

[242] Report of the Panel, "United States - Taxes on Petroleum and Certain Imported Substances"- (L/6175 - 34S/136), adopted on 17 June 1987.

[243] Import restrictions may be placed on goods of foreign origin only when: Art. XI (2): Import prohibitions on the basis of not meeting standards or regulations, Article XII: Import restrictions to safeguard balance of payments, Article XVIII: - Governmental Assistance to Economic Development, Article XX: General Exceptions. None of these conditions is applicable for banning parallel imports. Article XX is the only provision which could be relied on for banning parallel imports about which will be dealt in detail in the following sections.

[244] Art. III:4 :- The *products* of the territory of any contracting party *imported* into the territory of any other contracting party shall be accorded *treatment no less favourable than that accorded to like products of national origin* in respect of all laws, regulations and requirements affecting their internal sale, offering for sale, purchase, transportation, distribution or use.

[245] Robert E. Hudec, "GATT/WTO Constraints on National Regulation: Requiem for an "Aim and Effects" Test", The International Lawyer, [Fall 1998], Vol. 32, No. 3, pp. 619-649, available at https://scholar.smu.edu/cgi/viewcontent.cgi?article=1843&context=til, (accessed on 22/12/2018).

The practical experimentation of free trade principles can be traced from the EC experiences as EC also provided useful principles for the functioning of free trade between nations. European countries strongly wanted the free movement of goods among them and thus decided to form European community during the 1950's.[246] The basic trade framework of the European Union relied heavily on GATT, 1947.[247] On the basis of the free trade philosophy of GATT, the European Union tried to expand the notion of free movement of goods and developed principles regarding the same. The judiciary too played a critical role in expanding the notion of free movement of goods. Therefore, it is imperative to analyse the European framework on free movement of goods for a better understanding of the concept of free movement of goods, which will be dealt in the coming sections. European program of trade liberalization proceeded under the auspices of European Economic Co-operation and European Economic Community.[248] The attempt to create a true European domestic market through the abolition of non-tariff trade barriers, and thus to complete the free movement of goods, opened a new chapter in European regional economic integration.[249]

[246] Jarrod Tudor, A Comparison of the Jurisprudence of the ECJ and The EFTA Court on the Free Movement of Goods in the EEA: Is there an Intolerable Separation of Article 34 of the TFEU And Article 11of the EEA, San Diego Int'l L.J. 75, [Fall 2015], Vol.17, Issue 1, pp.77-78, available at https://digital.sandiego.edu/cgi/viewcontent.cgi?referer=https://www.google.com/&httpsredir=1&article=1003&context=ilj, (accessed on 22/12/2018).

[247] See for eg: Art. 28 and Art. 36 of TFEU, 2007, which are similar to Art.XI and Art.XX(d) of GATT, 1947 and 1994.

[248] Douglas A. Irwin, "The GATT's contribution to economic recovery in post-war Western Europe", p.137, available at https://www.dartmouth.edu/~dirwin/docs/GATT%20contribution.pdf, (accessed on 10/12/2018). Also see; Le Huynh Tan Duy, "Free Movement Of Goods - Quantitative Restrictions -In The European Community And The ASEAN Economic Community", (Master thesis, Faculty of Law, University of Lund, Spring, 2006), available at http://lup.lub.lu.se/luur/download?func=downloadFile&recordOId=1555049&fileOId=1563530, (accesses on 10/12/2018) ; Pedro A. Perichart, "Free Movement of Goods: a Comparative Analysis of the European Community Treaty and the North American Free Trade Agreement" (LLM Theses and Essays, University of Georgia, Paper 42, 2005), available at http://digitalcommons.law.uga.edu/stu_llm/42, (accessed on 27/11/2018).

[249] Wolfgang Ernst *et. al*, "The Free Movement of Goods and Services Within the European Economic Community in the Context of the World Economy", Journal of Institutional and Theoretical Economics, vol. 137, no. 3, [1981], pp.556-574, available at www.jstor.org/stable/40750375, (accessed on 22/12/2018). Also see ; Le Huynh Tan Duy, "Free Movement Of Goods - Quantitative Restrictions -In The European Community And The ASEAN Economic Community", (Master thesis, Faculty of Law, University of Lund, Spring, 2006), available at http://lup.lub.lu.se/luur/download?func=downloadFile&recordOId=1555049&fileOId=1563530, (accesses on 10/12/2018).

The freedom of movement of goods is a fundamental principle that underpins the European internal market.[250] The free trade theories propounded above were practically implemented in the Europe in the form of Treaty of Rome, 1957.[251] The Treaty of Rome was later amended to form the Treaty on the functioning of the European Union.[252] The European Economic Union [later renamed as European Union, (EU)], is a common market that requires that all member-states maintain a common import policy (i.e., customs union), in conjunction with an agreement for the free flow of goods, services, capital and labour.[253] They are called as the four fundamental freedoms.[254] The goal behind the creation of the European Union was to create a larger, politically-unified, economic area.[255] The concept of free movement of goods got matured under the European Union.[256] The core of the European Community is a common market which has achieved a high degree of integration. Trade liberalization in the EU was followed by a far-reaching programme of market integration and harmonisation, not just in the area of goods but also in services, establishment, workers and capital, all leading to the establishment of a single

[250] Santiago BarónEscámez , "Restrictions to the free movement of goods : The protection of the environment as a mandatory requirement in the ECJ case law", (Master thesis, Faculty of Law, University of Lund, 2006,) p.4, available at http://lup.lub.lu.se/luur/download?func=downloadFile&recordOId=1555204&fileOId=1563581, (accessed on 27/11/2018).

[251] Treaty of Rome, 1957, was the first international instrument in facilitating the formation of the European Economic Union and the Customs Union for the creation of a common market wherein customs duties and tariffs where proposed to be reduced to the maximum for facilitating free trade.

[252] Santiago BarónEscámez , "Restrictions to the free movement of goods : The protection of the environment as a mandatory requirement in the ECJ case law", (Master thesis, Faculty of Law, University of Lund, 2006,) p.6, available at http://lup.lub.lu.se/luur/download?func=downloadFile&recordOId=1555204&fileOId=1563581, (accessed on 27/11/2018). Also see; Theodore H. Cohn, *Global Political Economy*, Longman, Boston, (6th edn, 2008), p.243.

[253] Theodore H. Cohn, *Global Political Economy*, Longman, Boston, (6th edn, 2008), p.243.

[254] Title II – Art. 28-37 of TFEU, 2007, regarding free movement of goods, Title IV, Art. 45 – Art. 66 , of TFEU, 2007, – Free movement of persons and services and capital. Also see CarriGinter, "Free movement of goods and parallel imports in the internal market of EU", European Journal of Law Reform, [2006], Vol.VII no.3/4, 505-524, at p.505. Also see; Santiago BarónEscámez , "Restrictions to the free movement of goods : The protection of the environment as a mandatory requirement in the ECJ case law", (Master thesis, Faculty of Law, University of Lund, 2006,) available at http://lup.lub.lu.se/luur/download?func=downloadFile&recordOId=1555204&fileOId=1563581, (accessed on 27/11/2018).

[255] Richard Baldwin and Charles Wyplosz, *The Economics of European Integration*, Macgrow Hill, London, (4th edn, 2012), pp.45-46.

[256] See generally, Pedro A. Perichart, "Free Movement of Goods: a Comparative Analysis of the European Community Treaty and the North American Free Trade Agreement" (LLM Theses and Essays, University of Georgia, Paper 42, 2005), available at http://digitalcommons.law.uga.edu/stu_llm/42, (accessed on 27/11/2018);

market and, later, even to the creation of a monetary union.[257] That market consists of a union of national economies forming a uniform economic area which is free from distortions of competition, within which obstacles to the free movement of goods, persons, and capital and the freedom to provide services have been abolished to a large extent. The international relations of the Union are conducted by an independent entity under public international law with limited powers to conclude treaties.[258]

Treaty of Rome, 1950, (now renamed as Treaty on the Functioning of European Union), in its preamble highlights the importance of creating a common market for the economic development of Europe and other countries and to abolish all restrictions on the international trade.[259] The treaty aims at establishing a European Economic Community and thus to establish a common market to promote through the community a harmonised development of economic activities.[260] For achieving the above said objective, elimination as between member states of customs duties and quantitative restrictions on import and export of goods and all other measures having equivalent effect was required to be made.[261]

European Union conceptualises free trade as the abolition of customs duties and of quantitative restrictions among the member states of the Union.[262] For furthering the free movement of goods between member countries, a customs union was established and all sorts of impediments such

[257] Tamara Perišin, "Balancing Sovereignty With the Free Movement of Goods in the EU and the WTO- Non-Pecuniary Restrictions on the Free Movement of Goods", Croatian Yearbook of European Law and Policy, [2005], Vol. 1(1), p.3, available at https://www.researchgate.net/publication/27205267_Balancing_Sovereignty_with_the_Free_Movement_of_Goods_in_the_EU_and_the_WTO_-_Non Pecuniary_Restrictions_on_the_Free_Movement_of_Goods, (accessed on 27/11/2018).

[258] Manfred A. Dauses, "The System of the Free Movement of Goods in the European Community", The American Journal of Comparative Law, [1985], Vol.33, p.210, available at https://opus4.kobv.de/opus4-bamberg/frontdoor/deliver/index/docId/6796/file/Free_MovementOCRseA2.pdf, (accessed on 20/12/2018).

[259] Preamble of the TFEU, 2007.

[260] Art. 1 and Art.2 of the TFEU, 2007.

[261] Art. 3 of the TFEU, 2007.

[262] Art.9, Part Two Foundations of the Community, Title I, Free Movement Of Goods , Treaty of Rome, (corresponding article 28 of TFEU) reads : "The Union shall comprise a customs Union which shall cover all trade in goods and which shall involve the prohibition between Member States of customs duties on imports and exports and of all charges having equivalent effect, and the adoption of a common customs tariff in their relations with third countries."

as customs duties and charges and tariffs and all measures and charges having equivalent effect shall be abolished within this Union.[263] This clearly shows what the Union had in mind when they wanted to adopt free trade within the Union. However, the approach of the Union towards countries outside the Union is different from that they follow within the Union among its members. It maintained the tariffs for countries outside the Union in a uniform manner whereas, customs duties on imports and exports and charges having equivalent effect are prohibited between Member States. This prohibition applies also to customs duties of a fiscal nature.[264] In addition, quantitative restrictions on imports and all measures having equivalent effect are prohibited between Member States.[265] These maybe called 'prohibitions upon quantitative restrictions' which is practiced within the Union by the member countries. This further strengthens the free movement of goods principle. These free trade principles could be derogated only under certain specified circumstances.[266]

2.2.4.Judicial Understanding of the Concept of Free Trade

The ECJ has been instrumental in recognising the following principles of free trade- (i) Basic principle of Dassonville (prohibition of quantitative restrictions) (ii) Concepts of non-discrimination (iii) Principle of Mutual recognition and market access, IV) Restriction on "any other measure"[267] which hinders access of products originating in another market. The following discussion of case law explains how these concept were evolved by the judiciary. It is evident from these cases that the European courts have tried to understand the clear implication of the concept of free trade and what constituted a reasonable restriction upon the principle, by

[263] Art. 9 of Treaty of Rome, (Article 28 of TFEU, 2007) reads – "The Union shall comprise a customs Union which shall cover all trade in goods and which shall involve the prohibition between Member States of customs duties on imports and exports and of all charges having equivalent effect, and the adoption of a common customs tariff in their relations with third countries."

[264] Art. 30 of TFEU, 2007.

[265] Art. 34 of TFEU, 2007.

[266] Art. 36 of TFEU, 2007, reads: "The provisions of Articles 34 and 35 shall not preclude prohibitions or restrictions on imports, exports or goods in transit justified on grounds of public morality, public policy or public security; the protection of health and life of humans, animals or plants; the protection of national treasures possessing artistic, historic or archaeological value; or the protection of industrial and commercial property. Such prohibitions or restrictions shall not, however, constitute a means of arbitrary discrimination or a disguised restriction on trade between Member States."

[267] Art. XI. of GATT, 1994.

examining the scope of one of the major principles of free trade, viz., free movement of goods under the EEC treaty. In fact, it was the contributions of the courts, which gave utmost clarity to the concept.

As seen from the Article 30 of EC treaty (the current Article 34 of TFEU), there should not be any quantitative restriction regarding movement of goods between member countries. We may now look into some cases in which the ECJ has tried to examine the implications of such quantitative restrictions on free trade/free movements of goods. In *Procureur du Roi v Benoît and Gustave Dassonville,* the ECJ held interpreting Art.30 and Article 36 of EC treaty, that all trading rules enacted by member States which are capable of hindering directly or indirectly, actually or potentially, intra Community trade are to be considered as measures having an effect equivalent to quantitative restrictions.[268] This principle laid down in this land mark decision by the ECJ regarding free movement of goods came to be known as the Dassonville formula. The decision brings out the importance of free movement of goods over the restrictions placed upon the same.

The concept of quantitative restriction under Art 30 of EC treaty was further expanded in *Commission v. Italy*,[269] and it was held that measures having equivalent effect refer not only to the discriminatory national rules and the rules that lay down requirements to be met by goods but also to "any other measure which hinders access of products originating in other Member States to the market of a Member State".[270] The thrust provided in the decision obviously seems to be on the promotion of access to products under the free movement of goods regime. The decision is also aiming at doing away protectionism based on source of origin of goods. Further, any measure which amounts to a total or partial restraint of imports or goods in transit was held to be quantitative restriction and against the spirit of free trade principle of free movement of goods.[271] The observations made by the court in these decisions expand the notion of quantitative

[268] *Procureur du Roi v Benoît and GustaveDassonville*(1974) Case 8/74.

[269] C-110/05 (2006) ECR 519. Italy prohibited the use of motorcycles towing trailers within its territory. Considering this rule to be an obstacle to the free movement of goods contrary to Article 28 EC, the Commission brought proceedings against Italy before the Court of Justice. The Court held that the general and absolute prohibition on towing of trailers by mopeds throughout Italian territory impede the free movement of goods.

[270] C-110/05 (2006) ECR 519.

[271] *Geddocase*[1973] ECR 865.

restriction from mere restriction on quantity to any mode of restriction which hinders free movement of goods between nations.

Another landmark decision which codified the free movement of goods as an essential part of trade was the *Schmidberger* case[272]. In this case ECJ held that free movement of goods within the European territory is a fundamental freedom. Court held that if a Member State abstains from adopting the measures required in order to deal with obstacles to the free movement of goods, which are not caused by the State. Article 28 and 30 are the crux of the principle of free movement of goods.

ECJ further expanded the notion of free trade by recognising another fundamental principle of free trade, viz., the principle of mutual recognition. This principle means that any product lawfully manufactured and marketed in any member states should be accepted by other member states as a lawful product.[273] While interpreting Article 30 of the EC treaty, the court held that the fixing of minimum level of alcohol level on beverages, which are lawfully manufactured and sold in a member state is in contravention of Article 30 and amounts to quantitative restriction. In *Keck Case*,[274] the court examined certain selling arrangements between sellers which were prohibited under the French law (eg: resale arrangements) and held the prohibition to be lawful as it did not restrict trade and was applicable both to domestic and foreign made goods equally. However, the Court observed that unless on account of public interest, any rules made which create obstacles to free movement of goods that are lawfully manufactured and marketed, amount to measures of equivalent effect to that of quantitative restriction under Article 30 of the EC treaty, which is prohibited.

Another principle that evolved from judicial pronouncement regarding free trade was the *principle of proportionality* in the decision rendered in the *Henn and Darby* case.[275] ECJ emphasised that any restriction made to free movement of goods should comply with the

[272] C- 112/00 [2003] ECRI-5659.

[273] *Cassis de DijonRewe-Zentral AG* v.*BundesmonopolverwaltungfürBranntwein*, (case 120/78), wherein the prohibition on importation of liquor made on the ground that the percentage of alcohol in the liquor was too high was rejected by the ECJ which held that fixing of minimum alcohol content for importing products amounts to quantitative restrictions abolished under Article 30. Also see Commission v. Italy, C-110/05 (2006) ECR 519.

[274] (1993) ECR I-6097.

[275] C-34/79 (1979) ECR 3795.

principle of proportionality. The principle of proportionality meant that the measure adopted by the member country was to be proportionate with the aim or reason for the adoption of the measure. This means that if a trade restrictive measure exceeds what is required for curbing a problem, it will be against the principle of proportionality. Whether a measure is proportional can be measured using the following parameters-

1) Appropriateness for attaining the objective
2) Necessity referred to as least trade restrictive

Other measures if available should be used. The measure adopted must be absolutely necessary for achieving a desired purpose. This measure must be used least trade restrictive and if any alternate measures which can be least trade restrictive is available then the same should be adopted.

To sum up, any measure which amounts to quantitative restriction, or against principle of mutual recognition or the principle of proportionality, is arbitrary, and trade restrictive, and hinders market access to consumers is against free trade principle.

2.3 Exhaustion and Free Trade- Can the Principles of Free Trade Be Differently Applied to IP Goods?

It is evident from the earlier discussions that freedom of trade is the fundamental principle behind free trade and exhaustion. However, it is also clear that different modes of exhaustions are permitted under the WTO. In order to understand if this is creating a conflict or not two fundamental questions need to be raised: (i) can the principles of free trade be applied differently to IP goods? (ii) can different modes of exhaustion be justified in a free trade framework? For analysing these issues one needs to examine if any exceptions provided under the GATT itself provide justification for a differential treatment to the doctrine of exhaustion. Once it is clear that no such exceptions are available, no justification remains for keeping the option to follow different forms of exhaustion open within the WTO framework.

2.3.1. Permissible Exceptions to free trade under GATT

While encouraging free trade, WTO places several restrictions upon the free import of goods and it is attempted here to have an analysis of such restrictions to see if restrictions on parallel import

is permissible in the free trade context and also to see if the different modes of exhaustion permitted under the WTO is in tune with its basic tenet of free trade.

Several exceptions to free trade are built in to the GATT for different purposes.[276] What is necessary here is to explore if such exceptions to free trade having any impact on intellectual property.

2.3.1.1. General Exceptions:

Article XX, providing for general exceptions, brings out instances wherein free trade principle under GATT could be restricted, such as when "it is necessary to secure compliance with laws and regulations which are not inconsistent with the provisions of" GATT. The most relevant exception in this respect is the one under Article XX (d).[277] It states that any measure adopted to secure compliance with IP laws, should not be considered as derogatory of free trade regimes under the GATT. However, the Article comes with a rider to the effect that no IPR policy shall be inconsistent with the general principles of free trade enshrined in the WTO, which implies that unreasonable restriction on imports shall not be placed by members in the case of Intellectual Property goods.[278] In other words, it could be gathered from this provision that national or regional exhaustion are not justified under Article XX (d).

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[276] Art. XI (2)(b) of GATT, 1994,: Import prohibitions on the basis of not meeting standards or regulations, Article XII of GATT, 1994, :Import restrictions to safeguard balance of payments, Article XII (3) (c) (III):Import restriction for non-compliance of IP laws, Article XVIII of GATT,1994,:Governmental Assistance to Economic Development.

[277] Art. XX, of GATT, 1994,: Subject to the requirement that such measures are not applied in a manner which would constitute a means of *arbitrary or unjustifiable discrimination between countries where the same conditions prevail*, *or a disguised restriction on international trade*, nothing in this Agreement shall be construed to prevent the adoption or enforcement by any contracting party of measures:
(d) necessary to secure compliance with laws or regulations which are not inconsistent with the provisions of this Agreement, including those relating to customs enforcement, the enforcement of monopolies operated under paragraph 4 of Article II and Article XVII, the protection of patents, trade marks and copyrights, and the prevention of deceptive practices.

[278] Art. XX (d) of GATT, 1994, states : "necessary to secure compliance with laws or regulations *which are not inconsistent with the provisions of this Agreement*, including those relating to customs enforcement, the enforcement of monopolies operated under paragraph 4 of Article II and Article XVII, the protection of patents, trademarks and copyrights, and the prevention of deceptive practices". The words "not inconsistent with the agreement" means that the overall philosophy of free trade governs the exception under Article XX(d) of GATT, 1994.

However, the proponents of national exhaustion and regional exhaustion try to justify their standby taking protection under Article XX (d) of GATT.It provides for adoption of measures for the protection of intellectual property. Article XX (d) provides an exception tothe obligations under GATT agreement for the purpose of enabling Member States to take 'measures necessary' to secure compliance with laws or regulations including, *inter alia*, those relating to customs enforcement, the protection of patents, trademarks and copyrights, and the prevention of deceptive practices, it adds a rider to this exception. Therefore, the proponents of national or regional exhaustion argue that the recognition of national or regional exhaustion is for securing compliance of the IP law which prohibits parallel imports. However, it also stipulates that such "measures" shall not be applied "in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade".

The exceptions under Article XX paved way to serious discussions among the member countries during the drafting stage.[279] Many members opined that such exceptions could be misused for indirect protection, which is undesirable. As a result, the words in the preamble of GATT text - arbitrary or "unjustifiable discrimination between countries or disguised restriction on international trade"- were incorporated in to the text also.[280] Thus these words form the primary limitation upon the application of the exceptions to GATT agreement. The exception is important as it also forms an exception to the national treatment principle of the agreement and thus the application of the same should also be careful and sparingly applied i.e., when they are absolutely necessary. The provision also stresses the importance or supremacy of international trade over the exceptions provided and therefore any unnecessary restriction on free movement of goods.

[279] PadidehAla'I, "Free Trade or Sustainable Development? An Analysis of the WTO Appellate Body's Shift to a More Balanced Approach to Trade Liberalization", American University International Law Review, [1999], Vol.14, No. 4, p.1134, available at https://digitalcommons.wcl.american.edu/cgi/viewcontent.cgi?article=1330&context=auilr, (accessed on 20/12/2018).

[280] PadidehAla'I, "Free Trade or Sustainable Development? An Analysis of the WTO Appellate Body's Shift to a More Balanced Approach to Trade Liberalization", American University International Law Review, [1999], Vol.14, No. 4, p.1135, available at https://digitalcommons.wcl.american.edu/cgi/viewcontent.cgi?article=1330&context=auilr, (accessed on 20/12/2018).

In the 1989 Panel Report on "United States - Section 337 of the Tariff Act of 1930"- panel held that for a measure to be "necessary" under the Article XX (d) certain conditions have to be met :

a) *laws or regulations* with which compliance is being secured are themselves*not inconsistent with the General Agreement*;
b) measures are *necessary to secure compliance* with those laws or regulations;
c) measures are *not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade* .(emphasis added).

The above limitations should be complied with when a country adopts a measure invoking Article XX (d). The Panel noted that each of these conditions must be met if an inconsistency with another GATT provision is to be justified under Article XX(d).[281] Further addition was made by another GATT panel whereby it was stated as below:

> "Clearly, Article XX(d) is susceptible of application in respect of a wide variety of "laws and regulations" to be enforced. It seems to us that a treaty interpreter assessing a measure claimed to be necessary to secure compliance of a WTO consistent law or regulation may, in appropriate cases, take into account the relative importance of the common interests or values that the law or regulation to be enforced is intended to protect. The more vital or important those common interests or values are, the easier it would be to accept as "necessary" a measure designed as an enforcement instrument"[282]

Thus various factors are necessary so as to make a measure under Article XX (d) a necessary and justifiable one under Article XX (d), which includes the importance of the measure in implementing the law, the social welfare encompassed by the law, and its effect on imports and

[281] Report of the GATT Panel, "United States - Section 337 of the Tariff Act of 1930"- (L/6439 - 36S/345)adopted on 7 November 1989.

[282] Report of the Appellate Body, "Korea – Measures Affecting Imports of Fresh, Chilled and Frozen Beef", (WT/DS161/AB/R WT/DS169/AB/R) adopted on 11 December 2000.

exports.[283] It is important at this stage to analyse what is the implication of these limitations on under Article XX (d).

(a) Disguised restriction on international trade

The measure adopted by the contracting party to the agreement in pursuance of Article XX (d) should not be such that it indirectly acts as a restriction on international trade. International trade is the order of international relations and economic rule of the era. Therefore, any kind of restriction, either direct or indirect, is prohibited. Thus, applying IP law in a manner in which it restricts trade cannot be upheld under Article XX (d). In the Panel report of EC- Asbestos case, the panel held that it must be examined whether a measure that formally meets the requirements of the Article XX is in fact designed to pursue a protectionist and trade-restrictive objective.[284] The 1983 Panel Report on "United States - Imports of Certain Automotive Spring Assemblies"[285] examined a ban on imports of certain automotive spring assemblies under an exclusion order of the U.S. International Trade Commission. The Commission, under Section 337 of the Tariff Act of 1930, had found that the importation resulted in the infringement of United States patents. Even though the panel found that the measure adopted by U.S. to prohibit goods which infringe U.S. patents was not a disguised restriction on trade, it concluded that the exclusion order shouldnot prohibit importation of automotive spring assemblies produced by any producer outside the United States, who had a license from patentee to produce these goods. And it was on this ground the panel upheld the provision.[286] The Panel thus clarified that though measures under Article XX (d) can be invoked to protect IP by banning importation of infringed or counterfeit goods, ban on importation of genuine products cannot be justified under it. The conclusion to be drawn from the above observation of the GATT panel is that the right of import

[283] Report of the Appellate Body, "Korea – Measures Affecting Imports of Fresh, Chilled and Frozen Beef", (WT/DS161/AB/R WT/DS169/AB/R) adopted on 11 December 2000.

[284] Report of the Panel, "European Communities — Measures Affecting Asbestos and Asbestos-Containing Products", (WT/DS135/R and Add.1), adopted 5 April 2001, as modified by the Appellate Body Report, (WT/DS135/AB/R).

[285] Report of the Panel, "United States - Imports of Certain Automotive Spring Assemblies", (L/5333 - 30S/107), adopted on 26 May 1983.

[286] Report of the Panel, "United States - Imports of Certain Automotive Spring Assemblies", (L/5333 - 30S/107), adopted on 26 May 1983.

recognised under any patent law could not be used to ban genuine imports of legal goods. Thus the ambit of the right to import recognised under U.S. law should be questioned.[287]

(b) Necessary to secure compliance with laws/protection of IP laws

The measure adopted under the exception of Article XX (d) should be as to protect or enforce a national law. The measure adopted should be necessary in the absence of which the law cannot be properly enforced. In The 1983 Panel Report on "United States - Imports of Certain Automotive Spring Assemblies"[288] the Panel considered whether or not the exclusion order was applied in a manner which would constitute a disguised restriction on international trade. Measure against Patent infringement by people outside the country was a necessary measure to be adopted. The Panel further held that the exclusion orders under U.S. Trade Act was 'necessary' within the meaning of Article XX (d) since there was no other efficient alternative for the patent holder for a remedy. If any other least trade distortive method was available, then the measure would have been inconsistent within the GATT provisions.[289] This points out to the fact that the word necessary refers to a situation where there is no other means of method other than the measure adopted by the party which could justify the measure as covered under Article XX (d).However, when an alternative method is available which will not disturb the international trade, such least distortive method should be used. The 1989 Panel Report on "United States - Section 337 of the Tariff Act of 1930"- the Panel held that a contracting party cannot justify a measure inconsistent with another GATT provision as 'necessary' in terms of Article XX(d) if an alternative measure which it could reasonably be expected to employ and which is not inconsistent with other GATT provisions is available to it- the least trade restrictive trade measure should be adopted.[290] The panel further held that Patents was one among the few areas specifically mentioned in Article XX (d) of GATT, which allows parties to take measures which

[287] Similar decision was arrived in the recent U.S. case, *kirtsaeng v. John wiley& sons, inc.*568 U.S. 519 (2013) wherein Supreme Court opined that the right to import conferred upon a copyright owner does not guarantee the right to block genuine goods made lawfully outside U.S.

[288] Report of the Panel, "United States - Imports of Certain Automotive Spring Assemblies", (L/5333 - 30S/107), adopted on 26 May 1983.

[289] Report of the Panel, "United States - Imports of Certain Automotive Spring Assemblies", (L/5333 - 30S/107), adopted on 26 May 1983.

[290] Report of the GATT Panel, "United States - Section 337 of the Tariff Act of 1930"- *(*L/6439 - 36S/345) adopted on 7 November 1989.

ordinarily would be against the spirit of the agreement but necessary for the enforcement of the law.[291] However, it also mean that if a contracting party could reasonably secure that level of enforcement in a manner that is not inconsistent with other GATT provisions, it would be required to do so.[292] The panel further found that it is up to the contracting party seeking to justify measures under Article XX(d) to demonstrate that those measures are 'necessary' within the meaning of that provision.[293] Article XX is a limited and conditional exception from obligations under other provisions of the General Agreement, and not a positive rule establishing obligations in itself.[294]

(c) Unjustifiable discrimination between countries:

The last condition attached to the section is that the measure adopted under Article XX should be such that it is applied uniformly to all the countries. In the 1982 Panel Report on "United States - Prohibition of Imports of Tuna and Tuna Products from Canada"- the Panel found that prohibition of Tuna was not merely from Canada but also from many other countries such as Peru, Costa Rica and Mexico and for same reasons.[295] Therefore was not unjust discrimination. Similar dictum was found in The 1983 Panel Report on "United States - Imports of Certain Automotive Spring Assemblies"- Panel held that the exclusion order under Section 337 of Tariff Act was not directed merely against Canada but to all foreign sources which infringed U.S. patents.[296] This limitation mandates that a measure which is adopted by a country must apply equally to all nations. It is clear from the above analysis that free trade through encouraging imports is the basic philosophy enshrined in the WTO framework. The kinds of restrictions imposed on imports are not complete ban on imports but restrictions in the form of taxes and duties. Imports are banned only on the contexts of situations either favouring developing nations

[291] Report of the Panel, "United States - Imports of Certain Automotive Spring Assemblies", (L/5333 - 30S/107), adopted on 26 May 1983.

[292] Report of the Panel, "United States - Imports of Certain Automotive Spring Assemblies", (L/5333 - 30S/107), adopted on 26 May 1983.

[293] Report of the Panel, "United States - Imports of Certain Automotive Spring Assemblies", (L/5333 - 30S/107), adopted on 26 May 1983.

[294] Report of the Panel, "United States - Restrictions on Imports of Tuna"(DS29/R), adopted on 16 June 1994.

[295] Report of the Panel, "United States - Restrictions on Imports of Tuna"(DS29/R), adopted on 16 June 1994.

[296] Report of the Panel, "United States - Imports of Certain Automotive Spring Assemblies", (L/5333 - 30S/107), adopted on 26 May 1983.

or in the cases of balance of payment cases which are of temporary in nature. From the analysis of the above said provisions in the WTO agreement, it is clear that WTO works on the comparative advantage theory of free trade and thus encourages maximum production of goods which could be cheaply produced locally for exportation and imports of those which are disadvantages for local production. Even though exceptional circumstances do provide for affecting these imports, restrictions like duties, taxes etc., are favoured rather than prohibitions on imports. Besides, preamble of TRIPs aims at desiring to reduce distortions and impediments to international trade and taking into account the need to effective protection of IPR and ensure that measures and procedures to enforce IPR do not themselves become barriers to legitimate trade. TRIPs is also subject to the basic principle of GATT 1994.[297] Thus banning imports of genuine goods merely for the reason that it originated in another territory goes against the basic notion of free trade under WTO. Thus from the analysis of WTO principles it could be safely concluded that, WTO principles favour international exhaustion.

2.4.Free trade, Intellectual property and exhaustion

We have already seen that one of the basic principles underlying WTO is free trade. One may naturally expect the general GATT/WTO philosophy of free trade to be reflected in the Agreement on Trade Related Aspects of Intellectual Property (TRIPs) as well. However, it seems that the concept of free trade gets an altogether different meaning when it comes to IP goods. The lack of consensus on the mode of exhaustion to be followed by WTO member countries is an example. In fact, it can be seen that the different modes of exhaustion act as a trade barrier as some modes of exhaustion hinders free movement of IP goods across borders and international exhaustion alone is in line with the free trade concept. This establishes that the free trade theory is applied differently when it comes to IP goods which cannot be justified.

International trade can be welfare enhancing only when it takes place freely between the nations.[298] The IP goods are marketed globally under differential pricing, making them available in different markets at different prices, based on the purchasing capacity of consumers in the

[297] Preamble, TRIPs agreement, 1994.

[298] AmartyaSen, *Development As Freedom*, First Anchor Books, United States of America, (1st edn, 2000), p.6

respective markets.[299] This results in the availability of similar products at cheap prices in one country and at high prices in another country, sold by the IP holder himself in both these markets. Parallel import is taking advantage of these price differentials, and allowing importing of cheap priced goods from one market to another high priced market, making it available at a cheaper rate to consumers there. Thus it can be seen that the founding principle of parallel imports and comparative advantage are the same.[300] It should be further noted that the ability of the IP holder to produce products at different prices in different markets i.e., to resort to differential pricing, is on account of the comparative advantage that these markets offer. Therefore, prohibiting the benefit of the same to global consumers is against the free trade theory. Further, in many countries the IP holder is granted right to import.[301] What the IP holder does is, in many cases, to produce the goods in places where they are cheaper to produce and then to import it to other countries at much higher prices depending on the consumer's purchasing capacity in those countries. This practice goes well with the concept of free trade and the comparative advantage theory. This being the case, denying cheaper goods to move freely between nations in the name of intellectual property is contrary to the principles of free trade, which bases itself on the comparative advantage theory. This is because under such situations though the first limb of the theory viz., taking advantage of the free trade is fulfilled by producing goods at places where they are comparatively advantageous to produce, the second limb of the theory, viz., to enhance consumer welfare, is being discarded by avoiding competition, just for the sake of amassing maximum profit. Parallel imports, as already discussed, occurs due to the differential pricing mechanism adopted by the producers in different markets depending upon the difference in the nature of market structure, and other factors like

[299] Sarah R. Wasserman Rajec, "Free Trade in Patented Goods: International Exhaustion for Patents", Berkeley Tech. L.J. [2014], Vol. 29, p.362, available at https://scholarship.law.berkeley.edu/cgi/viewcontent.cgi?referer=https://www.google.com/&httpsredir=1&article=2023&context=btlj, (accessed on 26/11/2018).

[300] Even though it might be impossible for the countries to forego production of goods at the home country and merely continue to import from countries where they are cheaper to produce, since IP goods involve the aim of technology transfer, for which local working is crucial, this should not prohibit the importation of parallel imports. Further, in countries where local manufacturing is not mandatory, the IP holders often produce goods from countries where they are cheaper to produce and import them, since they have a right to import. See for eg; *Kirtsaeng v. John Wiley & Sons, Inc.,* 568 U.S. 519 (2013), where court observed the falsity of granting right to import but prohibiting parallel imports. If the importation of IP holder can be justified, so can parallel imports be.

[301] At least in the case of patents it is mandatory under TRIPs to recognise right to import.

availability of cheap labour, and which support differential pricing. These factors are the determining factors for the benefit of international trade and denial IE /PI is tantamount to rejection of the principles of free trade as it discriminates IP goods from other goods. Similarly, consumer welfare, the main advantage of parallel imports, also is the focal point of comparative advantage. Another important negative aspect of refusing parallel import of legally purchased goods is that the IP owner is thereby contributing to the slowing down of development by exerting undue monopoly and restraining economic transaction of a legally purchased good.[302]

Excessive protection of Intellectual property rights is considered a non-tariff barrier to the free movement of goods.[303] The abuse of IP rights by prohibiting genuine products from being imported from one country to another act as non-tariff barrier, restraining free movement of IP goods.[304] As enunciated above, any kind of restriction on free movement of genuine goods is against free trade. Intellectual property rights, prima facie, act as restrictions on the free movement of goods since they confer on the owner the exclusive right to sell, distribute, etc.[305] However, as the earlier discussion in Chapter 1 reveals, the apparent conflict has been resolved by the law and the judiciary by balancing the conflicting interests of IP owner and the purchaser of the IP good.[306] The rights granted by IP are territorial in nature and therefore, exhaustion is

[302] See AmartyaSen, *Development As Freedom*, First Anchor Books, United States of America, (1st edn, 2000), p.9, who brings out the fact that freedom of economic transactions are a great engine of economic growth.

[303] Sarah R. Wasserman Rajec, "Free Trade in Patented Goods: International Exhaustion for Patents", Berkeley Tech. L.J., [2014], Vol. 29, p.329, available at https://scholarship.law.berkeley.edu/cgi/viewcontent.cgi?referer=https://www.google.com/&httpsredir=1&article=2023&context=btlj, (accessed on 26/11/2018).Also see; Kobak James B., 2005. "Exhaustion of Intellectual Property Rights and International Trade," Global Economy Journal, De Gruyter, vol. 5(1), p.3, available at https://ideas.repec.org/a/bpj/glecon/v5y2005i1n5.html, (accessed on 22/12/2018); *BBS KraftfahrzeugTechnik AG v. Kabushki Kaisha Racimex*, Case No. 7 Helsei (WO) 1988 (1997)

[304] KrithpakaBoonfueng, "A Non-Harmonized Perspective on Parallel Imports: The Protection of Intellectual Property Rights and the Free Movement of Goods in International Trade", (S.J.D . dissertation, United States – District of Columbia: American University, 2003), P.9, available from https://digitalcommons.wcl.american.edu/cgi/viewcontent.cgi?article=1005&context=stu_sjd_abstracts, (accessed on 26/11/2018).

[305] Sarah R. Wasserman Rajec, "Free Trade in Patented Goods: International Exhaustion for Patents", Berkeley Tech. L.J., [2014], Vol. 29, p.330, available at https://scholarship.law.berkeley.edu/cgi/viewcontent.cgi?referer=https://www.google.com/&httpsredir=1&article=2023&context=btlj, (accessed on 26/11/2018).

[306] Chapter I of the thesis, Historical Evolution and Theoretical Justifications of the Concept of Exhaustion, pp.24-31.

considered as inherent mechanism within IP system which facilitates free movement of goods.[307] This means that upon the initial sale of an IP product, as stated earlier, the IP gets exhausted, so that the IP product can move freely between nations. Denouncing international exhaustion, therefore, amounts to restriction on free trade. Exhaustion aims to further consumer welfare of IP system. The common thread of international free trade and international exhaustion is consumer welfare and promotion of affordable access to IP goods, and this feeling is strengthened on further analysis of the development of exhaustion doctrine.

2.4.1.The Concept of Exhaustion of Intellectual Property Rights as an element of Free Trade

Exhaustion doctrine is the result of judicial contribution rather than legislative efforts, in response to the stringent measures resorted to by the IP owners to extend their monopoly power beyond their legally permissible limits, and to the detriment of the consumer welfare. The initial case laws regarding exhaustion, which sowed the seeds of development of the doctrine of exhaustion, aimed at freeing IP goods from unnecessary restrictions placed upon them by the IP owners.[308] It recognised the right of the owner of an IP good to resell it by placing restrictions on

[307] See BBS*Kraftfahrzeugtechnik AG v. Racimex Japan KK*51 MINSHU 299, 1612HANREI Ju1-to 3 (Sup. Ct. 3rd Petty Bench, July 1, 1997), Translated by Takeo Hayakawa. In the instant case, a German company BBSholding patents in Europe and Japan for a particular type of car wheel wanted to prevent Racimex Japan KK to import those machines from Germany to Japan on the premise that, because BBS had not consented to the sale of those particular goods in Japan, their importation and sale was akin to piracy, even though the goods had been legitimately manufactured and sold in Germany under the relevant European patent. The court held that a voluntary sale in a national market of goods protected by a national patent activates the emerging principle of international law that the freedom of international trade takes precedence over national intellectual property protection. It found that the patent owner's monopolistic right to control the resale of its goods got exhausted by the voluntary first sale of the goods and a contrary view would damage the development of industry and the expectations of commerce. The court was also concerned with independence of patents- whether the territorial nature of IP as enunciated under Paris Convention Article 4bis through independence of patents bars international exhaustion. However court interpreted the same as "[T]he principle of territoriality with regard to patents means that patent rights in each country are subject to domestic legal provisions insofar as establishment, transfer, and validity are concerned. It means that the patent rights only have effect within the geographical limits of such country". The Court concluded that if patented products are sold domestically, either by the patentee or with his consent, the patent is deemed exhausted because it has fulfilled its purpose. The patent does not give rights to subsequent use of the patented product by acts of transfer or lease.

[308] The exhaustion doctrine, as explained, in my first chapter, helps in increasing the commercial value of a good purchased by the person, by removing restraints on those goods. This is exactly what free movement of goods philosophy aims to achieve. International free trade enables unrestricted movement of lawful goods across

the rights of the IP holder and facilitating free circulation of it globally. Such decisions were made with the intention to facilitate the purchaser of IP good to enjoy the benefits of the property which he has lawfully purchased. But soon the courts began to realise that it is not just the purchasers who are at a loss if the resale is prohibited. Such restraints on further sale affected trade adversely, which in turn affected competition negatively. To avoid such negative impacts, the courts differentiated between ownership in IP and ownership of purchasers over products. The court concluded that the restraints placed by IP owners upon sold goods using IP rights restrained the movement of lawful goods.[309] The purchaser was declared to have owned the right to use the product at any place at any point of time and can engage in trading of the same. The logic for the same was to recognise free circulation of goods in the market so as to cater public interest. Merely because intellectual property grants monopoly in certain products does not mean that the free movement of the once sold product could be curtailed.[310] The judiciary while doing away with the restraints also observed the national development perspectives through freedom of trade that could be furthered by the exhaustion principle. Thus it is clear that, among various principles used by the courts to recognise exhaustion, rule against on alienation was the most important. Free movement of IP goods without any restraint was the focus of the courts. The major concern of the courts was the larger public interest that and they highlighted this in all the cases, bringing out the importance of free movement of intellectual property goods. In fact, it could be observed that the theory behind the concept of exhaustion is an extension of the theory of free movement of goods.

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borders- without any restraint. Even the exhaustion doctrine was developed so as to achieve this objective. Even in the modern context, the notion of free movement of goods and free trade is indeed an extended philosophy underlying the rule against restraint of trade. The GATT philosophy of free trade also aims at unfettered movement of goods across the globe. For detailed discussion see first chapter of the thesis. Also see Christopher Heath, "Parallel Imports and International Trade", available at,
www.wipo.int/edocs/mdocs/sme/en/atrip_gva_99/atrip_gva_99_6.pdf, (accessed on 18/08/2017).

[309] See for eg: *Wilson* v. *Rousseau* 45 U.S. 646*, Bloomer* v.*Mcqueen*, 55 U.S. 539 (1852)*, Mitchell* v. *Hawley* 83 U.S. (16 Wall.) 544*, Adams* v. *Burke* 84 U.S. 453 (1873).

[310] *Dr. Miles Medical Co.* v. *John D. Park & Sons Co*., 220 U.S. 373 (1911): "but because there is monopoly of production, it certainly cannot be said that there is no public interest in maintaining freedom of trade with respect to future sales after the article has been placed on the market and the producer has parted with his title."

2.4.2. Parallel imports and free trade under GATT

The question to be addressed is can parallel imports, being genuine goods and goods produced by the consent of the IP holder himself, be banned and is a claim of exemption from Article XI of GATT, 1994 valid? Article XI of the GATT which stipulates free movement of goods across borders does not differentiate between intellectual property goods and normal goods. Parallel import, as we know, is the activity of importing genuine intellectual property protected goods across the borders. The free trade principle enshrined in Art. XI of GATT supports parallel imports as importation of products cannot be restrained using quantitative restrictions.[311] Report of the working Party on the use of quantitative restrictions for protective and commercial purposes, 1950, examined the use of both export and import restrictions.[312] The report addressed total prohibition on imports of products which are in direct competition with the domestic product on the disguise of balance of payment exception and concluded that they are inconsistent with Article XI.[313]It is thus clear from the above discussions that the aim of the quantitative restrictions is not to ban parallel imports and that Article XI furthers the concept of parallel imports, as it encompasses even the competitive mechanism that imports can bring in.

Even under Article XX (d) of the GATT, the restriction provided in the case of IP is in the context of enforcement of measures of intellectual property rights and it does not form a disguised restriction on free trade. Thus ban on parallel imports would amount to disguised restriction on international trade as such goods are produced legally outside the territory. In the case of parallel imports, even in the Uruguay round, the arguments against international exhaustion was that the same would lead to inflow of counterfeit goods into markets of the IP owner which destroys his market.[314] When it comes to the IP scenario, it is clear from panel

[311] Chung-LunShen, "Intellectual Property Rights and International Free Trade: New Jurisprudence of International Exhaustion Doctrine under the Traditional Legal System", Journal of International Commercial Law and Technology, [2012], Vol.7, Issue3, p.184, available at SSRN: https://ssrn.com/abstract=2103684, (accessed on 21/12/2018).

[312] Report of the Working Party on "The Use of Quantitative Restrictions for Protective and Commercial Purposes" (GATT/GP.4/ 33), 28 March, 1950, available at https://www.wto.org/gatt_docs/English/SULPDF/90320408.pdf, (accessed on 11/12/2018)

[313] Report of the Working Party on "The Use of Quantitative Restrictions for Protective and Commercial Purposes" (GATT/GP.4/ 33), 28 March, 1950, available at https://www.wto.org/gatt_docs/English/SULPDF/90320408.pdf., (accessed on 11/12/2018).

[314] See for discussion Chapter 3 of thesis on negotiating history of Article 6 of the TRIPs agreement.

decision in U.S. Automotive Spring case that restriction on trade could be made only to fight counterfeit goods and not genuine goods.[315] Even when that is the case, the least trade distortive method should be used. This is very similar to the Principle of proportionality enunciated by the European courts.[316] Both the principle of proportionality ad the panel decision in the automotive spring case stresses the point that only a measure which least trade distortive should be used. From the above analysis it is clear that the least trade distortive measure should be used to fight the counterfeit goods rather than banning genuine goods as a whole from other countries merely on the ground that it originated in another territory and that for the effective enforcement of IP laws banning parallel imports is not a necessary condition.[317] Further Article XX (d) obligates to treat all nations equally. This limitation negates the adoption of regional exhaustion. Even if banning parallel imports is justified, the ban must be equally applied by the nation to all the countries and cannot be applied differently to different countries. Under regional exhaustion one could entertain goods which are sold once in any of the region while does not permit to import from a nation outside the jurisdiction of the region even though they are similarly placed. This makes it clear that for banning parallel imports through any measure under IP law, it must be shown that such measure is necessary for effective enforcement of the IP law and also that it should not be an arbitrary or unjustifiable discrimination between countries or a disguised restriction on international trade.

The ban on parallel imports also infringes national treatment principle under Article III of GATT. National treatment principle aims at avoiding discrimination of goods on the basis of origin of products. Once imported into a member and have cleared customs, they have to be

[315] Report of the GATT Panel, "United States - Imports of Certain Automotive Spring Assemblies", (L/5333 - 30S/107), adopted on 26 May 1983.The Panel Report examined a ban on imports of certain automotive spring assemblies under an exclusion order of the U.S. International Trade Commission. The Commission, under Section 337 of the Tariff Act of 1930, had found that the importation resulted in the infringement of United States patents.

[316] See for an analysis of the Principle of Proportionality the discussion on *Henn*v.*Barby* C-34/79 [1979] ECR 3795.

[317] It is submitted that the argument that the inflow of counterfeit goods will be promoted if parallel imports are allowed cannot be accepted without any sufficient evidence. See for eg; study conducted by *REMIT Consultants, Impediments to Parallel Trade in Pharmaceuticals Within the European Community: Final Report Prepared for DGIV of the European Commission* (May 1991), EEC reference IV/90/06/01 , referred to by as referred to by Christopher Stothers, *Parallel Trade in Europe: Intellectual Property, Competition and Regulatory Law*, HART Publishing, North America and Portland, (2007), p.22, wherein the study concluded that the issue of parallel imports and counterfeiting goods should be dealt as separate issues.

treated no less favourably than like products originating in that member.[318] The principle of national treatment makes it is clear that measures could not be adopted against imported products for protecting domestic market.[319] This provision should be read along with Article XI of GATT. Article XI, as explained above, mandates that no prohibitions on imports shall be made on genuine goods on borders of the nations. Therefore, the genuine parallel imported products under Article XI of GATT cannot be prohibited at the borders. Once inside the borders, the goods cannot be discriminated with that of the similar local products as per Article III of the national treatment. This implies that there should be free movement of parallel imports between nations and cannot be restrained. This calls into question the right to import guaranteed under the intellectual property rights to the owner.

The right to import is the ground for IP holders to challenge the parallel imports as no other person can import when an express right is guaranteed to IP owner unless exceptions are provided. The right to import is, thus, in contradiction with the concept of free trade as reflected in Article III. Even if right of importation is granted under the IP regime, this could not be used to ban parallel imports, as it goes against the both national treatment principle and the principle of free movement of goods. This is because national treatment principle under WTO read along with Article XI presupposes a right to import a legitimate good by any person into any other country since free trade is advocated under the regime.[320] This implies that an exclusive right to import cannot be granted under any law to any goods to the extent that it can block the entry of any genuine goods produced abroad.[321] This forms the crux of the principle and therefore, prima facie, the practice of following different modes of exhaustion in different jurisdictions goes against the national treatment principle and the free trade philosophy. In fact the compromise achieved between nations through the incorporation of Article 6 of TRIPs too is in violation of GATT principles. Similarly, Article III: 4 mandates equal treatment of products of foreign origin

[318] National treatment applies to goods which have been cleared by the customs to enter into the market of the importing country. Goods cannot be blocked under the border measure rule unless it is a prohibited category under WTO rules.

[319] Raj Bhala and Kevin Kennedy, *World Trade Law: The GATT-WTO System, Regional Agreements, and U.S. Law*, Lexis Law Publishing, Virginia, 1998, p.98.

[320] Art. XI of GATT, 1994- No prohibitions on imports other than duties, taxes or other charges made effective through licenses or other measures shall be made on imports.

[321] Import restrictions can be placed only in accordance with the provisions enumerated above which does not cover parallel imports.

imported into another territory[322] with that of like domestic product.[323] This, again, implies that no discrimination shall be made on the ground of place of origin of goods. This provision, thus, is in direct conflict with the theories of national and regional exhaustion which in fact differentiates the goods based upon the origin of goods.

It is not in dispute that the parallel imported goods are like products as they are the same product once sold by the IP holder. In these cases, imported and domestic products may be considered to be alike under Article III: 4.[324] Therefore in the case of parallel imports the only difference which exists would be based on the origin of goods, which, according to Article III: 4 of GATT, cannot be a legitimate ground of differentiation. In other words, national and regional exhaustion cannot coexist. Practically what national and regional exhaustion does is indirectly protecting the domestic industry by banning competing foreign products. This is exactly what national treatment principle tries to curb. The aim of this Principle is to prevent indirect protection of domestic production which countries may try to provide through internal mechanisms and to avoid protectionism and to ensure equality of competitive conditions between imported and domestic products.[325] The intention of the drafters of the Agreement was clearly to treat the imported products in the same way as the domestic products, once they clear through customs.[326] Otherwise indirect protection could be given.[327]

[322] Import restrictions may be placed on goods of foreign origin only when: Article XI (2): Import prohibitions on the basis of not meeting standards or regulations, Article XII: Import restrictions to safeguard balance of payments, Article XVIII: - Governmental Assistance to Economic Development, Article XX: General Exceptions. None of these conditions is applicable for banning parallel imports. Article XX is the only provision which could be relied on for banning parallel imports about which will be dealt in detail in the following sections.

[323] Art. III:4 :- The *products* of the territory of any contracting party *imported* into the territory of any other contracting party shall be accorded *treatment no less favourable than that accorded to like products of national origin* in respect of all laws, regulations and requirements affecting their internal sale, offering for sale, purchase, transportation, distribution or use.

[324] Report of the WTO Panel*,* "Argentina – Measures Affecting the Importation of Goods"*,* (WT/DS438/R, WT/DS444/R, WT/DS445/R)*,* adopted on 22 August 2014.

[325] Art. III:1 of GATT, 1994.

[326] Clearance through customs is mandatory unless it falls under any of the express exceptions provided through GATT mechanism.

[327] Report of the GATT panel, "Italian Discrimination against Imported Agricultural Machinery", (L/833 - 7S/60) adopted on 23 October 1958.

By banning parallel imports the basic philosophy and aims of the national treatment are completely violated. Parallel imports are foreign originated goods and if they are banned merely on that ground, it goes against the national treatment principle and becomes discrimination based on origin of goods. Prohibition of parallel trade prevents the foreign producers from competing with domestic products for unduly protecting the domestic industry. This results in prevention of the intra-band competition in the domestic market which amounts to a protectionist measure as well as results in anti-competitive behaviour.[328] Therefore, it is submitted that the measure under the IP law which prohibits parallel imports must be subject to scrutiny of Article III.

It is also important to look in to the regional or national exhaustion policies followed by different countries in the context of national treatment principle since the Preamble of the TRIPs agreement clearly mandates for consistency with the overall philosophy of the text. While examining the national treatment provisions under GATT agreement, it becomes clear that regional or national exhaustion policies are quite inconsistent with the overall philosophy of GATT. All these reasons point to the fact that only international exhaustion can co-exist with the principle of national treatment enshrined in the GATT philosophy.

2.4.3. Parallel Imports and EU Framework on Free Movement of Goods.

As stated above, European legislative framework and courts have played an important role in evolving the concept of free trade. Therefore, it would be worth analysing the position of parallel imports in the European framework of free trade. The thrust of the analysis would be to understand whether the prohibition of parallel imports from third countries could be justified under the European free trade regime. This section, therefore, will also analyse the case laws pertaining to parallel imports which were decided using the lens of principles of free movement of goods. The concept of regional exhaustion evolved in EU is also examined here to see whether regional exhaustion, which allows free movement of goods between nations forming part of the Union or international exhaustion which facilitates free movement of goods across nations the world over, is best suited to promote free trade. It is finally concluded in this section that in the WTO scenario international exhaustion needs to be the norm.

[328] Kerin M. Vautier, "Economic Considerations on Parallel Imports", in Christopher Heath, *Parallel Imports In Asia,* Max Plank Series on Asian Intellectual Property Law, Vol. 9, Kluwer Law International, Netherlands, (2004),p.6.

It is interesting to note that the earlier case laws in Europe regarding parallel imports were favouring parallel imports, recognising international exhaustion. Later, the lobbying of the industrial groups led to the adoption of regional exhaustion.[329] However, one could witness decisions favouring international exhaustion being rendered by courts, even after recognition of regional exhaustion by the Union.[330]

2.4.3.1. Principles of Free Trade under TFEU and Parallel Imports:

We have already seen during the discussion on the European framework on free trade that the EC had different approaches of trade among countries within the community and among countries outside the Community.[331] This portion of the chapter tries to analyse the position of EC on parallel imports in the light of the free trade principles under TFEU discussed earlier.[332] The section also tries to bring out how free movement of goods principle are applied differently and almost arbitrarily to IP goods.

While no quantitative or qualitative restrictions are to be maintained by the member countries (except as provided under express exceptions) within the European Union,[333] it is expressly provided that tariffs may be maintained for countries outside the EC in a uniform manner. The Union also decided that products coming from outside the EC shall be considered to be in free circulation in a Member State if the import formalities have been complied with and any customs duties or other charges payable have been levied in that Member State.[334] The provision is important from the angle of parallel imports. With respect to a product which has originated in a country outside the Union, if it is imported in to the union, and once the required import formalities are complied with and customs duties have been paid, the movement of the good

[329] See, Ramses Trogh, "The International Exhaustion of Trade Mark Rights after Silhouette: the End of Parallel Imports?" (Master Thesis, Faculty of Law, University of Lund, Spring, 2002), p. 19, available at http://lup.lub.lu.se/student-papers/record/1554568, (accessed on 20/12/2018). Also see, Irene Calboli, "Trademark Exhaustion in the European Union: Community-Wide or International? The Saga Continues", Intellectual Property L. Rev. 47, [2002], Vol. 6, p.82, available at:
http://scholarship.law.marquette.edu/iplr/vol6/iss1/3, (accessed on 27/11/2018).

[330] For eg: see *Zino Davidoff S.A.* v. *A& G Imports Ltd*. (1992) CMLR 1056.

[331] See pp. 71-72 of the thesis.

[332] See pp. 71-72 of the thesis.

[333] Art. 28 of TFEU, 2007.

[334] Art. 29 of TFEU, 2007.

shall not be restricted within the Union. However, when it comes to the IP products, the products imported from a third country, even if import formalities are complied with, is not allowed free movement within the Union, merely because it has originated in a third country i.e. since EU follows regional exhaustion. Further, Article 30 of the TFEU, which pertains to prohibitions of quantitative restrictions, applies to these products from third countries as per Article 28(2). This is an attempt to enable free movement of goods coming from third countries on the simple formality of payment of required import charges. This means that the community exhaustion or the regional exhaustion mooted by the EU countries go against their own principles of free movement of goods. Combined reading of Articles 28, 29 and 30 makes it clear that regional exhaustion acts as a restriction on the free movement of goods from countries outside the Union in the case of IP related goods alone, on the simple reason that they originated outside the Community. This amounts to undue restriction on free movement of IP goods. The double standard adopted by European Union to IP goods becomes evident here. While they agree that free movement of goods is welfare enhancing for the economy of a country, they do not show the willingness to extend the same attitude towards IP goods coming from countries outside the Community.

Under the exceptions to the principle of free movement of goods in Article 36 it is stated that for the sake of protection of Intellectual property one may restrict the free movement of IP goods.[335] Therefore, it may appear that this Article justifies the restrictions placed on goods pertaining to intellectual property regime. However, it could be seen that a check has been placed on the exceptions to the same Article, which stipulates that the prohibitions or restrictions shall not constitute a means of arbitrary discrimination or a disguised restriction on trade between Member States.[336] Therefore, any measure, which might constitute a disguised restriction on trade under the guise of exceptions provided, has to be done away with. The protection from counterfeit goods can be a good example of protection of IP laws under Article 36.The protection of IP laws cannot mean banning of genuine goods when viewed from the free movement of goods principles under the TFEU. This provision directly addresses parallel imports. Banning

[335] Art. 36 of TFEU, 2007.
[336] Art. 36 of TFEU, 2007.

parallel imports can constitute an abuse of exceptions provided by the treaty and therefore has to be done away with as per the very philosophy of the Treaty.

Here a discussion on the ban of parallel imports in the light of free trade principles recognised by the European judiciary is crucial. As per the decision in Dassonville, any trading rule which hinders free movement of goods violates free trade principle.[337] Even though the decision pertains to the movement of goods within the Union, the main logic behind the decision was to entertain free trade which, when extended to international context, can encompass parallel imports.

Another major principle recognised was principle of mutual recognition. According to this principle, as observed before, free movement of lawful goods manufactured in a member state cannot be curtailed within the union.[338] Parallel imports, as we know, are imports of genuine products but manufactured outside the union. Merely because they originated outside the Union it does not give reasonable ground to curtail free movement of those genuine goods within the Union. If the consumer welfare gets hampered while restricting the movement of genuine goods within the community, the global consumer welfare also will get hampered when parallel imports are restricted across borders. The author is of the view that the principle of mutual recognition should be applied universally to IP goods also so that genuine IP goods sold in one nation may be imported to any other nation furthering consumer welfare. When the logic behind the principle of mutual recognition is extended to the WTO context, the condition should be that the goods must be legal goods and must have originated in a WTO member country. When both these conditions are satisfied, then the principle of mutual recognition calls for international exhaustion. Restrictive application of the mutual recognition principle by the European jurisdiction brings out the double standards followed by the European Union in case of free movement of goods principle. In the *Commission v. Italy case*,[339] wherein mutual recognition principle was discussed, ban on import of genuine goods to any community territory was held arbitrary. It was also held that legality of any measure banning imports of goods has to be checked up with the non-discriminatory principle. The community exhaustion principle is also

[337] Procureur du Roi v. Benoît and GustaveDassonville, (1974), Case 8/74.

[338] For further details see p.74 of the thesis.

[339] C-110/05 (2006) ECR 519

hit by the principle of proportionality.[340] The principle of proportionality mandates that the measure adopted should be appropriate and should not be in excess of what measure adopted aims for. For the protection of intellectual property holders, banning counterfeit goods is understandable. However, banning parallel imports would be contravening the principle of proportionality of free movement of goods and would not qualify as a proportionate measure. Even if the aim of restricting parallel imports is to restrict the counterfeit goods, banning parallel imports would be an inappropriate measure since they are genuine goods and would thus directly contravene principle of proportionality.[341] No justification other than originating in a territory other than the importing nation could be attributed to the banning of parallel imports. Therefore any measures to restrain parallel import would be disproportionate and thereby trade restrictive. The protection of the monopoly profit of the producer by restricting competition in the market is the only other reason that could be attributed. It would also amount to arbitrary and discriminative measure.

It should be appreciated that European Union has wonderfully applied the free trade principle within the Union, recognising various principles which promotes free trade within EU and banning all those measures which hinders the same. However, Confining the application of the free trade principles to the European Union alone is not justifiable and does not have any other justification other than to promote free trade within EU alone, which is unjust discrimination towards the other nations in the international trade and also towards other international obligations. Therefore to promote free trade globally one needs extend these principles to the international level. Thus the prohibition on parallel imports contravenes all the basic principles of free trade.

It is worthy here to have a reference to a couple of U.S. Supreme court decision[342] at this point of discussion. The U.S. Supreme court also has observed that genuine goods originating in another

[340] *Henn* v. *Darby* , C-34/79 [1979] ECR 3795. ECJ emphasised that any restriction made to free movement of goods should comply with the principle of proportionality which can be measured using the following parameters-

1) Appropriateness for attaining the objective
2) Necessity referred to as least trade restrictive
3) Other measures if available should be used.

[341] See *Henn*v. *Darby*, C-34/79 [1979] ECR 3795, in which the principle was elaborately discussed.

[342] See *Kirtsaeng*v. *John Wiley & Sons, Inc.* 568 U.S. 519 (2013)and *Impression Products, inc.*v.*Lexmark Int'l, Inc*., 581 U. S. 1523, (2017).

country should not be restricted from being imported to U.S. merely because it originated outside U.S. The philosophy behind the decision seems to be in consonance with the mutual recognition principle. The author, thus, comes to the conclusion that the application of the mutual recognition principle to IP goods is highly appropriate, encouraging parallel imports, and banning the same would become arbitrary. To sum up, the decisions in the above stated cases categorically lead to the conclusion that banning of parallel imports is restriction on free trade.

2.4.3.2. Judicial approach on Parallel Imports in EC

The judicial trend in EU regarding parallel imports can be, in the authors view, divided into three faces. In the initial days of the creation of the EC, the European courts seem to have been upholding the principle of international exhaustion based on the principles of Free trade. Then the ECJ started recognising community exhaustion (regional exhaustion) as a minimum mode of exhaustion but not debarring international exhaustion. This allowed member countries to recognise international exhaustion if they desired to. The recognition of regional exhaustion by the ECJ must be seen as an effort to promote free movement of goods in EU and not to expressly abandon international exhaustion.[343] However, after the conclusion of TRIPs the ECJ, through the *Silhouett*e decision,[344] has completely forsaken international exhaustion. However, in the same year the Court of Justice of European Free Trade Association recognised international exhaustion in *Mag instruments case*.[345] The reversal in the stand on international exhaustion in the post TRIPs scenario can be attributed to the introduction of Trade Mark Directive in 1988 and the politics behind TRIPS and the lobbying efforts of MNC'S in Europe. With the initiation of international negotiations on WTO on free trade, the trend seems to have reversed in EU. The EU legislation as well as European judiciary began to stress for regional exhaustion.[346] This

[343] *Centrafarm BV* v. *Sterling Drug Inc*., (1974) ECR, *Deutsche GrammophonGesellschaft GmbH* v. *Metro-SB Grossmärkte*(1971) ECR, 487. Also see generally, TuomasMylly, "A Silhouette of Fortress Europe?International Exhaustion of Trade Mark Rights in the EU", MJ, (2000) Vol.7, Issue 1, pp.51-80, available at https://doi.org/10.1177%2F1023263X0000700104, (accessed on 1/9/2019)

[344] *Silhouette International Gmbh and Co KG v HartlauerHandelsgesellschaftmbH*, C-355/96, [1998] ECR I-4799.

[345] *Mag Instrument Inc. v. California Trading Company Norway,* Case E-2/97, 1997.

[346] The EU legislation on trademarks serves as an excellent example for regime shifting in legislative point of ciew. The trademark directive of 1988 expressly introduced regional exhaustion within EU.

seems to be a paradox. Since the negotiations on free trade were on, one would naturally expect more support for international exhaustion.[347] But it wasn't the case.

In one of the earliest cases, commonly called as the *Maja case*,[348] the court favoured international exhaustion principle[349] and held that "Maja", a Spanish trademark for soap products has not been violated by parallel import into Germany. Court held that the trademark rights protected the right owner only from importation and sale of spurious trade mark goods as market of the trademark owner is universal even though he acquires rights in different jurisdictions and cannot prohibit importation of genuine parallel imported goods.[350] The Court tried to bring out the point that parallel imports are genuine products and the importation of the same are valid and the protection of trademark law can be availed only against spurious goods.[351] Therefore, the court concluded that exclusive distributor or licensee or transferee of a trademark does not possess the right to hinder parallel imports by others of trademarked product.[352]

[347] TuomasMylly, "A Silhouette of Fortress Europe?International Exhaustion of Trade Mark Rights in the EU", MJ, (2000) Vol.7, Issue 1, pp.51-80, available at https://doi.org/10.1177%2F1023263X0000700104, (accessed on 1/9/2019).

[348] 22 January 1964, GRUR Int. 202. Also see ; Christopher Heath, "Legal Concepts of Exhaustion and Parallel Imports",in Christopher Heath, *Parallel Imports In Asia,* Max Plank Series on Asian Intellectual Property Law, Vol. 9, Kluwer Law International, Netherlands, (2004), p.18.

[349] 22 January 1964, GRUR Int. 202.Also see; Ramses Trogh, "The International Exhaustion of Trade Mark Rights after Silhouette: the End of Parallel Imports?", (Master Thesis, Faculty Of Law , University of Lund, Spring, 2002,) p.17, available at
https://lup.lub.lu.se/luur/download?func=downloadFile&recordOId=1554568&fileOId=1563370, (accessed on 22/12/218).Lazaros G. Grigoriadis**,** *Trade Marks and Free Trade: A Global Analysis***,** Springer Internatonal Publishing, Switzerland, (2014), p.201**.** Also see : Lawrence F. Ebb , "The Grundig-Consten Case Revisited: Judicial Harmonization of National Law and Treaty law in the Common Market", University of Pennsylvania Law Review, [1967], Vol.115,No.6, p.865, available at
https://scholarship.law.upenn.edu/cgi/viewcontent.cgi?article=6206&context=penn_law_review, (accessed on 21/12/2018). Christopher Heath, "Legal Concepts of Exhaustion and Parallel Imports",in Christopher Heath, *Parallel Imports In Asia,* Max Plank Series on Asian Intellectual Property Law, Vol. 9, Kluwer Law International, Netherlands, (2004), p.18.

[350] 22 January 1964, GRUR Int. 202.

[351] 22 January 1964, GRUR Int. 202.

[352] Similar decision was followed in *Cinzano v. Java* (1974) 2 CMLR 21.

Several jurisdictions and national courts followed the path of recognising international exhaustion in different cases.[353]

In *Centrafarm v. Sterling Drug Inc*.,[354] ECJ was faced with the question whether using Patent rights to prevent imports of goods lawfully made and marketed in other member states would fall within the exception to the principle free movement of goods encompassed under Article 36 of the treaty. ECJ held that derogations from the principle of free movement of goods using IP can be justified only if it is to protect IP rights and that those cannot be used as an absolute freedom to prevent free movement of goods. The Court opined that protection of IPR under Article 36 can be exercised only in a way facilitating protection for manufacturing and selling/distributing the goods for the first time.[355] The court was more concerned regarding prohibition of free movement of goods which was once sold in EU. Therefore, the court was clear in its judgement that if it was once sold in EU then its further sale in EU cannot be prohibited. This does not imply that this decision was against international exhaustion. The court was merely trying to implement free movement of IP goods in EU. This is clear from the observations of the court that IP rights cannot be exercised in an excessive manner to prohibit free movement of goods. Even though the court was deciding a case which pertained to free movement of goods within the member states, the language of the court clearly indicates that banning of parallel imports in the name of protecting rights of the IP owner cannot be justified as reasonable exercise of IP rights. Derogation from the principle of free movement of goods in order to block parallel imports cannot be justified. Blocking parallel imports would amount to partition of markets and thereby restricting trade between states whereas such restriction is not genuinely necessary to protect the IP rights. ECJ thus justifies restrictions on free movement of goods through IPR only for protecting IPR and blocking of parallel imports is not necessary in that sense. The court also observed that when the owner of patent in different countries is the same (parallel patent), prohibiting his own goods, which was sold once with his consent, from entering into another member state, would amount to partition of markets and undue derogation from the free

[353] *Cinzano*v. *Java* (1974) 2 CMLR 21, *Revlon Inc.* v. *Cripps & Lee Ltd* (1980) FSR 85 (1980) 11 I.I.C. 372, *Colgate Palmolive* v.*Markwell Finance Ltd.* (1989) R.C.P. 497.

[354] 1974 ECR 1147.

[355] *Centrafarm v. Sterling Drug Inc*. 1974 ECR 1147.

movement of goods principle.[356] The significance of this judgement is that it places free movement of goods at a higher pedestal than IP rights and also does not preclude the countries from following international exhaustion. The observation that the prohibition on free movement of goods first sold in EU is unjustified is in fact in tune with the Article 28 and Article 36 of the treaty as it merely reinforces free movement in EU.

The observation that the *Centrafarm case* does not preclude the courts from recognising the international exhaustion is further substantiated by the Mag Instrument case. In *Mag Instrument Inc. v. California Trading Co.*,[357] the Court of Justice of European Free Trade Association (EFTA), while upholding the validity of parallel import of the 'Maglite lights' from U.S. to Norway, ruled that "(t)he principle of international exhaustion is in the interest of free trade and competition and thus in the interest of consumers. Parallel imports from countries outside the European Economic Area lead to a greater supply of goods bearing a trademark on the market". The court further interpreted Article 7 (1) of the Trademark Directive of 1988[358] as enabling member countries to follow a minimum standard of community exhaustion and not prohibiting to follow a maximum standard of international exhaustion.[359] The ECJ followed the principle in Centrafarmin the GEMA case[360] as well, and when German Copyright Management Society decided to charge fees for works which are imported from one member state to another, the Court held that such an action would be contrary to free movement of goods as enshrined in Article 30 of the EC treaty.[361]

However, the trend regarding the recognition of international exhaustion appears to have reversed after 1980's, probably due to the increased campaigning of the owners of IP.[362] This

[356] *CentrafarmBvv. Sterling Drug Inc*. [1974] ECR 1147.

[357] Case E-2/97,1997 Rep. EFTA Ct. 127, [1998] 1 C.M.L.R. 331

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

[359] *Mag Instrument Inc.* v. *California Trading Company Norway* , Case E-2/97, 1997, Para 22 , p.7

[360] [1981] ECR 147

[361] In another case *Zino Davidoff S.A.* v. *A& G Imports Ltd*. (1992) CMLR 1056 , while Interpreting Article 7 (1) Of EC directive on Trademarks dealing with exhaustion ECJ held that the law does not prohibit States from adopting international exhaustion.

[362] One of the major impact for the change was the introduction of Trademark Directive In EU .the Draft of the directive recommended for international exhaustion. However, the same was not implemented. The commission

reversal of trend began after the conclusion of TRIPs agreement.[363] The legislative policy regarding exhaustion was ambiguous. For example, as stated above, Article 7 (1) of the Trademark Directive, 1988, did not mention either community exhaustion or international exhaustion but merely stated that the once the goods has been sold in EU, it cannot be prohibited from further use in relation to those sold product.[364] This could be seen as enunciated in Mag Instruments Case, in which it was said that international exhaustion could be adopted by the member states. In *Phytheron International SA v. Jean Bourdon*[365], the court held that product originating outside EU, when brought to EU and put into circulation in EU by the trademark owner himself or by his licensee, the further movement of the same cannot be prohibited. This means that the place of origin of the product even if it is outside EU does not affect the goods from resale in EU but a sale must take place inside EU by the owner or authorised licensee.

In *Silhouette International Schmied v. HartluerMbh*[366] when the defendants tried to parallel import Silhouette spectacles from Bulgaria, the Court held that exhaustion cannot take place if the good is marketed in a country outside the European community since the law relating to trademarks applied only within the community. The court opined that if the countries wished to have international exhaustion they will have to conclude separate free trade treaties and then opt for the same. Universality principle was left out in this case and the court decided against international exhaustion. The silhouette judgement favoured regional exhaustion over

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seems to have reversed its stand just before the beginning of the Urugay round probably to increase its bargaining position.

[363] The first case to preclude international exhaustion in express words was the *Silhouette International Schmied*v.*HartluerMbh,* 1998 All ER (D) 351, which is discussed below in the main text.

[364] The Draft of the directive recommended for international exhaustion. However, the same was not implemented. The commission seems to have reversed its stand just before the beginning of theUrugay round probably to increase its bargaining position. See, TuomasMylly, A Silhouette of Fortress Europe? International Exhaustion of Trade Mark Rights in the EU, MJ (2000) Vol.7, Issue 1, pp.51-80, available at https://doi.org/10.1177%2F1023263X0000700104, (accessed on 1/9/2019). Also See. Frederick M. Abbott and D. W. FeerVerkade , "The Silhouette of a Trojan Horse: Reflections on Advocate General Jacobs' Opinion in Silhouette v. Hartlauer" , Journal of Business Law, 1998, p. 413 available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1921869, (accessed on 22/12/2018). Also see ; Bronckers, "The Impact of TRIPs: Intellectual Property Protection in Developing Countries", Common Market Law Review, [1994], Vol.31, p.1267, available at https://heinonline.org/HOL/LandingPage?handle=hein.kluwer/cmlr0031&div=56&id=&page=, (accessed on 22/12/2018).

[365] SA(1997) ECR 1729.

[366] 1998 All ER (D) 351.

international exhaustion and prohibited countries from adopting international exhaustion as in the opinion of the court if countries are given freedom to practice different modes of exhaustion, it would create impediments to trade within EU. If this is the logic followed by the ECJ, the author fails to understand how the international exhaustion cannot be the mandate in the global free trade regime. As per the logical observation of the ECJ and rightly so, following different modes of exhaustion creates impediments to international free trade if the logic of the ECJ is extended to the international scenario. The Silhouette court failed to address the issues of international free trade obligations which the EU was by then obliged under WTO regime. The judgment would have been different if the EU law was interpreted with international free trade in mind.

Similarly in *Van Doren + Qmbh v. Life Styles Sports + Sports wearHandelesgesell*[367], where the goods were produced within Europe but was subsequently taken to U.S. for marketing and was re-imported to Europe by the defendants and the plaintiffs challenged the same. Defendants alleged that the product was first sold in Europe and then taken to U.S. and that banning re-importation of such a product was against the principle of free movement of goods as exhaustion has already taken place. ECJ held that it is the origin of goods and the market of first sale which determines whether exhaustion will kick in or not and if the goods have been initially produced and put in market in Europe[368] exhaustion can kick in and the subsequent re-importing of them cannot be blocked as it will amount to partitioning of markets which is against the spirit of free movement of goods.

Thus, it is clear from the above analysis that exhaustion must be applied in any relevant market for the existence of free movement of goods to function smoothly and perfectly. Even the decisions which precluded international exhaustion stated that for free movement of goods within EU regional exhaustion was necessary. The reluctance of the court to extend this benefit to the global scenario is not appropriate. Maybe, as stated above, it is due to the fact that the judiciary was simply interpreting the literal wordings in the Free Trade Treaty of EU which

[367] Case C-244/00.

[368] Under Art. 7 (1) of the Trademark Directive 89/104, it states, 'The trade mark shall not entitle the proprietor to prohibit its use in relation to goods which have been put on the market in the Community under that trade mark by the proprietor or with his consent.'

merely obligated the nations to provide free movement of goods within EU. Or it might be that the judiciary too went with the policy decisions of the legislation rather than going into the welfare and economical aspects of global free trade and international exhaustion.[369] In the European context when the Union was formed, the member countries demanded regional exhaustion for the enhancement of free trade within their market. The recognition of regional exhaustion within the Union where free trade is being practiced unequivocally suggests that where there is free trade between countries there needs to be an understanding of exhaustion among them. If that is the case, when the market becomes universal market, the logical conclusion would be to adopt international exhaustion for facilitating free trade. The demand for regional exhaustion for free trade but objecting international exhaustion globally amounts to a kind of protectionism. The creation of trade blocs can in these instances act as non- tariff barriers. Free movement of goods is now considered as best to boost the world economy. Therefore, resorting to different modes of exhaustion can hinder free movement of goods by constructing regional trading barriers and against global economic welfare. Banning parallel imports amounts to quantitative/ disguised restrictions on free movement of goods. International exhaustion which would further free movement of goods alone is suitable in the free trade scenario.

2.5 Conclusion

The theoretical foundations of international trade aiming at facilitating access to cheaper goods to consumers across the globe can only be strengthened by parallel imports. The observations of Adam Smith and David Ricardo regarding free trade and comparative advantage expecting every country to make advantage of free movement of goods across borders supports the notion of parallel imports. When the intellectual property regime hinders free movement of goods due to the territorial protection granted by each regime, without international exhaustion, the free movement of IP goods gets severely hampered. International exhaustion promotes overall welfare of the society while ensuring that the intellectual property owner is fairly/equitably rewarded by the first sale. Restriction on parallel trade would contravene the free trade theory, as it blocks the free physical movement of goods from cheaper to high priced

[369] Tuomas Mylly, A Silhouette of Fortress Europe? International Exhaustion of Trade Mark Rights in the EU, 7 MJ 1 (2000), Vol.7, Issue (1), p.32.

areas, and obstructs the efficient allocation of production resources on a global level.[370] In other words, by banning parallel imports the static gains envisaged under the comparative advantage theory i.e., the benefits of the increased production in developed countries,[371] is blocked from being distributed and cheaper goods are not allowed to move across frontiers. Moreover, if the increased market demand in the developed countries is artificially controlled by laws restricting parallel importation, this would have an overall negative effect on production in developing countries.[372]In brief, parallel imports promote all the expected benefits of comparative advantage theory. Since International exhaustion and resulting Parallel trade is in consonance with the concept of free trade and its presence does not result in the negation of IP protection, denial of parallel import needs to be looked at as abuse of IP protection. Intellectual Property protection can be justified only to the extent it promotes social welfare and any undue advantage of the monopoly conferred falls beyond the objectives of the IP system

WTO law on free trade also supports parallel imports. Article XI calls for no fetters on movement of goods except under the express exceptions provided under the GATT. The analysis of the Article XX (d) providing for exceptions under intellectual property rights read along with Article XI and Article III on national treatment makes it clear that the restrictions placed on genuine products from being imported into another country clearly amounts to disguised, arbitrary, unjustifiable restriction on free trade. The practice of following different modes of exhaustion, therefore, amounts to a trade barrier. Protection of intellectual property cannot be analysed outside the WTO framework and its philosophy of free trade. Over protection of IP

[370] Enrico Bonadio, "Parallel imports in a global market: should a generalised international exhaustion be the next step?", European Intellectual Property Review, [2011], Vol.33(3), pp. 153-161, available at http://openaccess.city.ac.uk/4106/1/Parallel%20Imports%20in%20a%20Global%20Market.pdf, (accessed on 11/11/2018).

[371] The goods which are cheaper to produce in developing nations can be sold at a price lower than that is produced in a high priced country. Therefore, instead of producing in a high priced country and importing it at a high price, if it is produced at the country where it is cheaper to produce, then the production in the country will naturally increase and consumers will get the product a lower price which will lead to efficient allocation of resources or in other words static efficiency. For details see Chapter IV on Economics and Competition perspective.

[372] Frederick M. Abbott, *Parallel Importation: Economic and social welfare dimensions*, Prepared for the Swiss Agency for Development and Cooperation (SDC), 2007, p.6, available at https://www.iisd.org/pdf/2007/parallel_importation.pdf, (accessed on 27/11/2018).

virtually amounts to non-tariff barrier to free trade.[373] Banning of parallel imports is practically a measure quite unnecessary for the protection of the IP holder's reasonable rights/interests and amounts to unreasonable restriction on free trade. Moreover, protection against competition from the parallel imports amounts to undue protection resulting in abuse of IP rights. The European practical example also testifies this. Thus it is clear that international exhaustion alone could be supported under the WTO framework, which anticipates an international free trade regime.

[373] Krithpaka Boonfueng, "A Non-Harmonized Perspective on Parallel Imports: The Protection of Intellectual Property Rights and the Free Movement of Goods in International Trade", (S.J.D . dissertation, United States -- District of Columbia: American University, 2003), P.9, available from https://digitalcommons.wcl.american.edu/cgi/viewcontent.cgi?article=1005&context=stu_sjd_abstracts, (accessed on 26/11/2018).

CHAPTER III

Free Trade and the Concept of Exhaustion under the TRIPs Agreement

3. Introduction

As seen in the second chapter on free trade and exhaustion, free trade principles govern the overall WTO framework, which includes within its sweep the TRIPS Agreement,[374] and WTO propounds free movement of goods across borders without unreasonable trade restrictions. Therefore, the doctrine of exhaustion has to be seen as an inherent mechanism within the IP system to facilitate free trade while, at the same time, preserving the incentive structure of IP system. However, it could be seen from the practice of Member countries following different forms of exhaustion, viz., international, regional and national, that IP goods are often restricted from free movement across national borders, based on the territorial nature of IP. This fact prompts one to believe that the free trade regime under WTO is applied differently when it comes to IP goods and has created impediments to free trade in the context of IP goods. It is argued in this chapter that the territorial nature of IP protection merely signifies that the rights granted to the IP holder are territorial in nature and does not, in any way, imply negation of international exhaustion. Therefore the TRIPS based IP system cannot be used to hamper the free trade system envisaged under the WTO.

However, in reality, the IP system has been used to create impediments to trade in two ways. One is by enabling member countries to recognise the right to import to holders of IP under the TRIPs Agreement. .The implication of it is placing impediments on free movement of goods across borders since it confers the exclusive right to import the IP goods to the IP holders or their agents. Thus parallel imports are prevented and purchasers of genuine goods are denied their opportunity to resell those goods in other member countries. The right to sell conferred on the IP

[374] Preamble to TRIPs, 1994.

holder and the extent to which it can be exercised also can be construed in such a way as to limit free trade.

Another way in which the free movement of IP goods has been thwarted in the international legal context is by drafting the exhaustion provision in the TRIPS Agreement confusingly. International exhaustion is not mandated in the TRIPS Agreement and this is quite contrary to free trade philosophy of the WTO regime. In addition to it, we can see that the leeway provided under Article 6 of the TRIPS Agreement and the related provisions give ample opportunities to WTO member countries to defeat the application of international exhaustion by countries which opt for that. In brief, the international policy and the historical background of the negotiations that culminated in the final text of Article 6 and the related provisions reveal a clear bias against IP goods in relation to application of the principle of free movement of goods.

In order to address the issue whether free movement of goods principle apply differently to IP goods, three main analyses should be made: (i) of the free trade agreements entered into prior to and after TRIPs, so as to understand whether any changes have occurred to principle of free movement of goods with the linkage of IP to it, (ii) of the TRIPs provisions providing for free movement of goods (iii) of the Negotiating History of Article 6 and related provisions. The chapter concludes by explaining how the compromises in the drafting of TRIPS provisions dealing with exhaustion has had adverse impacts on the post TRIPS FTAs.

3.1. Free Trade Agreements prior to TRIPs

It was in the Uruguay round of negotiations of GATT, 1994, that intellectual property got introduced in to the international trade lain the form of TRIPs Agreement. However, despite the fact that free trade was the basis of the Uruguay round, the parties failed to come to an agreement on the issue of accepting international exhaustion as the international norm due to the conflicting interests of the member countries. The reason for the same, apparently, was to protect self-interest of each party. To begin answering the question whether IP was treated differently in the WTO agreement, one must first analyse the free trade agreements entered by different countries prior to TRIPs. Analysis of prior Free Trade agreements is also necessary to understand the

compromise that occurred regarding Article 6 and to understand the notion of free movement of goods in these FTA's.

Even prior to Uruguay round, free trade agreements between nations were common among developed nations. The agreements did not contain IP as its main agenda, but talked only very minimum regarding the same. Initial free trade agreements were confined mainly to free movement of goods and services and IP was just a part of their discussions. It was after the beginning of Uruguay round negotiation that IP became part of the trade agreement and thereafter the FTA's began to follow this trend. The FTAs were negotiated mainly between developed countries, and U.S. was a party to majority of such agreements. The basis of such FTA negotiations was the provision under GATT framework which provided for free trade areas.[375] The remaining sections of the chapter would be analysing the different free trade agreements entered by nations prior to the conclusion of TRIPs.

The main free trade agreements analysed in this paper are Central American Common Market (CACM), 1960, Australia–New Zealand Closer Integration (1983), Israel – U.S. free trade agreement 1985, Canada-– U.S. (1988), EFTA– Turkey (1992), EFTA–-Israel (1993), NAFTA, 1993. The selection of these agreements are based on the fact that these agreements contain discussions regarding protection of IP and the extent to which it may be protected and that it is important for this analysis to see how they have dealt with the exhaustion issues, if any.

3.1. (a) Central American Common Market (CACM), 1960:

The objective of forming a treaty for the Central America was based on the objective of establishing a common market among them.[376] The agreement aimed at achieving free trade treatment of goods originating in the territories of the parties.[377] The treaty mandated that goods originating in the territory of member States shall be accorded national treatment and shall be exempted from all quantitative or other restrictions or measures, except for such measures as may be legally applicable in the territories of the Contracting States for reasons of health,

[375] Art. XXIV (4) in GATT, 1994.
[376] Art. 1 of CACM, 1960.
[377] Art. 3 of CACM, 1960.

security or police control.[378] This facilitates free movement of goods which is brought into a member country provided that the goods originated in a member country. This implies that the treaty mandated that for free movement of goods to apply; the only condition was that the product should originate in a member state and this guaranteed unfettered movement of goods.[379] The other restrictions that could be placed upon such freedom were only on the grounds of health, public security and police measures.

The treaty also mandated that no discrimination shall be placed upon goods originating in another member state and the product of local origin for protecting the local industry. [380] The treaty mandated that no Signatory State should establish or maintain regulations on the distribution or retailing of goods originating in another Signatory State in such a way as to place the said goods in an unfavourable position in relation to similar goods of domestic origin or imported from any other country.[381] The parties were mandated to ensure full freedom of transit through its territory for goods proceeding to or from the other Signatory States.[382] Even though the treaty was silent about IP goods, it has tried to bring about a good deal of freedom of movement of goods within their community.

3.1. (b) Australia- New Zealand Closer Integration (1983):

Similar to the American treaty, the parties aimed at establishing a common market for trading activities. For achieving the same, the parties decided to eliminate trade barriers[383] and develop trade under conditions of fair competition[384]. Similar to American Common market treaty, rules of origin are framed for this treaty also.[385] All goods originating in a member state shall be subject to non-tariff policy. [386] However unlike CACM treaty, this treaty provided for taking measures in consideration of assistance and protection for industry in a Member State and

[378] Art. 3 of CACM, 1960.
[379] This rule is commonly known as rule of origin. See Art. 3 of CACM, 1960.
[380] Art.VII of CACM, 1960.
[381] Art.VII of CACM, 1960.
[382] Art.XV of CACM, 1960.
[383] Art.1 (c) of Australia- New Zealand Closer Integration Treaty, 1983.
[384] Art. 1(d) of Australia- New Zealand Closer Integration Treaty,1983
[385] Art. 3 of Australia- New Zealand Closer Integration Treaty, 1983.
[386] Art. 4 of Australia- New Zealand Closer Integration Treaty, 1983.

permitted the states to set the tariff at the lowest level which is necessary to protect its own producers or manufacturers from like or directly competitive goods in such a way as to permit reasonable competition in its market between goods produced or manufactured in its own territory and similar goods or directly competitive goods imported from the territory of other Member States.[387] The treaty also prohibited any measure which amounts to quantitative restrictions placed upon the member states.[388] The treaty placed restrictions on the use of ban on imports of goods only to instances where importation threatened to damage the local industry[389]. The exceptions clause under the treaty dealt with the matter of intellectual property as a ground for derogation from the free trade principles. As per the Exceptions clause, unless measures are not used in an arbitrary or as a disguised restriction on trade, they may be adopted to protect intellectual or industrial property rights or to prevent unfair, deceptive, or misleading practices.[390]

3.1. (c) Israel – U.S. free trade agreement 1985:

The treaty aimed at achieving a free trade area between Israel and U.S.[391] It is interesting to note that the treaty provided for supremacy of the treaty over GATT in case of inconsistency.[392] Thus the reluctance of the developed community to accept the free movement of goods norm as enshrined in the global treaty is evident in this provision. Therefore in this Treaty, unlike as seen in GATT text of 1947, concerns of the domestic traders were given priority over the trading between nations. Thus the Treaty prohibited cross country importations in order to protect domestic traders from competition. The treaty mandated the protection of IP as per the international standards.[393]

[387] Art. 4 (11) of Australia- New Zealand Closer Integration Treaty, 1983.
[388] Art.5 of Australia- New Zealand closer integration treaty, 1983.
[389] Art.16 (3) of Australia- New Zealand closer integration treaty, 1983.
[390] Art.18 of Australia- New Zealand closer integration treaty, 1983.
[391] Art. 1 of Israel – U.S. free trade agreement 1985.
[392] Art.3 of Israel – U.S. free trade agreement 1985.
[393] Art. 14 of Israel – U.S. free trade agreement 1985.

3.1. (d). EFTA-Israel free trade agreement (1993):

Another important free trade agreement entered by Israel is the EFTA-Israel free trade agreement (1993). The EFTA- Israel free trade agreement was concluded between the nations with the objective of promoting international trade through removal of barriers and to provide fair conditions of competition for trade.[394]Apart from the general stipulations that we have witnessed in other agreements, regarding IP, the agreement mandated that adequate protection has to be granted by the parties, with the rider that the level of protection granted shall not distort trade between the parties[395]. The essential question to be asked here is what the adequate level of protection for IP is, and whether banning parallel import, in the light of the fact that non-IP goods cannot be banned, is within the spirit of the agreement.

The agreement further mandated that no quantitative measures having equivalent effect of prohibition or restriction on imports shall be placed.[396]And regarding non-economic reasons for restriction on the free movement of goods, prohibitions or restrictions on imports, exports or goods in transit are justified on grounds of (a) public morality, public policy or public security; (b)the protection of health and life of humans, animals or plants and of the environment; (c)the protection of national treasures possessing artistic, historic or archaeological value; or the protection of intellectual property.

In Israeli IP law parallel imports were initially banned through legislative framework. Several cases came up before the District Court of Israel in the late 1990's challenging the legitimacy of parallel imports and courts held parallel imports were illegal in the initial cases.[397] However in *Brystol Myers Matter case*,[398] the Supreme Court of Israel held that an ordinance allowing parallel imports was legal and that it favoured adopting international exhaustion allowing free

[394] Objective of the EFTA- Israel free trade agreement, 1993.

[395] Art. 15 of the EFTA-Israel free trade agreement, 1993.

[396] Art. 7 of the EFTA-Israel free trade agreement, 1993

[397] Frank S., "Why Small Market Economies Do and Don't Parallel Import . In Test Tubes for Global Intellectual Property Issues: Small Market Economies, Cambridge Intellectual Property and Information Law, pp.159-184, available at https://www.cambridge.org/core/books/test-tubes-for-global-intellectual-property-issues/why-small-market-economies-do-and-dont-parallel-import/944D12647EA09BE895EB57C6D5159EE3/core-reader, (accessed on 21/12/2018).

[398] *Bristol-Myers Squibb Company* v. *Minister of Health*, HCJ 5379/0, IsrSC 55(4) 447 (2001)), Administrative Appeal 5379/00.

competition over patents rights. [399] The case law was thus contrary to prior decisions and it opened up the gates of the Israel market for parallel imports. Thus it is long after the period of entry of these agreements that the national courts and legislations began to legitimize the parallel imports.

3.1. (e) Canada- U.S. Free trade Agreement (1988):

As stated in the above treaties the Canada- U.S. free trade agreement too aimed at encouraging/promoting trade between the nations through reducing trade barriers and creating conditions for fair competition. However, the nature of free trade achieved by the provisions of the treaty was dubious since trade barriers seems to have been raised from the earlier agreements. The provision provided for stringent measures in the case of re-importation. Goods re-imported to a territory of a party by the other party were to be subjected to customs duties.[400] This could directly affect the parallel imported goods since the price of the good further raises due to customs duties disincentivizing parallel importer. However no ban on parallel imports was to be seen. However, the treaty provisions also in a way deviated from the free trade principles by justifying unnecessary obstacles to trade if the obstacles made were to achieve legitimate domestic purpose.[401] Thus local requirements of nations, rather than that of the trading partner were given priority.

Import and export restrictions were to be subject to the GATT obligations and any form of quantitative restrictions was removed even though countervailing actions were justifiable.[402] A provision having a positive effect on free movement of IP goods was that no standards related measures which constitute disguised barriers to trade between the parties could be maintained by the parties.[403]

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[399] *Bristol-Myers Squibb Company* v. *Minister of Health*, HCJ 5379/0, IsrSC 55(4) 447 (2001)), Administrative Appeal 5379/00.

[400] Art. 404 (1) of the Canada- U.S. Free trade Agreement (1988).

[401] Art. 603 of the Canada- U.S. Free trade Agreement (1988).

[402] Art. 1201 of Canada- U.S. Free trade Agreement (1988).

[403] Art.1407 of Canada- U.S. Free trade Agreement (1988).

It is often stated that Canadian Intellectual property law is rooted in the British tradition of intellectual property.[404] Therefore similar to English tradition, judiciary played a vital role in the development of exhaustion doctrine in Canada. Though the legislative framework on exhaustion pointed towards the recognition of national exhaustion[405] the judiciary, it appears, wanted to recognise international exhaustion.[406] Judiciary was consistently holding the position that the settled law was that the purchaser who purchases a patented article from a patentee, acquires at the same time the right to use and sell the article. In an important case, the Supreme Court of Canada held that "the distribution of a trade-marked product lawfully acquired, is not by itself, prohibited under the Trade-marks Act of Canada, or indeed at common law.[407] Therefore it is evident that judicial approach towards exhaustion was favouring international exhaustion while legislature clearly was against encouraging parallel imports. Therefore, it is no surprise that parallel imports do not find any mention in the Canadian free trade agreement with U.S.

3.1. (f) European Free trade Area(EFTA)- Turkey, Free trade Agreement (1992):

The EFTA – Turkey free trade agreement aimed to achieve free trade between the nations through increased competition and by taking away all barriers of trade.[408] The agreement tried to encourage maximum imports of products through abolishment of all custom duties on imports.[409] As seen in other agreements, quantitative restrictions and measures having equivalent effect were not permitted to be maintained.[410] However, Prohibitions or restrictions could be placed for protection of IP.[411] Any agreements providing for prohibition or restriction of competition was

[404] Jeremy de Beer and Robert Tomkowicz,"Exhaustion of Intellectual Property Rights in Canada", Canadian intellectual Property Review, [2009], Vol. 25, No. 3, p.11, available at https://ssrn.com/abstract=1636425, (accessed on 20/12/2018). Also see; W.L. Hayhurst, "Intellectual Property Laws in Canada: The British Tradition, the American influence and the French Factor" I.P.J, [1996], Vol.10, p.265.

[405] Sec.27. 2 (e) of Canadian Copyright Act, 2009, prohibits import into Canada for the purpose of selling or renting out or distribute etc.

[406] *Signalisation de Montreal Inc.* v. *Services de BétonUniverselsLtée*, (1992), 46 C.P.R. (3d) 199, at 208.

[407] *Consumers Distributing Co.* v. *Seiko Time Canada Ltd*. [1984] 1 S.C.R. 583, 1984 CarswellOnt 869

[408] Art. 1 of European Free trade Area *(EFTA)- Turkey, Free trade Agreement (1992).*

[409] Art. 4 of European Free trade Area *(EFTA)- Turkey, Free trade Agreement (1992).*

[410] Art. 7 of European Free trade Area *(EFTA)- Turkey, Free trade Agreement (1992).*

[411] Art. 8 of European Free trade Area *(EFTA)- Turkey, Free trade Agreement (1992).*

also prohibited.[412] The linkage of IP to trade was evident as the TRIPs were on the verge of completion. The trade was substantially considered lower to the IP framework.

3.1. (g) North American Free Trade Agreement (NAFTA ,1993):

NAFTA was the first trade agreement which included among its aims protection of IP. Its preamble stated that one of its objectives was to promote creativity and innovation and trade in IP goods. This fact has serious significance as the agreement was negotiated and concluded during the same period as that of the Uruguay round when TRIPs agreement was under negotiation. This Agreement should be seen as a major step towards pushing IP inside free trade negotiations.

The treaty mandated that the restrictions placed upon the free movement of goods needed to be in compliance with Article XI of GATT 1947.[413] Further the treaty mandated that no party can prepare, adopt, maintain or apply any standards-related measure with a view to or with the effect of creating an unnecessary obstacle to trade between the Parties. However had restriction been made for achieving a legitimate objective and the measure did not operate to exclude goods of another Party who meet that legitimate objective, it should not be considered as an unnecessary obstacle to trade.[414] Apart from the general exceptions provided for protection of IP under free trade agreements[415], NAFTA enabled more extensive protection of IP under their national legislations.[416] The treaty, however, did not provide for any ban on imports of genuine goods and only banned imports of counterfeit goods[417].

NAFTA is a free trade agreement designed to reduce trade barriers for facilitating free movement of goods. When NAFTA says that the free trade in goods could be restricted for achieving legitimate objectives and thereafter leaving loose as not to confine what amounts to legitimate objective empowers national legislations the power to define what legitimate objective is. Thus

[412] Art. 17 of European Free trade Area *(EFTA)- Turkey, Free trade Agreement (1992).*
[413] Art. 309 of NAFTA, 1993.
[414] Art. 904 (4) of NAFTA, 1993.
[415] Art. 1018 of NAFTA,1993.
[416] Art. 1702 of NAFTA, 1993.
[417] Art. 1705 (copyright), Art. 1708 (trademarks) and Art.1709 (Patents) of NAFTA, 1993. Also see Art. 1718: Enforcement of IPR at the Border, NAFTA, 1993.

even excessive protection of IP becomes a legitimate objective. The agreement did not use the word free movement of goods but trade in goods and NAFTA wanted to achieve trade in goods in as least restrictive manner as possible. However the issue of parallel imports had been left out in the NAFTA even though the agreement did not ban parallel imports expressly. It is reasonably assumed by the author that the reason why no discussion or provision regarding parallel imports is present in the NAFTA was the coercive measures of U.S. under Trade sanctions through Section 301 of U.S. Trades Act, 1974.[418]

The Free Trade Agreements certainly have to be critically examined to see how they responded to the question of parallel imports in the pre-TRIPS context. Their predominant concern was free movement of goods between nations in a manner synchronising with the major principles of GATT. IP was not extensively discussed in these initial FTA's. However, when it comes to the NAFTA agreement in 1993 which was the period during which TRIPs was on the verge of conclusion, one can see extensive discussion on IP. This could be due to the influence of the parallel negotiations in the GATT forum on TRIPs. Another point to be noted is that except a few FTAs[419] ensuring free trade was given predominance over domestic industrial protection. And it was just in Canada - U.S. Free trade agreement (1988) that re-importation was subjected to the customs duties which naturally raises the price of re-imported good disincentivizing re-importation. But then again that must be viewed under the scanner of the ongoing debates on exhaustion in TRIPs forum. But the general framework of all these FTA's gave predominance to free trade over IP protection. It must also be noted that the issue of exhaustion was never addressed in these FTA's. Even when it came to IP protection, what the FTAs claimed was only legitimate protection of IP and not anything which distorts trade. Adequate level of IP protection need not amount to prohibition of parallel imports. Even competition principle imbibed into the FTAs supported international exhaustion. In the era of globalisation and free trade the territorial restriction placed on the IP goods were to be abandoned to embrace the theory of Universality, like in the case of other non-IP goods. In other words, the free trade regime mandates the

[418] For further details see the subsequent portion on negotiating history of Article 6 of the TRIPs agreement wherein the author brings out details of the U.S. pressure on negotiating members.

[419] Australian- New-Zealand Closer Integration Treaty, (1983), Israel- U.S. Free trade agreement, 1985.

recognition of international exhaustion. It could be seen that the flexibility provided by Article 6 practically/virtually acts as a trade barrier.[420]

3.2. TRIPS provisions on free movement of goods and exhaustion

Having analysed the free trade agreements prior to TRIPs, it is now pertinent to find out how TRIPs have conceived the notion of free movement of goods within TRIPs framework. Preamble to any law or treaty gives the insight to any one the basic intention of framers of the law as to what was the overall vision and aim of the law. Likewise the preamble to the TRIPs also plays an important role in shedding light to the overall philosophy of law. Since the very philosophy underlying GATT/WTO is built on the principles of free trade, the framers of TRIPs took care to ensure that no restrictions should be there on free movement of goods. They were vigilant enough to include in the preamble to TRIPs a clause to the effect that that the Members should strive towards reducing distortions and impediments to trade.[421] Article 8, laying down the Principle of the TRIPS Agreement, also throws light into this fact. It states that Members can take appropriate measures, which are needed to prevent the right holders from abusing intellectual property rights or from indulging in practices which unreasonably restrain trade.[422]Another mandate of the TRIPs agreement is to apply the general principles of GATT while practicing or interpreting it.[423] This means that the TRIPs agreement is subject to GATT principles. Thus, there can be no provision which contravenes the GATT principles. The means of enforcement of intellectual property is also important and it is stipulated that appropriate means of enforcement of the same must be adopted.[424] The objectives enshrined in the TRIPs agreement also mandates that IP law should not be merely for protection of the producers of knowledge but it must also have a public interest angle to it which is to protect the interest of

[420] Following different modes of exhaustion can create trade barriers to free trade. See; *Silhouette International Gmbh and Co KG* v.*HartlauerHandelsgesellschaftmbH*, [1998] E.C.R,I-4801, where it was observed by the court that following different modes of exhaustion by the different members in the community created trade barriers between the nations.

[421] Introductory part of the Preamble to TRIPs agreement, 1994.

[422] Art. 8.2 of the TRIPs agreement, 1994.

[423] Clause (a) to the Preamble to TRIPs agreement, 1994, recognises "the applicability of the basic principles of GATT 1994 and of relevant international intellectual property agreements or conventions".

[424] Clause (c) to the Preamble to TRIPs agreement, 1994, recognises; "the provision of effective and appropriate means for the enforcement of trade-related intellectual property rights, taking into account differences in national legal systems".

users of knowledge.[425] In addition, the main concern of TRIPs agreement was to prohibit counterfeit goods.[426] This in fact was the main aim even at the commencement of the Uruguay round of negotiations.[427] Therefore, trade in genuine IP goods cannot be restricted even with the IP principles, since, as seen, free trade has predominant role even with the IP goods.

Article 6 of the TRIPs agreement is the most significant provision dealing with the free movement of goods. The provision relates to exhaustion of the right to sell of the IP owner on first sale, enabling reselling of the IP goods by its purchaser. Thus, exhaustion facilitates free movement of goods. As stated in the above paragraph, when the objective of the TRIPs agreement is to further free trade, one would reasonably expect adoption of international exhaustion as the international norm. However, Article 6 leaves it to the members to decide the mode of exhaustion which they are intending to adopt.[428] This in fact goes against the principle of free trade enshrined both under TRIPs and GATT frameworks. The logic of this argument is that the moment regional or national exhaustion is recognised, frontiers creates barriers to free movement of goods, as goods are being restricted to move across borders simply on the ground of foreign origin. This is in contravention to the general philosophy of free trade. Moreover, Article 6 also leaves the countries remediless in cases of conflict among them by expressly stating that the WTO would not entertain any disputes on the issue of exhaustion. Therefore, Article 6 has, in fact, annihilated free movement of IP goods and it cannot therefore be called flexibility under TRIPs nor does it promote free trade. The developing countries were, in fact, being fooled to believe that Article 6 indeed provided them with a flexibility to choose the desired form of exhaustion.[429] However, the compromise reached through Article 6 indeed not only enables developed nations to adopt protectionist measures in the form of national or

[425] Art. 7 of TRIPs agreement, 1994.

[426] Preamble to the TRIPs agreement, 1994.

[427] The Ministerial declaration of 1985, MIN. DEC. 20 September 1986.

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

[429] A.V. Ganesan, "Negotiating for India", in JayashreeWatal and Antony Taubman , *The Making of the TRIPS Agreement Personal insights from the Uruguay Round negotiations Personal insights from the Uruguay Round negotiations* , World Trade Organisation, Geneva, (2015), p. 230, available at https://www.wto.org/english/res_e/booksp_e/trips_agree_e/history_of_trips_nego_e.pdf , where in the author admits that India was happy with the structure of Article 6 believing it to grant freedom and flexibility to follow international exhaustion.

regional exhaustion but also prevents the developing nations from making use of international exhaustion. This is because when the freedom guaranteed by Article 6 of the TRIPs is interrupted and nations have a grievance against the same, they are disabled from approaching WTO DSB. Thus, Article 6 in fact is a double-edged sword.

Another relevant provision in TRIPS which seriously affect free movement of goods is the one describing rights. The rights guaranteed under the TRIPs agreement for various IP regimes also play a central role in determining the free trade nature of TRIPs envisages. The right which is relevant for this discussion on free movement of goods is the right to import.[430] Right to import can act as a barrier to free movement of goods since importation of genuine goods by any other person can be deterred through the importation right. Free movement of goods gets considerably affected by the nature of competition prevailing in any market, be it domestic or world market. The free movement of goods has direct impact on the competition it can create in the market. Article 40 of the TRIPs agreement discusses the need to control anti-competitive practices among the IP owners and the possible measures that can be taken to execute such control.[431] The Article aims to prohibit the licensing practices or agreements entered by the intellectual property holders with distributors or consumers so as to enforce their rights, which adversely affects the international trade by limiting competition. The territorial restrictions placed on selling of intellectual property goods is a clear cut example of abusive agreements entered by the intellectual property holder in the guise of exercising their rights. Even in the digital context, one of the most common practices that prevail in different markets in the selling products by the IP owner is the licensing practice. Such restrictive practices can act as abuses of intellectual property rights if it restricts trade, and the TRIPs allows the member countries to specify the licensing practices which they consider as constituting abuse of intellectual property rights. Article 40 of TRIPs, provision has to be read along with the objectives of the agreement.[432] Article 40 grants the freedom to the member countries to declare such agreements as anti-competitive.

[430] Art. 26 and Art.28 and Art.36 of the TRIPs agreement, 1994.

[431] Art. 40 (1) of the TRIPs agreement, 1994: Members agree that some licensing practices or conditions pertaining to intellectual property rights which restrain competition may have adverse effects on trade and may impede the transfer and dissemination of technology.

[432] Art. 8(2) of the TRIPs agreement, 1994, mandates that measures may be taken to curb practices which constitute abuse of rights and unreasonably restrain trade.

Another significant provision in TRIPs which can be used to torpedo attempts to parallel import is the one dealing with Border control measures. As stated earlier, one major objective of TRIPs negotiation was to promote trade through fighting counterfeit goods. For enabling the same, strengthening of border measures was important. And what constituted 'counterfeitgood' was also important. The TRIPs empowered nations to suspend the release of imported trademark or copyrighted goods upon the suspicion that they were counterfeit or pirated goods.[433] However, it also added that it was not mandatory to apply the provision for those goods sold once in any market with the consent of the right holder.[434] This indicated that parallel imported goods did fall in the category of legitimate goods. Further the agreement goes on to define pirated and counterfeit goods which does not cover parallel imports.[435] The detailed rules on the enforcement measures and border measure in the TRIPs are the contributions of the U.S.[436] and EU.[437] Unlike the other provisions in TRIPs not much discussion has taken place regarding the enforcement and border measures provisions.[438] The U.S. and EU recommendations on the border measures were very much similar, and in spite of the resistance from countries like India, found its way in to the TRIPs text without any substantial alterations. The U.S. and EU wanted to provide mandatory obligation for border measures for the purpose of enforcing the rights of the intellectual property owner against infringing goods.[439] One of the major concerns of the U.S.

[433] Art. 51 of the TRIPs agreement, 1994.

[434]Footnote 13 to Art.51 of the TRIPs agreement, 1994.

[435]Foot note 14 to Art. 51 of the TRIPs agreement, 1994, : (a)"counterfeit trademark goods" shall mean any goods, including packaging, bearing without authorization a trademark which is identical to the trademark validly registered in respect of such goods, or which cannot be distinguished in its essential aspects from such a trademark, and which thereby infringes the rights of the owner of the trademark in question under the law of the country of importation;

(b) "pirated copyright goods" shall mean any goods which are copies made without the consent of the right holder or person duly authorized by the right holder in the country of production and which are made directly or indirectly from an article where the making of that copy would have constituted an infringement of a copyright or a related right under the law of the country of importation.

[436] For U.S. proposals please see WTO documents : MTN.GNG/NG11/W/14/Rev.1, 17 October 1988, MTN.GNG/NG11/W/70, 11 May 1990

[437] For EU proposal see; MTN.GNG/NG11/W16, Nove.1987, MTN.GNG/NG11/W/31 30 May 1989, MTN.GNG/NG11/W/49, 14 Nov.1989.

[438] *Resource Book on TRIPS and Development*, UNCTAD-ICTSD, (2005) p.578, available at https://unctad.org/en/PublicationsLibrary/ictsd2005d1_en.pdf, (accessed on 20/12/2018).

[439] MTN.GNG/NG11/W/14, MTN.GNG/NG11/W14/Rev.1, 17 October, 1988. MTN.GNG/NG11/W/70, 11 May 1990.

was regarding the lack of procedures to deal with imports of infringing goods.[440] Initially both U.S. and EU demanded that the border measures must also be extended to goods in transit.[441] However, countries like India insisted that border measures should be simple and expeditious and must be applicable only against counterfeit and pirated goods and must not affect genuine goods.[442] India was of the view that the appropriate place for the discussion of the issue of border measures was the Agreement on Prohibition of Counterfeit Goods which was negotiated parallel to TRIPS Agreement.[443] The reason for this could be the argument put forward by them that the application of border measures should not be extended to genuine goods.[444] In the later submissions by U.S. and E.U, goods in transit were removed from the purview of border measures.[445] Further, the EU submission specifically demanded that the parallel imports should be removed from the purview of power of seizure granted to the customs authorities.[446] The present Article 51 of the TRIPs agreement is very much similar to the draft proposals submitted by the U.S. and EU nations. However, in the present Article 51 footnote 2 leaves it open for the member countries to decide whether they should extend the border measures to parallel imports and to goods in transit. Even though the Article 51 does not provide for a mandate for the extension of border measures to parallel imports and goods in transit, it enables the member countries, who so desires, to extend border measures to genuine parallel imports and goods in transit. Article 6 read along with Article 51 and its footnote thus empowers the detention of not only counterfeit goods but also genuine parallel imported goods and goods in transit.

Even though the TRIPs agreement does not mandate to apply the border measures to goods in transit, certain member countries had done so. However, it is submitted that the goods must be counterfeit or pirated goods. Further, the provision defining counterfeit or pirated goods does not cover patent goods. This is because the definition of the pirated or counterfeit goods does not cover patent goods. The reason for inclusion of pirated and counterfeit goods is because these

[440] MTN.GNG/NG11/W/14, 20 October 1987.
[441] MTN.GNG/NG11/W14/Rev.1, 17 October, 1988,MTN.GNG/NG11/W16, Nov.1987.
[442] MTN.GNG/NG11/W40.
[443] MTN.GNG/NG11/W40.
[444] MTN.GNG/NG11/W/37.
[445] For eg: see MTN.GNG/NG11/W/70, 11 May 1990.
[446] MTN.GNG/NG11/W/31.

goods could be identified as infringing goods on the face itself.[447] Still, the second footnote to Article 51 exempts goods which are once put in the market with the right holders' consent which can cover even patented goods. However, parallel traded goods which were put on the market through compulsory licensing could be seized by a nation under the shade of Article 51. As a matter of fact, even genuine goods produced in a country destined to another country had been confiscated by other countries when in transit while they are on their way to the destination country.[448] The IP holders demand the customs to confiscate goods on the ground of suspected infringement of goods. India and Brazil had filed complaints before the WTO DSB against such confiscations.

The complaint raised by India was regarding repeated confiscation by Netherlands, of medicines imported by many countries from India when they reach the port of Netherlands while in transit.[449] The confiscation was done under the so called 'manufacturing fiction' principle.[450] The principle derives its power from Recital 8 of EU regulation of 2003 regarding customs action against goods considered to be infringement of intellectual property rights. According to the 'manufacturing fiction', goods which are in transit will be scrutinised under parameters of the national law which determines whether goods produced in that country infringe intellectual property law.[451] In other words, the goods in transit would be deemed to have originated in the

[447] *Resource Book on TRIPS and Development*, UNCTAD-ICTSD,(2005), p.610, available at https://unctad.org/en/PublicationsLibrary/ictsd2005d1_en.pdf, (accessed on 20/12/2018).

[448] EU for example amended its trade regulation in 2003 so as to allow the Patent holders to consfiscate goods which were believed to be infringing goods. See "Council Regulation (EC) No 1383/2003 of 22 July 2003 concerning customs action against goods suspected of infringing certain intellectual property rights and the measures to be taken against goods found to have infringed such rights".

[449] "European Union And A Member State – Seizure of Generic Drugs in Transit, Request for Consultations by India", WT/DS408/1 G/L/921 IP/D/28, 19 May 2010, p.1. The complaint was raised under the Article 4 of the Understanding on Rules and Procedures Governing the Settlement of Disputes, Art. XXII:1 of the General Agreement on Tariffs and Trade 1994 (the "GATT 1994") and Art. 64.1 of the Agreement
on Trade-Related Aspects of Intellectual Property Rights (the "TRIPS Agreement")

[450] Recital 8 of Council Regulation (EC) No 1383/2003 of 22 July 2003 concerning customs action against goods suspected of infringing certain intellectual property rights and the measures to be taken against goods found to have infringed such rights. Under the manufacturing fiction principle, generic drugs actually manufactured in India and in transit to third countries were treated as if they had been manufactured in the Netherlands.

[451] Recital 8 of Council Regulation (EC) No 1383/2003 of 22 July 2003 concerning customs action against goods suspected of infringing certain intellectual property rights and the measures to be taken against goods found to have infringed such rights. Also see G.Theuws, "ECJ to Decide on 'Manufacturing Fiction' Under Counterfeit Goods Regulation", [2009], available at

nation where it has been seized.[452] Therefore, the seizures were made on the ground of patent infringement.[453] India claimed that the confiscation of the generic medicines was infringement under GATT[454] and TRIPs[455]. The basic argument raised by India was under Article V of the GATT agreement regarding free transit of goods destined for third nation. Unfortunately the issue is still in the consultation stage in WTO. Similar complaints upon same grounds were made by Brazil against EU.[456]

It is submitted that these confiscations result in hindrance to free trade. These medicines were originally destined to other countries and never entered the commerce of the EU or Netherlands or any in transit nations.[457] Confiscating such goods considering them to be originating in the territory of the confiscating nation creates absurd logic and amounts to abuse of power.

The European jurisdiction themselves seems to be at poles apart on the issue of seizure of goods in transit. In *Montex Holdings v. Diesel SpA*,[458] the goods of the Montex Holdings manufactured in Ireland, where Diesel has no trademark protection, and destined to Poland, were seized in Germany while in transit. Diesel had trademark protection in Germany. They were seized on the ground that the goods posed potential danger to Diesel as there were chances that they might

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http://www.eplawpatentblog.com/PDF_December09/Fiction%20Geert%20Theuws.pdf, (accessed on 21/12/2018).

[452] Recital 8 of Council Regulation (EC) No 1383/2003 of 22 July 2003 concerning customs action against goods suspected of infringing certain intellectual property rights and the measures to be taken against goods found to have infringed such rights. Also see G.Theuws, "ECJ to Decide on 'Manufacturing Fiction' Under Counterfeit Goods Regulation", [2009], available at
http://www.eplawpatentblog.com/PDF_December09/Fiction%20Geert%20Theuws.pdf, (accessed on 21/12/2018). Also see; Frederick M. Abbott, "Seizure of Generic Pharmaceuticals in Transit Based on Allegations of Patent Infringement: A Threat to International Trade, Development and Public Welfare", World Intellectual Property Organization Journal (WIPO), [2009], Vol. 1, p. 43, available at https://ssrn.com/abstract=1535521, (accessed on 12/12/2018) . Also see *Philips* v.*Postech*, H.R. 19 March, 2004.

[453] WT/DS408/1 G/L/921 IP/D/28, 19 May 2010, p.1.

[454]Paragraphs 2, 3, 4, 5 and 7 of Art. V of the GATT, 1994 because the measures at issue, *inter alia*, are unreasonable, discriminatory and interfere with, and impose unnecessary delays and restrictions on, the freedom of transit of generic drugs lawfully manufactured within, and exported from, India by the routes most convenient for international transit; Art. X of the GATT , 1994,

[455] Art. 28, Art. 41, Art.42 and Art. 31 of the TRIPS Agreement, 1994.

[456] Request for Consultations by Brazil, "European Union and A Member State – Seizure of Generic Drugs in Transit", WT/DS409/1 IP/D/29 G/L/922, 19 May 2010.

[457] This logic was used by the European court of Justice in Montex Holdings v Diesel SPA, (C-281/05) (2006) E.C.R. I-10881. *Nokia* v. *UK Customs* (2009) EWHC (Ch) 1903.

[458]Montex Holdings v. Diesel SPA, (C-281/05) (2006) E.C.R. I-10881.

enter into the commerce in Germany and thus violated the trademark right of the Diesel. The court rejected the argument and stated that mere threat of violation of rights cannot be a ground for confiscation of genuine goods in transit.[459]In another case, the ECJ even went to the extent of stating that the UK Customs did not have the right to detain even fake goods which were in transit to other countries if there is no evidence to prove that the goods have been placed in the market of commerce of any member country and that the goods in transit does not qualify this condition.[460] The European courts, in both these decisions, rejected the manufacturing fiction principle. Later on, in 2014 the regulation of 2003 was repealed and replaced by the Regulation of the European Parliament and of the Council concerning customs enforcement of intellectual property rights and repealing Council Regulation (EC) No 1383/2003.[461] The recital 8 of 2003 regulation has been repealed by the 2014 regulation. The 2014 regulation further excludes parallel imports from the action of customs authorities and cannot be confiscated since the provision expressly says that since parallel imports as genuine goods, it is not appropriate that customs authorities focus their efforts on such goods.[462] This is a very positive move from the European Union which could stop confiscation of goods in transit in the future scenarios. In the 2015, the European Union introduced a trademark directive.[463] The trademark directive empowers trademark owner of the Union to prevent entry of counterfeit products which are in transit to some other nations and not meant to be placed in the commerce of the EU, from entry into the Union.[464] The provision further mandates that the customs authority must exercise the

[459]Montex Holdings v.Diesel SPA, (C-281/05) (2006) E.C.R. I-10881.

[460]*Nokia* v. *UK Customs*, [2009] EWHC (Ch) 1903.

[461] Regulation (EU) No 608/2013 of 12 June 2013

[462] In Recital 6 of Regulation (EU) No 608/2013 of the European Parliament and of the Council of 12 June 2013 concerning customs enforcement of intellectual property rights and repealing Council Regulation (EC) No 1383/2003, Infringements resulting from so-called illegal parallel trade and overruns are excluded from the scope of Regulation (EC) No 1383/2003 : "Goods subject to illegal parallel trade, namely goods that have been manufactured with the consent of the right-holder but placed on the market for the first time in the European Economic Area without his consent, and overruns, namely goods that are manufactured by a person duly authorised by a right-holder to manufacture a certain quantity of goods, in excess of the quantities agreed between that person and the right-holder, are manufactured as genuine goods and it is therefore not appropriate that customs authorities focus their efforts on such goods. Illegal parallel trade and overruns should therefore also be excluded from the scope of this Regulation."

[463] Directive (EU) 2015/2436 of the European Parliament and of the Council of 16 December 2015 to approximate the laws of the Member States relating to Trade Marks

[464] Directive (EU) 2015/2436 of the European Parliament and of the Council of 16 December 2015 to approximate the laws of the Member States relating to Trade Marks, clause (22) states:

power to seize goods as per the 2014 directive mentioned above. A combined reading of the trademark directive of 2015 and that of the 2014 regulation clearly exempts parallel imports from the purview of customs authority. The directive also mandates that there should be smooth transit for generic drugs through the European Union. This again is a positive observation by the EU, probably due to the pressure of WTO cases filed by India and Brazil regarding the confiscation of generic drugs.[465]

3.3. Negotiating History of Article 6 of TRIPS and related provisions

The Free Trade Agreements discussed above brings out the general mood of different countries regarding free movement of goods vis-à-vis exhaustion of IP and parallel importation. It becomes important in this context to analyse the position taken on Article 6by different nations during the TRIPs negotiation to understand the real politics behind the provision. The TRIPs Agreement, in fact, is a compromise between the conflicting interests of the developed and developing countries.[466] An analysis of the TRIPS negotiation reveals that the balance of convenience is tilting, more often, towards the former.[467] The Uruguay round of negotiations mainly aimed at regulating the international trade, into which IP was pushed in on the ground

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"To this effect, it should be permissible for trade mark proprietors to prevent the entry of infringing goods and their placement in all customs situations, including, in particular transit, transhipment, warehousing, free zones, temporary storage, inward processing or temporary admission, also when such goods are not intended to be placed on the market of the Member State concerned. In performing customs controls, the customs authorities should make use of the powers and procedures laid down in Regulation (EU) No 608/2013 of the European Parliament and of the Council (2), also at the request of the right holders. In particular, the customs authorities should carry out the relevant controls on the basis of risk analysis criteria."

[465] Directive (EU) 2015/2436 of the European Parliament and of the Council of 16 December 2015 to approximate the laws of the Member States relating to trade marks, clause (25) states :

"Appropriate measures should be taken with a view to ensuring the smooth transit of generic medicines. With respect to international non-proprietary names (INN) as globally recognised generic names for active substances in pharmaceutical preparations, it is vital to take due account of the existing limitations on the effect of trade mark rights. Consequently, the proprietor of a trade mark should not have the right to prevent a third party from bringing goods into a Member State where the trade mark is registered without being released for free circulation there based upon similarities between the INN for the active ingredient in the medicines and the trade mark."

[466]Peter K. Yu, "TRIPS and Its Discontents", 10 Marq.Intell. Prop. L. Rev. 369, [2006], p.371, available at: https://scholarship.law.tamu.edu/facscholar/461, (accessed on 20/12/2018)

[467] Frederick M. Abbot, "First Report(Final) to the Committee on International Trade Law of the International Law Association on the Subject of Parallel Importation", Journal of International Economic Law, [1998], Vol. 1, No. 4, pp.607-636 , available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=915046, (accessed on 4/11/2018).

that lack of IP protection leads to trade distortions.[468] Precisely for this reason protection of IP under the WTO has to aim at protecting trade from impediments. In other words, the TRIPS Agreement cannot support any policy facilitating restraint on trade. The trade demands of the developed and developing countries are different, so is the level of protection sought by these parties. The tension between the nations is precisely due to these conflicting interests. Strong protection of IP was the demand of the developed countries whereas the developing countries sought for a weaker regime. Therefore the developing nations wanted maximum flexibilities inside the TRIPs. Exhaustion was one among the mostly debated flexibility amongst all. The debate centred on the mode of exhaustion that is to be recognised by the parties, i.e., whether national, regional or international exhaustion need to be the mandate in TRIPs. While the developing nations demanded international exhaustion, developed countries went for national or regional exhaustion. The question to be addressed is that when facilitating free trade was the clear mandate of the parties to WTO, why did the language of Article 6 of TRIPs dealing with exhaustion fail to bring out any such clear mandate? Was Article 6 of TRIPs a compromise between two opposite poles? Why was there a compromise? What are its implications on free trade?

3.3.1. Pre- TRIPs Position

In order to correctly appreciate the politics behind the TRIPS negotiation, one needs to have some idea about the pre – TRIPS scenario. Prior to TRIPs, exhaustion was a concept which was never an express agenda/item negotiated in any of the international document. However, we see that provisions in many international documents such as the Berne were influenced by and were subsequently drafted/amended keeping exhaustion in mind. For example, the Berne convention does not recognise the general right to distribute to the authors of literary and dramatic works.[469] However, the convention recognises author of the literary and artistic work authorizing a

[468] Thomas Cottier,"The Agreement on Trade Related Aspects of Intellectual Property Rights(TRIPs)", in P.F.J. Macroy, A. E. Appletion, M.G. Plummer, *The World Trade Organization: Legal, Economic and Political Analysis,* Springer, (2005), Vol. I, pp. 1041.

[469] Art. 9 of Berne recognises economic rights which give only reproduction right to the literary and artistic work.

cinematographic adaptation of the literary and artistic work for the subsequent distribution of the cinematographic film.[470]

As stated earlier, it was in cinematographic film that the right of distribution was first recognised in Berne. Prior to Berne such a right was not recognised even in the case of the author of a cinematograph film.[471] It was in the Berlin and subsequently in the Rome convention, that the right of reproduction and adaptation respectively were recognised.[472] The suggestion of recognising right to distribute was tabled for the first time in the Brussels conference of Berne Convention. Right of distribution was first time recognised in this conference in the case of cinematograph film. The changing technology and the concerns raised by the same were raised at the meetings, especially by France which mandated special treatment for the cinematographic film.[473] The text encompassed the same in Article 14 (1) (i). Therefore right of distribution came into existence. The leap is significant but not without ambiguity. What was the notion of 'distribution' under Article 14 (1) (i), which on subsequent Stockholm revision, became Article 14 bis? In other words, did the right to distribute include the right to circulate the work for the first time or control the circulation in perpetuity? The discussion becomes significant in the light of the difference in language in the English and French texts of the convention. The English text contains the word right to distribute,[474] which could either mean right for first distribution only or all the subsequent distribution as well. On the other hand, the French text contains the word putting into circulation[475] which could only imply the first circulation. Thus, there is no clarity in the language of Berne Convention as to whether the right to distribute under the Berne Convention implies national or international exhaustion.

[470] Art. 14 (1) (i) of Berne Convention, (1886).

[471] Sam Ricketson, Jane C. Ginsburg, *International Copyright and Neighboring Rights- The Berne Convention and Beyond*, Oxford University Press, (2nd Edition, Volume 1, 2006) pp.11.49-11.50.

[472] Mihaly Fiscor, *The Law of Copyright and the Internet: The 1996 WIPO Treaties, their Interpretation and Implementation*, Oxford University Press, Oxford, (1st edn, 2002), pp. 85-90.

[473] *Records of the Conference*, Convened in Berlin October 14 to November 14, 1908, at p. 211.

[474] Mihaly Fiscor, *The Law of Copyright and the Internet: The 1996 WIPO Treaties, their Interpretation and Implementation*, Oxford University Press, Oxford, (1st edn, 2002), p.147.

[475] Mihaly Fiscor, *The Law of Copyright and the Internet: The 1996 WIPO Treaties, their Interpretation and Implementation*, Oxford University Press, Oxford, (1st edn, 2002), p.147.

It would be worthy at this point to examine the negotiation that went in to the adoption of the right of distribution so as to understand whether the exhaustion was a subject under discussion of the same. During the Brussels conference, in which the right to distribute was first tabled as mentioned above, the French delegation proposed the "right to put into circulation" the copyrighted works.[476]Austrian delegate went further and demanded recognition of the right to distribute and circulate, which could mean all subsequent distribution.[477]However, not much deliberation took place upon the subject and no decision was made.[478] In the next session at Stockholm, much deliberation took place about right of distribution (right of putting into circulation) proposed by Austria, Italy, and Mexico.[479] They demanded that along with the word reproduction in Article 9 (1) of the draft proposal of Stockholm[480], the word circulation be added. Dutch supported the proposition.[481] However, the proposal was not well accepted in the Main committee I.[482]Chairman expressed his concern as to whether it was advisable to recognise a general right of distribution as he was worried about the fact that if right of distribution was recognised exception to the same and to that of reproduction right too will have to be included/incorporated in to the Treaty.[483] The chairman was doubtful whether it would be possible to reach a consensus on the issue of the exception to the right of distribution.[484] The main committee also commented that exceptions so made need not always be of acceptance to

[476] Mihaly Fiscor, *The Law of Copyright and the Internet: The 1996 WIPO Treaties, their Interpretation and Implementation*, Oxford University Press, Oxford, (1st edn, 2002), p.147.

[477] Mihaly Fiscor, *The Law of Copyright and the Internet: The 1996 WIPO Treaties, their Interpretation and Implementation*, Oxford University Press, Oxford, (1st edn, 2002), p.147.

[478] Mihaly Fiscor, *The Law of Copyright and the Internet: The 1996 WIPO Treaties, their Interpretation and Implementation*, Oxford University Press, Oxford, (1st edn, 2002), p.147.

[479] Mihaly Fiscor, *The Law of Copyright and the Internet: The 1996 WIPO Treaties, their Interpretation and Implementation*, Oxford University Press, Oxford, (1st edn, 2002), p.147.

[480] Mihaly Fiscor, *The Law of Copyright and the Internet: The 1996 WIPO Treaties, their Interpretation and Implementation*, Oxford University Press, Oxford, (1st edn, 2002), p.147.

[481] Mihaly Fiscor, *The Law of Copyright and the Internet: The 1996 WIPO Treaties, their Interpretation and Implementation*, Oxford University Press, Oxford, (1st edn, 2002), p.147.

[482] Mihaly Fiscor,*The Law of Copyright and the Internet: The 1996 WIPO Treaties, their Interpretation and Implementation*, Oxford University Press, Oxford, (1st edn, 2002), p.147.

[483] Mihaly Fiscor,*The Law of Copyright and the Internet: The 1996 WIPO Treaties, their Interpretation and Implementation*, Oxford University Press, Oxford, (1st edn, 2002), p.148.

[484] Mihaly Fiscor, *The Law of Copyright and the Internet: The 1996 WIPO Treaties, their Interpretation and Implementation*, Oxford University Press, Oxford, (1st edn, 2002), p.147.

all.[485] U.K strongly opposed the proposal.[486]German delegation strongly recommended recognition of the distribution right with the exception of international exhaustion to the distribution right.[487] The delegation of Italy asked the committee not to reject the joint proposal and suggested that if it is impossible to find a compromise solution and exceptions to the right of distribution, then the exceptions should be linked to the exceptions under Article 9 (2).[488] The decision was postponed due to lack of consensus[489] and at the next session the proposal was rejected.

The main reason for rejecting the proposal for recognition of a general right of distribution was not because of objection to right of distribution but the demand by certain delegations for a perpetual control on distribution of copies and lack of consensus on exceptions to distribution right i.e., whether international or national exhaustion was to be recognised. The Paris Convention does not specifically mention about exhaustion or parallel imports.

3.3.2. TRIPs Negotiation

TRIPs Agreement was one among the many agreements relating to trade forming part of the GATT final text. Trade policy in the early post-World War II era focused on the gradual reduction of tariffs and the elimination of preferential systems. Tariffs, the first generation of barriers, were high, stemming from the protectionist policies of the great depression of the 1930s.[490] The attempt for the same began with the GATT, 1947, and ended up in the Uruguay round and TRIPs. When TRIPs was pushed onto the General Agreement on Tariffs and Trade ("GATT"), as part of that regime's conversion into the World Trade Organization ("WTO"),

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[485] Mihaly Fiscor, *The Law of Copyright and the Internet: The 1996 WIPO Treaties, their Interpretation and Implementation*, Oxford University Press, Oxford, (1st edn, 2002), p.147.

[486] Mihaly Fiscor, *The Law of Copyright and the Internet: The 1996 WIPO Treaties, their Interpretation and Implementation*, Oxford University Press, Oxford, (1st edn,2002), p.147.

[487] Mihaly Fiscor, *The Law of Copyright and the Internet: The 1996 WIPO Treaties, their Interpretation and Implementation*, Oxford University Press, Oxford, (1st edn, 2002), p.147.

[488] Mihaly Fiscor, *The Law of Copyright and the Internet: The 1996 WIPO Treaties, their Interpretation and Implementation*, Oxford University Press, Oxford, (1st edn,2002), p.148.

[489] Mihaly Fiscor, *The Law of Copyright and the Internet: The 1996 WIPO Treaties, their Interpretation and Implementation*, Oxford University Press, Oxford, (1st edn, 2002), p.148.

[490] Thomas Cottier, "Intellectual Property in International Trade Law and Policy: The GATT Connection", Aussenwirtschaft, [1992], Vol.47, pp.79-105.

TRIPS moved radically beyond its initial purpose of creating a highly deferential standard of non-discriminatory treatment towards IP goods in international trade to an actual harmonization of substantive intellectual property rights laws.[491] However, the enthusiasm for harmonising intellectual property law was suddenly seem to be absent when the discussion turned to the related question of inter-territorial exhaustion. The negotiations broke down so completely over how the newly mandated national IPRs should work on the international level that the TRIPS accord contains only a statement reflecting the parties' failure to agree.[492]The main objective of the negotiation at the beginning was to oppose counterfeit goods.[493] The parties to the Uruguay negotiations adopted a declaration for the negotiation called as the ministerial declaration before the commencement of the negotiation. The Ministerial declaration of 1985[494] brought out the objectives of negotiation which included i) to bring about liberalisation and expansion of trade at the same time providing adequate protection to IP, ii)not to take any trade restrictive measures inconsistent with GATT iii) to improve market access through reduction of trade barriers etc.[495]

Thus, from the objectives in the declaration made prior to the negotiation itself it is clear that trade distortions and impediments should be reduced to the minimum, encouraging maximum trade. It was also pointed out that special treatment of developing countries should be taken into account. Improved access through reduction of trade barriers was also a highlight objective. It is very clear from the all these that banning of parallel imports per se becomes contravention of the objectives of the declaration.

[491] Anthony D'Amato & Doris Estelle Long, *International Intellectual Property Law*, Kluwer Academic Publishers, London, (1st edition, 1997), pp. 8-9.

[492] Vincent Chiappetta, "The Desirability of Agreeing to Disagree: The WTO, TRIPs, International IPR Exhaustion and A Few Other Things", Mich. J. Int'l L, [2000], Vol.21, 333, p.335, available at https://repository.law.umich.edu/cgi/viewcontent.cgi?article=1388&context=mjil., (accessed on 20/12/2018)

[493] *The Ministerial declaration of 1985*, MIN. DEC 20 September, 1986.

[494] *The Ministerial declaration of 1985*, MIN. DEC 20 September, 1986

[495] *The Ministerial declaration of 1985*, MIN. DEC 20 September, 1986.

3.3.3. The approach towards exhaustion at different stages of negotiation:

3.3.3 (a) First Phase of Negotiation

Negotiation can be divided into two phases: The first phase was examination of the scope of existing GATT provisions and suggestions of the countries regarding review of issues in respect of trade in counterfeit gods and second phase regarding tabling of texts by the different countries.[496] The main concerns raised by the Countries in the initial phase were regarding piracy and counterfeit goods.[497] Subsequently, a report was filed by the experts on counterfeit goods.[498] After collecting views from negotiating groups on problems in international protection of IP on June 10, 1987, negotiating group circulated draft agreement to discourage importation of counterfeit goods.[499] The agreement defined counterfeit goods as goods bearing unauthorized representations of legally protected trademark and excluding parallel imports.[500] The report of the group of experts in trade in counterfeiting goods, thus, expressly recognised parallel imported goods as genuine goods and not counterfeit goods. The report identified that the main problem relating to IP was importation of counterfeit goods causing unfair competition[501] and it also stressed the point that any safeguard taken to prevent imports of counterfeit goods should not become barrier to importation of genuine goods.[502] Developed countries argued that recognition of parallel imports would make it difficult to enforce border measures to prevent counterfeit goods, but this argument was finally rejected since parallel imports was accepted as genuine goods.[503] This implies that the issue of international exhaustion or parallel imports was already in the minds of the party countries and they were not against it. This is important for the further

[496] Terrence P. Stewart, *The GATT Uruguay Round: A Negotiating History (1986-1994), Volume IV: The End Game (Part 1),* Kluwer Law International, London, (1999), p.472.

[497] *Ministerial Declaration on The Uruguay Round*, MIN. DEC 20 September, 1986.

[498] *Report of the group of experts in trade in counterfeiting goods*, MDF/W/51, 4 September 1985.

[499] See *Draft Agreement to Discourage the Importation of Counterfeit Goods*, GATT Doc.L/5382(October18, 1982), *Draft Agreement to Discourage the Importation of Counterfeit Goods*, GATT Doc. MTN.GNG/NG11/W/9 (June25,1987) . Also see ; Terrence P. Stewart, *The GATT Uruguay Round: A Negotiating History (1986-1994), Volume IV: The End Game (Part 1),* Kluwer Law International, London, 1999, p.477.

[500] *Report of the group of experts in trade in counterfeiting goods*, MDF/W/51, 4 September 1985, p.10.

[501] *Report of the group of experts in trade in counterfeiting goods*, MDF/W/51, 4 September 1985, p.5.

[502] *Report of the group of experts in trade in counterfeiting goods*, MDF/W/51, 4 September 1985, p.7.

[503] *Report of the group of experts in trade in counterfeiting goods*, MDF/W/51, 4 September 1985, p. 12.

discussion on parallel imports, as the conclusion of TRIPs was not so favourable to parallel imports.

From Oct. 1987 to February 1988, U.S, E.U., Japan, Switzerland and Nordic countries outlined their initial suggestions for achieving negotiating objectives.[504] U.S. suggestion on the framework of the TRIPs was tabled on Oct. 20, 1987.[505] U.S. mainly raised the issue of lack of border measures regarding importation of counterfeit goods.[506] In the context of copyright, U.S. demanded the right of distribution with limitations and exceptions as those of Berne.[507] In the context of Patent, no right to import was demanded by the U.S.[508] In crux, no right of exhaustion was recognised either in copyright, patent or trademark. The EU, Japan and Switzerland however submitted general concerns on how counterfeit goods which are not genuine goods of the IP owner is a threat and suggested the path for negotiations to proceed.[509] The negotiating groups[510] raised concerns on country proposal regarding border measures which could restrict importation of foreign genuine goods. Many countries reiterated that parallel imports are genuine goods and should not be the subject of border measures.

3.3.3 (b) Second Phase of negotiations (1988-1989)

During this stage various countries added to their initial proposals and that was the stage when developing countries voiced their concerns. The U.S. suggested a revision of their earlier proposal placed at the first phase of negotiations by requiring national or community exhaustion to be recognised for trademark, which was absent in the first proposal.[511]In the context of copyright, inclusion of the right to distribute and the right to import was demanded.[512] They also demanded that any limitation upon the copyright owner should not affect the potential market of

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[504] Terrence P. Stewart, *The GATT Uruguay Round: A Negotiating History (1986-1994), Volume IV: The End Game (Part 1),* Kluwer Law International, London, 1999, p.478.

[505] See; *Suggestion by the United States for Achieving the Negotiating Objective,* MTN.GNG/NG11/W/14.

[506] *Suggestion by the United States for Achieving the Negotiating Objective,* MTN.GNG/NG11/W/14.

[507] *Suggestion by the United States for Achieving the Negotiating Objective,* MTN.GNG/NG11/W/14.

[508] *Suggestion by the United States for Achieving the Negotiating Objective,* MTN.GNG/NG11/W/14.

[509] Terrence P. Stewart, *The GATT Uruguay Round: A Negotiating History (1986-1994), Volume IV: The End Game (Part 1),* Kluwer Law International, London, 1999, pp.478-480.

[510] Negotiating groups were formed by countries for negotiating TRIPs in Uruguay round negotiations.

[511] Revision of earlier suggestion MTN.GNG/NG11/W/14.

[512] Revision of earlier suggestion MTN.GNG/NG11/W/14.

the owner.[513] The EU proposal, on the other hand, demanded that Patent shall confer right to prevent third parties from making, offering for sale or putting the product on the market or importing it.[514] Thus through recognition of the right to import and the right to put into market as rights, the EU proposal specifically aimed at banning parallel imports in the context of patents.[515] So far exhaustion was never mentioned in the patent context and it was only in the case of trademark that EU demanded regional exhaustion. However, the EU on another revision of their proposal suggested that if the goods have been put in the market of a third country with the consent of the right holder and if it is imported or re-imported without the consent of the right holder, it shall not be a good ground for customs intervention.[516] This is important for our analysis of parallel imports since the EU had expressly stated that re-imported goods which could be parallel imports cannot attract customs intervention.

From the perspective of developing countries, Brazil suggested that safeguards should be taken against excessive protection of IP during the negotiation as excessive IPR protection could restrict free genuine imports.[517] Brazil also suggested for recognition of flexibilities from inside the TRIPs.[518] It was also suggested by Brazil that restrictions like territorial licensing, import restrictions from other countries etc., should not be allowed.[519] Indian delegate suggested that Negotiation should take into account the public policy concerns of national systems, especially that of developing countries on access to technology, in the context of the international intellectual property system.[520] India also stressed the point that the essence of IP system should not be misunderstood as to confer exclusive rights to owners creating monopolistic and restrictive character.[521] India stressed the point that counterfeit goods are to be taken as those which infringe IP rights and not parallel imports.[522] India strongly opposed the inclusion of the

[513] Revision of earlier suggestion MTN.GNG/NG11/W/14.
[514] *Guidelines and objectives by EU*, MTN.GNG/NG11/W/26, 1988.
[515] *Guidelines and objectives by EU*, MTN.GNG/NG11/W/26, 1988.
[516] MTN.GNG/NG11/W/31.
[517] MTN.GNG/NG11/W/30.
[518] MTN.GNG/NG11/W/30.
[519] MTN.GNG/NG11/W/30.
[520] MTN.GNG/NG11/W/37.
[521] MTN.GNG/NG11/W/37.
[522] MTN.GNG/NG11/W/37.

right to importation in the patent system.[523] India also demanded that the exhaustion of rights of trademark owner should not be limited to a nation or free trade area but must extend globally. Thus India pressed for recognition of international exhaustion in the context of trademarks.[524] When it came to Copyright, India opined that Berne Convention was more than enough for copyright protection.

The general discussion on EU and US proposals was mostly against the proposals. Majority participants opposed the suggestion for inclusion of the right to import in the EC proposal.[525] India strongly opposed the efforts of America to recognise national exhaustion demanding international exhaustion to be recognised.[526]

3.3.3 (c) Draft proposals from different countries

The proposals from the developing countries before the negotiating group giving suggestions and expressing oppositions to the suggestions from other countries prompted the developed countries to prepare and submit a draft proposal of the TRIPs agreement. The U.S. Draft proposal[527] suggested incorporation of the right to import lawfully made copies and to prevent importation without authorization. The U.S. also demanded approval to the position that the right to make first public distribution of the original or each authorised copy should not be considered as exhausting importation right.[528] The U.S. proposal was however silent on the part of the exhaustion in the context of trademark and patent.

The main thrust of the EU in its draft proposal[529] was the creation of a customs union.[530] This was a hint towards pushing the idea of free trade among the member countries of EU. This implied that even though EU recognised exhaustion, it would only demand regional exhaustion

[523] MTN.GNG/NG11/W/37.
[524] MTN.GNG/NG11/W/37,
[525] NG 11/ 8.
[526] MTN.GNG/NG11/W/37.
[527] *Communication from the United States, Draft Agreement on the Trade-Related Aspects of Intellectual Property Rights*, MTN.GNG/NG11/W/70, 11th May 1990.
[528] *Communication from the United States, Draft Agreement on the Trade-Related Aspects of Intellectual Property Rights*, MTN.GNG/NG11/W/70, 11th May 1990.
[529] MTN.GNG/NG11/W/68.
[530] A group of states that have agreed to charge the same import duties as each other and usually to allow free trade between themselves.

and would never support international exhaustion.[531] EU demanded the rights as in Berne in the copyright context while it refused to recognize exhaustion in the trademark context.[532] This was indeed a retraction from the demand for regional exhaustion in its earlier proposal by the EU. It should also be noted that its earlier proposal that the re-imported goods should not be seized by the customs union was also not able to find a place in the draft proposal of EU. The reasonable inference from the above discussion is that even though at the beginning of the negotiation, U.S. and EU had difference of opinion regarding parallel imports, they reached at a consensus by the time the draft proposal was submitted. In the case of patent, it was suggested that the right holder be given the right of putting the goods into the market without their being limited by the exhaustion doctrine. In the general discussion by the negotiating group[533] on the draft proposals of EU and U.S., the negotiating parties strongly opposed the inclusion of customs union as suggested by E.U. as they feared it will create trade impediments between third nations and would create measures which would amount to protectionist measures.[534] The EU's reply was that recognition of customs union was for the purpose of recognising regional exhaustion.[535] The negotiating groups objected to the retracting move of E.U on exhaustion regarding TM since this enabled them to prevent parallel imports.[536] In its discussions the U.S. clarified that the reason for the demand for granting first public distribution right to the copyright owner was to get national exhaustion recognised.[537]Developing countries demanded that the issue of exhaustion be best left to the nations to decide based on their economic and social priority. The stand taken by developing countries was also very interesting as they retracted from the demand for recognition of international exhaustion as an international mandate, and conceded to the stand of freedom for nations to decide on what mode of exhaustion need to be recognised by them. The reason for the same will be brought out in the coming sections.

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[531] MTN.GNG/NG11/W/68.

[532] MTN.GNG/NG11/W/68.

[533] Status of Work in the Negotiating Group, *"Chairman's Report to the GNG",* (MTN.GNG/NG11/W/76), 23 July 1990.

[534] See for eg: *Meeting of Negotiating Group of 14–16 May 1990*, Note by the Secretariat, MTN.GNG/NG11/21, 22 June 1990, atparas. 17 & 38

[535] MTN.GNG/NG11/W/68, 29 March 1990

[536]*Note by the Secretariat, Meeting of Negotiating Group of 2, 4 and 5 April 1990*, MTN.GNG/NG11/20, 24 April 1990.

[537] Communication from the United States (NG11/W/70)

3.3.3 (d)The Chairman's draft or the Anell draft

The text prepared and distributed by Chairman Anell in July 1990 contained limited reference to the subject of exhaustion.[538] The following was the provision in the Anell draft regarding exhaustion in copyright:

(a) Right to import lawfully made copies and to prevent importation without authorisation.[539]

(b) Right to make first public distribution of original or each authorised copy but will not exhaust importation right.[540]

However a footnote was added to the same which said that "nothing in this agreement shall limit the freedom of parties to provide that any intellectual property rights conferred in respect of the use, sale, importation and other distribution of goods are exhausted once those goods have been put on the market by or with the consent of the right holder". [541]

3.3.3 (e) Brussels Draft, 1990[542]

It was in the Brussels conference that Article 6 began to be finalised in to the present shape. The provision regarding exhaustion read as follows:

> **"**Subject to the provisions of Articles 3 and 4 above, nothing in this Agreement imposes any obligation on, or limits the freedom of, parties with respect to the determination of their respective regimes regarding the exhaustion of any intellectual property rights conferred in respect of the use, sale, importation or

[538] MTN.GNG/NG11/W/76.
[539] Art. 3 A.1.1 of Annel draft.
[540] Art. 3 A.1.2 of Annel Draft.
[541] Footnote to Article 3 A.1.2 of Annel Draft.
[542] Draft Final Act Embodying The Results of the Uruguay Round Of Multilateral Trade Negotiations MTN.TNC/W/35/Rev.1, 3 December 1990.

other distribution of goods once those goods have been put on the market by or with the consent of the right holder."[543]

It also had a footnote to the provision which stated that for the purpose of exhaustion European community was to be considered as a single party.[544]

3.3.3 (f) Dunkel Draft and the TRIPs

The negotiation regarding exhaustion came to an almost finality with the Brussels draft. Therefore the provision as provided in the Dunkel draft was adopted subsequently into the TRIPs provision under its Article 6. The provision stated as follows:

> For the purposes of dispute settlement under this Agreement, subject to the provisions of Articles 3 and 4 nothing in this Agreement shall be used to address the issue of the exhaustion of intellectual property rights.[545]

The Article makes it clear that no party can approach the WTO panel upon an issue of mode of exhaustion that is followed by a country. In addition to it, TRIPs also makes it clear that right to import of a patentee shall be subjected to exhaustion regime of a party.[546] Thus Article 6 of TRIPs came into existence.

3.4. Was Article 6 a compromise solution?

The above analysis makes it clear that Article 6 of TRIPs is in fact a compromise provision arrived at by the parties to the negotiation.[547] From the very beginning of the negotiation there was no consensus among the member countries as the European Union sought to achieve

[543] Draft Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations, MTN.TNC/W/35/Rev.1, 3 December 1990, p.200.

[544] Draft Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations, MTN.TNC/W/35/Rev.1, 3 December 1990, Footnote 1.

[545] Art. 6 of TRIPs Agreement, 1994.

[546] Footnote 6 to Art.28 of TRIPs Agreement, 1994.

[547] Frederick M. Abbot, "First Report(Final) to the Committee on International Trade Law of the International Law Association on the Subject of Parallel Importation", Journal of International Economic Law,[1998],Vol. 1, No. 4, p.609, available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=915046, (accessed on 4/11/2018).

regional exhaustion as the international mandate[548] and the U.S. wanted a total ban on parallel imports[549]whereas the developing countries wanted international exhaustion.[550] However, Article 6 resulted in none of these but a very vague compromise solution leaving nations free to follow any mode of exhaustion but at the same time any issue related to the exhaustion was never to be raised in the WTO platform.

There are two reasons for the compromise solution on the mode of exhaustion. They are:

- Lack of consensus between parties: It is evident that lack of consensus among developed and developing countries was one of the major reasons for the inclusion of exhaustion as seen in TRIPs. As Adrian Otten, Director of the WTO Intellectual Property Division, who served as Secretary to the Trade Negotiating Group during the Uruguay Round negotiations, put it: Article 6 reflects a compromise between countries who wanted to leave it to the nations to determine the issue and the nations who opposed the same.[551]Thus the final document allows the countries to follow its own exhaustion principle while pleasing the developed nations by not expressly providing for the same. The lack of consensus was in fact a result of the wrong path treaded by the negotiation i.e. harmonisation of all national laws which was not practical in the context of exhaustion.
- U.S. pressure using Section 301 of U.S. Trade Act: The section allows the U.S. President to take action against foreign goods including suspension and withdrawal of U.S. trade concessions, impositions of duties or other import restrictions. Under Special 301, United State trade Representative issued a list of priority foreign countries that deny adequate

[548] Frederick M. Abbot, "GATT and the European community: A formula for peaceful co-existence", Mich. J.Intl'L, [1990], Vol.12, p.1, available at: http://repository.law.umich.edu/mjil/vol12/iss1/1, (accessed on 20/12/2018).

[549]Suggestion By The United States For Achieving The Negotiating Objective, (MTN.GNG/NG11/W/14/Rev.1) , 17 October 1988, Special Distribution.

[550] Frederick M. Abbot, "GATT and the European community: A formula for peaceful co-existence", Mich. J.Intl'L, [1990], Vol.12, p.1, available at: http://repository.law.umich.edu/mjil/vol12/iss1/1, (accessed on 20/12/2018).

[551] Remarks of Adrian Otten, in Frederick M. Abbott, "Second Report (Final) to the Committee on International Trade Law of the International Law Association on the Subject of the Exhaustion of Intellectual Property Rights and Parallel Importation", (presented in 69th Conference of the International Law Association, London, July 2000), p.24. Also See ; *Resource Book on TRIPS and Development*, UNCTAD-ICTSD, (2005), p. 103, available at https://unctad.org/en/PublicationsLibrary/ictsd2005d1_en.pdf, (accessed on 20/12/2018).

and effective protection. Many participants alleged this was violative of Uruguay round negotiation principles. Brazil was named in the priority watched countries from 1987-1993.[552] Even though Brazil succumbed to the pressure to prepare a draft of revised IP law, the U.S. complained that the draft was insufficient since it provided for parallel imports.[553] Argentinean IP law was ordered a Section 301 investigation in 1988 but was later lifted of the investigation upon the assurance by Argentina to provide adequate protection.[554] But the 1991 new patent law provided for parallel imports and on this ground was again listed in the priority watch list.[555] During the beginning of the negotiations, Taiwan law provided for parallel imports but upon the inclusion in the priority watch list in 1989, the country reversed its law and prohibited parallel imports.[556] Thus it is evident that U.S. using coercive pressures was forcing countries to ban parallel imports which would have had negative impacts upon the negotiations. Thus countries which supported parallel imports initially in the negotiations was forced to change its stands while countries like India still opposed developed countries recommendation of national or regional exhaustion.[557]

The path adopted by the negotiating parties in resolving the issue of exhaustion cannot be said to be appropriate. The focus of debate on exhaustion should have been about the appropriate mode of exhaustion for bringing in maximum efficiency resulting from free flow of goods.[558] Instead the negotiation focused on harmonizing national laws. It is also noteworthy that the negotiation deviated from the basic principles on which the negotiation began i.e. IPR policies should not

[552] Terrence P. Stewart, *The GATT Uruguay Round: A Negotiating History (1986-1994), Volume IV: The End Game (Part 1),* Kluwer Law International, London, 1999, pp.497-498.

[553] Terrence P. Stewart, *The GATT Uruguay Round: A Negotiating History (1986-1994), Volume IV: The End Game (Part 1),* Kluwer Law International, London, 1999,p.497.

[554] Terrence P. Stewart, *The GATT Uruguay Round: A Negotiating History (1986-1994), Volume IV: The End Game (Part 1),* Kluwer Law International, London, 1999, pp.498-499.

[555] Terrence P. Stewart, *The GATT Uruguay Round: A Negotiating History (1986-1994), Volume IV: The End Game (Part 1),* Kluwer Law International, London, 1999, pp.498-499.

[556] Terrence P. Stewart, *The GATT Uruguay Round: A Negotiating History (1986-1994), Volume IV: The End Game (Part 1),* Kluwer Law International, London, 1999, p.502.

[557] Terrence P. Stewart, *The GATT Uruguay Round: A Negotiating History (1986-1994), Volume IV: The End Game (Part 1),* Kluwer Law International, London, 1999, pp.495-502.

[558] See generally, Vincent Chiappetta, "The Desirability of Agreeing to Disagree: The WTO, TRIPs, International IPR Exhaustion and A Few Other Things", Mich. J. Int'l L. [2000] , vol.21, 333, available at: http://repository.law.umich.edu/mjil/vol21/iss3/1, (accessed on 17/11/18).

themselves become barriers to legitimate trade.[559] Thus countries believed themselves to have arrived at a compromise solution which resulted in Article 6 of TRIPS. However, in fact what occurred was much beyond a compromise.

The developing nations were in fact fooled to believe that it was a compromise. When TRIPs takes a clear stand on other IP issues, what Article 6 has done is a complete let off on the issue of exhaustion. They never understood the real implication of Article 6 completely. They believed that they were now free to adopt international exhaustion and doors would be opened to those nations were international exhaustion were opted. In fact even though Article 6 did give the nations to adopt international exhaustion, the real problem lies in the trading of goods across borders. When it comes to the international trading, goods will have to cross different national borders. If one of the nations through which the goods travel recognises national or regional exhaustion, then the goods could be confiscated by those nations. This is enabled through Footnote 13 to Article 51. The footnote 13 to Article 51 further illustrates/exemplifies this dilemma in to which the developing countries were pushed. It states that the there is no obligation to apply procedures for suspension of goods by customs authorities upon the allegation of infringement for goods in transit.[560] This footnote does not obligate for any procedures for customs duties for suspension of goods in transit. However, this was a trap. The implication of the provision is that it does not prohibit the trademark or copyright holder from requesting the customs authorities to suspend or confiscate the goods from entering into commerce by the customs authorities when they are in transit to another nation if there local law mandated national or regional exhaustion. Further, the provision defining counterfeit or pirated goods does not cover patent products. This means that patent products can be suspended even without prima facie infringement is proved when they are in transit through the country. In the WTO cases regarding confiscation of Indian patented pharmaceutical products destined to Brazil, by EU, the nature of goods cannot be scrutinised under the definition of pirated or counterfeit products as patent products are not covered by the definitions. However, the second footnote to 51 states that any goods which are placed in the market by the right holder or any goods in transit

[559] Preamble to the TRIPs Agreement, 1994.

[560] Footnote 13 to Art. 51 of the TRIPs agreement 1994 states that: "It is understood that there shall be no obligation to apply such procedures to imports of goods put on the market in another country by or with the consent of the right holder, or to goods in transit."

need not be necessarily suspended through border measures. Further the parallel trade of goods which are made without the express consent of the right holder, for eg: goods produced under compulsory licensing, will not be considered as genuine or parallel traded goods as far as Article 51 was concerned. This would in fact make Article 6, international exhaustion and free trade in IP goods a redundant stuff merely appearing in just the text of the TRIPs. This brings out the fact that the when it came to intellectual property, countries had problems in recognition of free movement of IP goods internationally even though they pushed IP to be within the framework of WTO. The obvious conclusion if the nations really opted for free trade of IP goods would have been international exhaustion. But the same nations who pushed for inclusion of IP as a matter of trade concern and shifted the negotiation from the IP exclusive WIPO forum to the WTO forum, also took the negative stand on free trade of IP goods and international exhaustion. In fact what has been called as a compromise on Article 6 is in fact a trade barrier to free trade between nations. The politics will be further clear when one sees Europe recognising regional exhaustion so as to facilitate free movement of goods within their territory. This points out that developed nations never wanted global welfare or welfare of the developing or under developed nations. These double standards followed by developed countries concretes the opinion that developed countries treats IP goods differently from normal goods for their own economic needs and are least bothered regarding the consumer interest both internally and in global community.

3.5. Impact of TRIPs provision of exhaustion on Post-TRIPS FTA's.

In order to analyse the impact of Article 6 on the international scenario, it is best to analyse post-free trade agreements. An analysis of Post-TRIPs free trade agreements containing intellectual property is important since these agreements are expected to function within the legal framework of TRIPs.. Even though many FTAs have been entered in to by different nations after TRIPs, not many of them contain express provisions on exhaustion. The FTAs which contain provisions on exhaustion either grant the freedom to parties to determine the mode of exhaustion or mandate national exhaustion. These free trade agreements are in fact entered so as to overcome the constraints of WTO which is a multilateral free movement framework.

These free trade agreements aim at the creation of free trade area between the two or more parties. The free trade agreements, most often, state in their objectives and provisions that they

aim at enhancing trade and also that IP should not be a barrier to the same.[561] The treatises have common aims such as elimination of tariffs and duties[562] and elimination of quantitative measures.[563] However, these remain merely as an eye wash. In the Australia- China free trade agreement, there is an express provision stating there should not be any restriction or prohibition on imports. However, when it comes to the issue of exhaustion, the nature of the kind of exhaustion is left for the each nation to decide.[564] Some free trade agreements do not address the issue of exhaustion at all. The double standard followed by the parties in the case of free movement of goods and exhaustion is thus evident. The parties could not even form a consensus on the same. Similar is the position in all the free trade agreements containing IP as a deliberated issue. In the Australia- U.S. free trade agreement the level of differential treatment gets higher wherein the right granted for a copyright owner as to distribute is over the original copies.[565] However when it comes to exhaustion issue the agreement leaves it to the freedom of the parties to determine the mode of exhaustion.[566] Another method in which certain free trade agreements restrict movement of goods is through granting importation rights. They state the desire to avoid unnecessary restrictions placed by trade but does not allow imports of IP goods without the consent of the owner.[567] Even right to place contractual restrictions upon the import of goods by the patent owners are recognised.[568] Thus Article 6 of the TRIPs necessarily facilitated the parties to deviate from the very nature of free movement of goods.

Even though majority provisions even inside TRIPs favour free movement of goods for the social welfare to be achieved, the structuring of the provision on exhaustion is very

[561] Art. 11.1 of Australia- China free trade agreement, 2015, Art. 17.7 of Australia-U.S. Free Trade Agreement, 2005, Singapore –U.S. Free trade Agreement, 2004.

[562] Art. 2 of the Australia- New Zealand Free trade Agreement,2004, Australia- U.S. Free Trade Agreement, 2005.

[563] Art. 7 of the Australia- New Zealand Free trade Agreement,2004.

[564] Art. 11.8 of the Australia- New Zealand Free trade Agreement,2004 states: EXHAUSTION : Nothing in this Chapter shall affect the freedom of the Parties to determine whether, and under what conditions, the exhaustion of intellectual property rights applies. The Parties agree to further discuss relevant issues relating to the exhaustion of patent rights.

[565] Art. 17.4.2 of the Australia- U.S. Free Trade Agreement, 2005.

[566] Art. 17.4.2 of the Australia- U.S. Free Trade Agreement, 2005, footnote.

[567] Art. 17.9.4 of the Australia- New Zealand Free trade Agreement, 2004, Art.15.5 and Art. 15.9.4 of US – Morocco Free Trade Agreement, 2006.

[568] Footnote to Art.15.9.4 of US – Morocco Free Trade Agreement, 2006.

disappointing. The impact of the compromise that has been reached in Article 6 of the TRIPs is now sufficiently clear-. to handle exhaustion in a suitable manner for developed countries using their freedom for introducing TRIPs plus standards using free trade agreements and thus providing higher IPR protection. The post- TRIPs free trade agreements expose this fact. In order to achieve the free movement of IP goods as envisaged by the provisions of the TRIPs agreement, the only logical method of exhaustion, which would facilitate the same, would be international exhaustion.

3.6. Conclusion

This chapter attempts an analysis of the concept of free trade and the appropriate mode of exhaustion. During this process it also critically examines the international understanding on the concept of exhaustion in the pre and post WTO context. A detailed analysis of the negotiation on the relevant provisions related to exhaustion in the TRIPS Agreement reveals two things: i) the incapacity of the developing world to conceptualize the exact significance and implications of the provisions related to exhaustion; ii) the ultimate result of it which led to the framing of highly insensible provisions which are contradictory to the established notions of free trade. We have already seen the second chapter that the most appropriate form of exhaustion in the free trade context is international exhaustion. However, the analysis conducted in this chapter reveals that Article 6 was never properly conceived and defended by the developing countries. A close examination of Article 6 reveals that it can never be termed a real flexibility under TRIPs. On the other hand, Article 6, which permits member countries to resort to any form of exhaustion they choose could be seen as facilitating creation of trade barriers between nations by disabling the free movement of intellectual property goods.

The researcher finds that the free trade regime under WTO is applied differently to the intellectual property goods under TRIPs without any justification. The member countries are not even allowed under Article 6 to challenge this non-tariff barrier before the WTO dispute settlement body. As explained above, the current provision in Article 6 and the Border measure provision under Article 51 run counter to Article XI of the GATT agreement which ensures free trade. This could be a culmination of, the pressure exerted by developed nations, as we have seen in the negotiating history of Article 6.The developed nations, especially U.S., achieved this

through their trade sanctions, which weakened the position of many developing nations who wanted international exhaustion. Developing countries never seem to have realised that Article 6 would become a barrier to free trade. The futility of the exhaustion related provisions in TRIPs is evident from the WTO case regarding the confiscation of patented pharmaceutical medicines by the EU, discussed in this chapter. Had Article 6 and Article 51 sufficient enough to ensure free movement of genuine products, the confiscations would not have been possible. India and Brazil,the complainants in this case, could not resort to Article 6 even for approaching the WTO DSB and had to rely on GATT provision on freedom of transit to do so. Therefore, it is suggested that the language of the Article 6 has to be amended to bring the provision on exhaustion in conformity with the GATT Philosophy of free trade.

Chapter IV

Economics of Parallel Imports

4. Introduction

Parallel imports, also called as grey market imports, are imports of genuine intellectual property goods placed into circulation in one market, into a second market without the authorization of the local IP owner relying on the doctrine of exhaustion of intellectual property rights on first sale.[569] Parallel imports occur when the producers sell the same products at different prices in different markets, using differential pricing mechanism. Purchasing in a lower-priced country and re-selling in a higher-price country is technically termed as "arbitrage", although in the context of trade with manufacturer-authorized distribution it receives the qualification of "parallel trade."[570] What are the gains of parallel import? Does it economically affect the IP holder? Is parallel import welfare enhancing? Will parallel import promote an economically efficient intellectual property system? To answer these queries one must understand the economics of parallel imports.

Parallel imports functions depending on the skill of the parallel importer to arbitrage away the price differences of the products.[571] The rationale for parallel trade comes from expected price differences between source and destination countries. These price differences should be higher than any anticipated or un-anticipated costs from performing parallel trade, thereby allowing parallel traders to profit out of this activity. Such costs include, among others, transport and transaction costs - costs resulting from obtaining marketing authorization to distribute a product

[569] Kieth E Maskus, "Parallel Imports", The World Economy, [2000], Vol. 23 , Issue 9, pp. 1269–1284,at p.1269,available athttps://onlinelibrary.wiley.com/doi/abs/10.1111/1467-9701.00329, (accessed on 21/12/2018) .
[570] Reza Ahmadi, B Rachel Yang, "Parallel imports: challenges from unauthorised distribution channels" Marketing Science, [2000], Vol.19(3), pp.279-294, p.280, available at www.jstor.org/stable/193190 (accessed on 21/12/2018).
[571] Martin Richardson, "An Elementary Proposition Concerning Parallel Imports", Journal of International Economics, [2002], Vol. 56 (1) pp. 233–245, available at https://www.sciencedirect.com/science/article/pii/S0022199601001106?via%3Dihub, (accessed on 21/12/2018)

in destination countries - and the costs incurred for hedging against exchange rate differentials.[572] The lower the above costs and the greater the price differentials between source and destination countries, the greater the potential for parallel trade in principle. The greatest factor which gives rise to differential pricing is the differences in the market structure of different countries[573], which will be explained in the coming sections of this chapter.

The economics of parallel imports would be incomplete if the impact of parallel imports on parallel importer, IP holder and the society is overlooked. The general argument against parallel imports is that the parallel importer free rides on the investment of the intellectual property holder. The reason attributed is that when the intellectual property holder brings out a product in to market after immense investments, both in R&D and other areas like promotion and distribution of the goods, the parallel importer does not incur any such costs.[574] However, a close analysis of the functioning of it reveals that the gains of the parallel importer hardly have any impact on the economic returns of the intellectual property holder. This is evidenced from the fact that the economic justification for every system of intellectual property envisages a permissible profit in every market, beyond which it becomes abuse of intellectual property rights. The welfare aspects of parallel imports exemplify this. It is the aim of the chapter to bring out that consumer as well as global welfare is increased as a result of parallel imports. Further, the act of parallel importing cannot be simply called as free riding, since the IP holder gets a onetime reward for the product that he has sold and it is this product which is being resold in another market.

Literature on the economic impacts of parallel imports seems to be few and it is even less when it comes to the literature which brings out the positive side of parallel imports. The strongest economic arguments raised against parallel imports are that parallel imports might force the manufacturer to stop differential pricing and adopt uniform pricing in all markets or drop the

[572] P Kanavos *et. al.*, "The economic impact of pharmaceutical parallel trade in European Union member states: A stakeholder analysis", (Special Research Paper, London School of Economics, 2004), p.16, available at http://www.lse.ac.uk/LSEHealthAndSocialCare/pdf/Workingpapers/Paper.pdf ,(accessed on 28/11/2018).

[573] Arthur C. Pigou, *The Economics of Welfare*, (1920), P. 282, available at http://files.libertyfund.org/files/1410/Pigou_0316.pdf. (accessed on 28/11/2018).

[574] P Kanavos *et. al.*, "The economic impact of pharmaceutical parallel trade in European Union member states: A stakeholder analysis", (Special Research Paper, London School of Economics, 2004), p.138, available at http://www.lse.ac.uk/LSEHealthAndSocialCare/pdf/Workingpapers/Paper.pdf ,(accessed on 28/11/2018).

small markets from being served with the products.[575] These conclusions have been drawn upon the economics of differential pricing. But these arguments appear to be incorrect. Theory of differential pricing and its economics do not support such a conclusion. The basic principle of differential pricing and the reason to adopt the same by the manufacturer is profit making. When profit making is the ultimate aim of the producer, the argument that parallel importing may force the intellectual property owner to resort to uniform pricing or to leave out markets from being served does not appear to be convincing.

The author, however, is not suggesting that differential pricing will not bring about welfare; on the contrary, it will. The suggestion, in fact, is that differential pricing mechanism adopted by the producers is for profit and that even in the presence of parallel imports differential pricing will take place. In order to establish the fact that differential pricing is for profit maximisation, the author tries to explore the pricing mechanism by analysing factors like the output produced under differential pricing ,the relevant aspects in determining the output under differential pricing etc., to see if parallel imports may lead to withdrawal of differential pricing. The author concludes this chapter by observing that the presence of parallel imports merely reduces the profit of the intellectual property holder and does not actually cause any serious loss to the IP holder. A close analysis reveals that the profit that would arise out of banning parallel imports is actually undue profit, resulting from the abuse of IP rights. It also reveals that the IP holder cannot do away with the differential pricing as it is a profit maximising process. Even the benefits gained by the low income countries through differential pricing mechanism, is an outcome of the maximisation of profit of the producer. This is testified by the fact that in markets where there is less price demand elasticity,[576] e.g., Uganda or Columbia, the producers opt for high prices and target only the affordable consumers.[577] It is an established fact that unless differential pricing creates

[575] D.Malueg, Marius Schwartz., "Parallel imports, demand dispersion and international price discrimination", Journal of International Economics, [1994], Vol.37, pp.167–195. Also see Daniel Knox and Martin Richardson, "Trade policy and parallel imports", European Journal of Political Economy, [2002], Vol. 19, pp.133 – 151, available at https://www.sciencedirect.com/science/article/pii/S0176268002001337, (accessed on 21/12/2018).

[576] Price elasticity of demand is an economic measure of the change in the quantity demanded or purchased of a product in relation to its price change. For additional information see: Price Elasticity Of Demand: Formula & Examples | Investopedia https://www.investopedia.com/terms/p/priceelasticity.asp#ixzz5Y9wpbMN0.

[577] John Barton, *Differentiated Pricing of Patented Products,* , Working Paper No. 63, Indian Council for Research on International Economic Relations , 2001, p. 7, available at http://icrier.org/pdf/WP-JOHN%20BARTON.pdf, (accessed on 28/11/2018).

increased output (sufficient access to maximum consumers) it is not welfare enhancing globally as suggested by IP holders.[578] Therefore even under differential pricing if the countries face access problems to IP goods then it must be said that the differential pricing mechanism is not welfare enhancing. In brief, parallel importing is essential to ensure that differential pricing mechanism is actually welfare enhancing.

This chapter is divided in to five portions. The first portion tries to understand the concept of differential pricing. The concept of third degree differential pricing, which is the relevant form of differential pricing for our analysis, is explained in the second portion. The third portion analyses the welfare effects of differential pricing by exploring the conditions for enhancement of third degree differential pricing so as to make it welfare enhancing. The pricing mechanism of a product and the output determination by the producer are also explained in this portion. The fourth portion examines the economic efficiency of parallel imports. The fifth portion explores the competition perspective of parallel imports.

4.1 The Concept of Differential Pricing

Differential pricing is the practice of selling the same commodity at different prices to different consumers in different markets world over.[579]The classic explanation to differential pricing involves an action by a monopolist to enlarge profits by dividing his market so that each buyer or class of buyers pays a price closer to the buyers' reservation prices — the maximum price the

[578] Arthur C. Pigou, *The Economics Of Welfare*, (1920), P. 286- 287, available at http://files.libertyfund.org/files/1410/Pigou_0316.pdf. (accessed on 28/11/2018). Also see; Richard Schmalensee, "Output and Welfare Implications of Monopolistic Third-Degree Price Discrimination", The American Economic Review, [1981], Vol. 71, No. 1, pp. 242-247, available at https://www.jstor.org/stable/1805058, (accessed on 28/11/2018) ; Joan Robinson, *The Economics of Competition*, MacMillan and Co. Limited, London, (1st Edition, 1938), pp.204-205 ; Simon Cowan, "When Does Third-Degree Price Discrimination Reduce Social Welfare, and When Does It Raise It?" (Department of Economics Discussion Paper Series, University of Oxford, 2008,) p.3, available at https://www.researchgate.net/publication/23536078_When_does_thirddegree_price_discrimination_reduce_social_welfare_and_when_does_it_raise_it, (accessed on 29/11/2018).

[579] Arthur C. Pigou, *The Economics Of Welfare*, (1920), pp.199-207, available at http://files.libertyfund.org/files/1410/Pigou_0316.pdf. (accessed on 28/11/2018). Also see generally, George J Stigler , *The Theory of Price*, (1966), available at https://ia601606.us.archive.org/25/items/in.ernet.dli.2015.166890/2015.166890.The-Theory-Of-Price.pdf, (accessed on 20/12/2018).

buyer is willing to pay — than would otherwise be the case.[580]Differential pricing is possible more profitably in a market with certain amount of monopoly.[581] The development of the concept of differential pricing owes to A.C. Pigou who classified differential pricing into three categories[582]. Pigou developed a typology for examining the maximization of profits by adopting selling prices that vary based on purchaser or number of units sold.[583] In order to enhance the profit, as per Pigou, three basic kinds of differential pricing could be used – first degree, second degree and third degree.[584] First-degree price discrimination occurs when a firm charges a different price for every unit consumed and the firm is able to charge the maximum possible price for each unit which enables the firm to capture all available consumer surplus for itself, while second degree differential pricing involves charging different prices depending upon the quantity consumed.[585] What is relevant for our discussion is the third degree differential pricing, which occurs when the producer divides his buyers into two or more than two sub-markets or groups depending on the demand conditions in each sub-market, and charges to a different price in each market.[586]

[580] Daniel J. Gifford and Robert T. Kudrle, "The Law and Economics of Price Discrimination in Modern Economies: Time for Reconciliation?", University of California Davis L. Rev., [2010] , Vol. 43, p.1235, at p.1240, available at http://scholarship.law.umn.edu/faculty_articles/358?utm_source=scholarship.law.umn.edu%2Ffaculty_articles%2F358&utm_medium=PDF&utm_campaign=PDFCoverPages, (accessed on 29/11/2018).

[581] Arthur C. Pigou, *The Economics Of Welfare*, (1920), pp.199-207, available at http://files.libertyfund.org/files/1410/Pigou_0316.pdf. (accessed on 28/11/2018).

[582] Arthur C. Pigou, *The Economics Of Welfare*, (1920), pp.199-207, available at http://files.libertyfund.org/files/1410/Pigou_0316.pdf. (accessed on 28/11/2018).

[583] Daniel J. Gifford and Robert T. Kudrle, "The Law and Economics of Price Discrimination in Modern Economies: Time for Reconciliation?", University of California Davis L. Rev., [2010], Vol. 43, 1235, at p.1239, available at http://scholarship.law.umn.edu/faculty_articles/358?utm_source=scholarship.law.umn.edu%2Ffaculty_articles%2F358&utm_medium=PDF&utm_campaign=PDFCoverPages, (accessed on 29/11/2018).

[584] Arthur C. Pigou, *The Economics Of Welfare*, (1920), p.209, available at http://files.libertyfund.org/files/1410/Pigou_0316.pdf, (accessed on 28/11/2018).

[585] Hal. R. Varian, "Price Discrimination", in Schmalensee and R.D. Willig 's, *Handbook of Industrial Organization*, Volume I, Elsevier Science Publishers, 1989, available at http://sites.bu.edu/manove-ec101/files/2017/11/VarianHalPriceDiscrimination1989.pdf, (accessed on 22/12/2/2018). Also see; Arthur C. Pigou, *The Economics Of Welfare*, (1920), p.201, available at http://files.libertyfund.org/files/1410/Pigou_0316.pdf, (accessed on 28/11/2018).

[586] Arthur C. Pigou, *The Economics of Welfare*, (1920), p. 201, available at http://files.libertyfund.org/files/1410/Pigou_0316.pdf. (accessed on 28/11/2018).

Differential pricing is most favourable, that is to say, it will yield maximum profit to the monopolist when the demand price for any unit of a commodity is independent of the price of sale of every other unit.[587] This implies that it is impossible for any one unit to take the place of any other unit.[588] In other words, no unit of the commodity sold in one market can be transferred to another market.[589] This, in turn, implies two things. The first implication of differential pricing is concerning resale and that resale need to be prohibited. Thus when resale is prohibited the manufacturer makes maximum profit. It is essential for the purpose of this discussion to examine the veracity of this statement. The second is that no unit of demand, proper to one market, can be transferred to another market.[590]Differential pricing brings in maximum profit only if certain conditions are satisfied. They are:

(a) Market Power: A monopolist adopting the method of differential pricing should primarily have the market power. This enables the monopolist to lower the price in a weak market as he doesn't face competition. Further there must not exist easily available, equally satisfactory substitutes, for the good or service the firm is selling. Otherwise customers from whom the firm seeks to extract a high price will defect to competitors. In the intellectual property context this situation is easily established as IP grants limited monopoly rights as incentive.[591]

Also see: Stefan Szymanski *et.al.,* "Parallel Trade, Price Discrimination, Investment and Price Caps", Economic Policy, [2005], Vol. 20, No. 44, pp. 705+707-749, available at https://www.jstor.org/stable/3601057, (accessed on 21/12/2018).

[587] Arthur C. Pigou, *The Economics of Welfare*, (1920), p. 202, available at http://files.libertyfund.org/files/1410/Pigou_0316.pdf. (accessed on 28/11/2018).

[588] Arthur C. Pigou, *The Economics of Welfare*, (1920), p. 199, available at http://files.libertyfund.org/files/1410/Pigou_0316.pdf. (accessed on 28/11/2018).

[589] Arthur C. Pigou, *The Economics of Welfare*, (1920), p. 199, available at http://files.libertyfund.org/files/1410/Pigou_0316.pdf. (accessed on 28/11/2018).

[590] Arthur C. Pigou, *The Economics of Welfare*, (1920), p. 199, available at http://files.libertyfund.org/files/1410/Pigou_0316.pdf. (accessed on 28/11/2018).

[591] Hal R. Varian, *Price Discrimination*, CREST Working Paper, Number 86-27, Department of Economics University of Michigan, 1987, pp.1-2, available at https://deepblue.lib.umich.edu/bitstream/handle/2027.42/101032/ECON469.pdf?sequenc, (accessed on 29/11/2018). Also see; Arthur C. Pigou, *The Economics of Welfare*, (1920), p. 199, available at http://files.libertyfund.org/files/1410/Pigou_0316.pdf. (accessed on 28/11/2018).

(b) Ability to prevent resale[592]: As stated above, monopolist will be engaging in differential pricing policy only if he can prevent resale of the product in another market on the contrary to which arbitrage can erode away the profit of the manufacturer. Our present discussion demands a probe in to the correctness of this argument. Is the ban on parallel imports essential for the very existence of the practice of differential pricing or is it only essential for maximizing the profit of the manufacturer?

(c) Ability to sort consumers: The manufacturer finally should be able to sort the consumers into different groups. Monopolist divides the market on the basis of price elasticity of demand.[593] It is in this ability to sort consumers that one sees the practice of degrees of differential pricing. Price discrimination usually benefits the firms that engage in it. By separating the potential customers into different subsets based on the elasticity of demand, and then by selecting the profit-maximizing price for each subset, the firms are able to earn more than they can earn from offering the same price to all their customers. [594]

There are different factors which induce a manufacturer to adopt differential pricing mechanism such as the urge to make maximum profits, differences in marginal costs and transportation costs, difference in market structure as arising out of the differences in the purchasing power of consumers, location differences, age of consumers, non-transferable nature of property, tariff barriers, and legal prohibition on resale. The issue of prohibition will be central enquiry of our discussion; i.e., whether differential pricing is used merely for maximising profit or is it an essential condition for the very existence of differential pricing. The author concludes in this chapter that the ban on parallel imports is not a necessary for the furtherance of differential

[592] Hal R. Varian, *Price Discrimination*, CREST Working Paper, Number 86-27, Department of Economics University of Michigan, 1987, pp.1-2, available at https://deepblue.lib.umich.edu/bitstream/handle/2027.42/101032/ECON469.pdf?sequenc, (accessed on 29/11/2018).

[593] Price elasticity of demand is the change in demand of products that occurs due to variations in prices of the products.

[594]Hal R. Varian, *Price Discrimination*, CREST Working Paper, Number 86-27, Department of Economics University of Michigan, 1987, pp.1-2, available at https://deepblue.lib.umich.edu/bitstream/handle/2027.42/101032/ECON469.pdf?sequenc, (accessed on 29/11/2018).Also see; JayasreeWatal, *Workshop on Differential Pricing and Financing of Essential Drugs*, (Background Note Prepared by JayashreeWatal, Consultant to the WTO Secretariat, 2001), p.11, available at https://www.wto.org/english/tratop_e/trips_e/wto_background_e.pdf., (accessed on 18/12/2018).

pricing and it is just used as a tool for profit maximisation of the producer. This finding will be substantiated in the coming sections.

4.1.1. Third Degree Differential pricing and its Economics

As discussed, it is the third degree differential pricing which is relevant for the purpose of analysing the interrelation between differential pricing and parallel imports. In the third degree differential pricing, as already stated, the producer divides his buyers into two or more sub-markets or groups depending on the demand conditions in each sub-market and charges a different price in each market.[595] The immediate effect of this discrimination would be to transfer all demands from the less to the more favoured market, and discrimination would yield less advantage to the monopolist.[596] This is the reason behind the demand for prohibiting resale of a product.

The price charged depends mainly on the output sold and demand conditions of that market. The defect of the same is that differential pricing need not cater all the consumers of the market as the manufacturer may limit the production and distribution to consumers who can afford to pay the price that brings maximum profit to the manufacturer.[597] In order to understand the welfare effects of differential pricing, one must understand how the price of products is fixed in a market by the monopolist. This analysis is also important to understand whether uniform pricing is possible for a product across the globe.

[595] Arthur C. Pigou, *The Economics of Welfare*, (1920), p. 201, available at http://files.libertyfund.org/files/1410/Pigou_0316.pdf. (accessed on 28/11/2018).
[596] Arthur C. Pigou, *The Economics of Welfare*, (1920), p. 201, available at http://files.libertyfund.org/files/1410/Pigou_0316.pdf. (accessed on 28/11/2018).
Also see: Tommaso M. Valletti and Stefan Szymanski, "Parallel Trade, International Exhaustion and Intellectual Property Rights: A Welfare Analysis", The Journal of Industrial Economics, [2006], Vol.54, pp. 499-526, available at https://www.researchgate.net/publication/284052010_Parallel_trade_international_exhaustion_and_intellectual property_rights_A_welfare_analysis, (accessed on 21/12/2018).
[597] Arthur C. Pigou, *The Economics of Welfare*, (1920), p. 205, available at http://files.libertyfund.org/files/1410/Pigou_0316.pdf. (accessed on 28/11/2018).

4.1.2. Welfare effects of third degree Differential Pricing

Economists are of the view that it is impossible to say whether price discrimination is socially desirable or not.[598] Generally, a move from non-discrimination to discrimination raises the profit of the firm, harms consumers where prices increase, and benefits consumers where prices fall.[599] Monopolist who adopts the method of differential pricing in a market has the difficult task of determining how much price and output of the product should be produced by him in order to make the maximum profit.[600] The producer may offer high price for the product and produce less and this method could be adopted if the target group of the consumers are small, especially in an inelastic market as that will fetch him the maximum profit in such markets.[601] If the market is highly elastic he may make it available at affordable price to a larger section of consumers as

[598] Arthur C. Pigou, *The Economics of Welfare*, (1920), available at http://files.libertyfund.org/files/1410/Pigou_0316.pdf. (accessed on 28/11/2018).
Also see; Daniel J. Gifford and Robert T. Kudrle, "The Law and Economics of Price Discrimination in Modern Economies: Time for Reconciliation?", University of California Davis L. Rev., [2010] , Vol. 43, 1235, at pp.1235-1293, available at http://scholarship.law.umn.edu/faculty_articles/358?utm_source=scholarship.law.umn.edu%2Ffaculty_articles%2F358&utm_medium=PDF&utm_campaign=PDFCoverPages, (accessed on 29/11/2018).
A.M.) ; Joan Robinson, *The Economics of Competition*, MacMillan and Co. Limited, London, (1st Edition, 1938), pp.179-202 ; Mark Armstrong, *Price Discrimination*, MPRA Paper No. 4693, Department of Economics, University College London , September 2007, pp. 23-24, available at http://mpra.ub.uni-muenchen.de/4693/, (accessed on 29/11/2018).

[599] Simon Cowan, *When Does Third-Degree Price Discrimination Reduce Social Welfare, and When Does It Raise It?*Department of Economics Discussion Paper Series, University of Oxford, 2008, p.3, available at https://www.researchgate.net/publication/23536078_When_does_thirddegree_price_discrimination_reduce_social_welfare_and_when_does_it_raise_it, (accessed on 29/11/2018).

[600] See generally Richard Schmalensee, "Output and Welfare Implications of Monopolistic Third-Degree Price Discrimination", The American Economic Review, [1981], Vol. 71, No. 1, available at https://www.jstor.org/stable/1805058, (accessed on 28/11/2018).

[601] Sarah R. Wasserman Rajec, "Free Trade in Patented Goods: International Exhaustion for Patents", Berkeley Tech. L.J., [2014], Vol. 29, p.365, available at https://scholarship.law.berkeley.edu/cgi/viewcontent.cgi?referer=https://www.google.com/&httpsredir=1&article=2023&context=btlj, (accessed on 26/11/2018).
Also see, John Barton, *Differentiated Pricing of Patented Products*, Working Paper No. 63, Indian Council for Research on International Economic Relations, 2001, p.7, available at http://icrier.org/pdf/WP-JOHN%20BARTON.pdf, (accessed on 28/11/2018) ; Keith E. Maskus, "Ensuring Access to Essential Medicines: Some Economic Considerations", Wisconsin International Law Journal , [2002], Vol.20, pp.563- 566, available at http://hdl.handle.net/10822/521116, (accessed on 18/12/2018). Peter K. Yu, "The International Enclosure Movement", IND. L.J., [2007], Vol.82, Issue 4, pp. 844-845, available at https://www.repository.law.indiana.edu/cgi/viewcontent.cgi?article=1373&context=ilj, (accessed on 15/12/2018).

that will be profitable him in such markets. The reasonable conclusion to be drawn from these statements is that the differential pricing mechanism adopted by the producer is for profit maximisation. Therefore to substantiate this conclusion and in order to understand the welfare effects of differential pricing it is necessary to understand the pricing mechanism of a product and how output is determined under differential pricing.

4. 1.2.1.Differential pricing and Price determination of a commodity in different markets

The price of a product depends on the volume of commodity produced and consumed in a market. There are basically two ways of making profit. One is to offer maximum price for the product and produce less. This method is adopted in an inelastic market where the target group of the consumers are small as per the factors which the producer normally relay on while resorting to differential pricing, mentioned in the introductory part of this section. In a highly elastic market the option is to make the product available at affordable price to the maximum consumers. In brief, the producer selects the pricing pattern depending upon the elasticity of demand in the market concerned.[602] Price elasticity of demand expresses the response of relative change in quantity demanded of a good to relative changes in its price, given the consumer's income, his tastes and price of all other goods. The producer of a good, when fixing the price of a commodity, takes into consideration the price that the consumers are able to pay for a product and the demand of the product at that given price. The demand of the product will vary from consumer to consumer at different prices. In simple terms, it is simply the proportionate change in demand given a change in price.[603]A market is said to be elastic if the demand changes

[602] Yongmin Chen and Marius Schwartz, "Differential Pricing When Costs Differ: A Welfare Analysis", The RAND Journal of Economics, [2015], Vol. 46, No. 2, pp. 442-460, available at https://www.jstor.org/stable/43895598,(accessed on 29/11/2018). Also see, Daniel J. Gifford and Robert T. Kudrle, "The Law and Economics of Price Discrimination in Modern Economies: Time for Reconciliation?", University of California Davis L. Rev., [2010] , Vol. 43, 1235, at p.1243-1244, available at http://scholarship.law.umn.edu/faculty_articles/358?utm_source=scholarship.law.umn.edu%2Ffaculty_articles%2F358&utm_medium=PDF&utm_campaign=PDFCoverPages, (accessed on 29/11/2018); Hal R. Varian, *Price Discrimination*, CREST Working Paper, Number 86-27, Department of Economics University of Michigan, 1987, p.37, available at https://deepblue.lib.umich.edu/bitstream/handle/2027.42/101032/ECON469.pdf?sequenc,(accessed on 29/11/2018).

[603] Patrick L. Anderson *et.al.,* "Price Elasticity of Demand", Makinac Center for Public Policy, [1997], available at http://www.mackinac.org/1247, (accessed on 16/4/18).

drastically in response to the rise or fall of prices. However, the market is inelastic if the demand does not change drastically at rise or fall of prices.At times the range of consumers will be such that there will be class of consumers who can afford any high price, and some can afford a middle price while the some class of consumers can afford only if the price is very low; i.e., close to the production cost. When the class of consumers in a country are so scattered we say that the dispersion of class of consumers is high and the elasticity of demand is high. When the dispersion of consumers is limited, i.e., for example, if there are only high income or low income consumers, (middle income consumers are absent) the change in demand with change in price might be low and therefore we say that the demand elasticity is low. The producer takes the market structure on demand elasticity into consideration. Differential pricing is more effective in a market which is more price elastic as difference in price can lead to increased demand among the consumers and it can also lead to increased consumer welfare. A producer fixes a price of a product with the price elasticity of the market in mind.

Price elasticity of demand of a market is analysed depending on various factors such as:[604]

- Availability of substitutes: - Of all the factors determining price elasticity of demand the availability of the number and kinds of substitutes for a commodity is the most important factor. If close substitutes are available for a commodity, its demand tends to be more elastic. Presence of such a substitute can shift the consumers to the same if the price of the product goes up.
- Consumer income: - A consumer's income determines his willingness to pay for the product. If the product causes much of the income that he incurs, then even if the product is available in plenty in the market, the consumer may not buy the product. If the price of the product is reduced, the consumers tend to shift more to the reduced priced product making the market more elastic. This is important for developing countries since the income of consumers in these nations is always low. Firms fix the price depending on the aggregate economic activity of a country which ultimately determines the income of consumers.

[604] See generally, Iñaki Aguirre *et.al.*"Monopoly Price Discrimination and Demand Curvature", American Economic Review, [2010], Vol.100, pp. 1601–1615, available at https://www.jstor.org/stable/27871267, (accessed on 20/12/2018).

- Consumer surplus: Price of a product depends on consumer's willingness to pay for it i.e., when there is consumer surplus. It is the difference between the price that one is willing to pay and the price one actually pays for a particular product. The consumer may be well aware that the price fixed by the producer for a particular product is well above its production cost. However, the consumer still might be willing to purchase the product for different reasons like the good being an essential good and no substitutes are available for the same. Consumer surplus is calculated based upon: (a) total utility of the product (b) price of the product. Consumer surplus also depends on income of a person.
- The number of uses of the commodity: If the number of uses of a commodity is very limited and at the same time if the price of the same is high, then the consumers will naturally either opt not to buy the product or opt for a better substitute. Therefore, the number of uses of the commodity has a critical role to play in the price elasticity of demand of the product.

Consumer may not purchase the product if any of these factors are missing and thus results in loss to the manufacturer. Therefore, an equilibrium price[605] is maintained by the manufacturer under differential pricing, assessing all the above factors. However, as noted earlier, if the market is so inelastic, the producers target the affordable population and the price is kept high. This implies that differential pricing, in effect, does not happen due to prohibition on arbitrage but due to market factors, for the purpose of profit maximisation. This can termed as undue use of market power.

4.1.2.2. Determination of output under Differential pricing:

In order to appreciate the welfare effects of differential pricing it is important to take stock of the output produced by the manufacturer under differential pricing. Differential pricing can lead to welfare enhancement only if the output is increased.[606]While bringing a product in to market,

[605] Equilibrium price is the price which the producer tends to maintain considering the price elasticity of demand whereby the producer gets profit and at the same time the consumer would be willing to pay the price charged. The price so determined does not become much arbitrary. Thus, in simple terms, equilibrium price is the market price where the quantity of goods supplied is equal to the quantity of goods demanded.

[606] Arthur C. Pigou, *The Economics of Welfare*, (1920), pp. 286-287, available at http://files.libertyfund.org/files/1410/Pigou_0316.pdf. (accessed on 28/11/2018).

the producer has to decide the following: a) how much total output should be produced; b) how the total output should be divided between the markets; and c) what should be the price in each market.[607] For this, the producer first finds out the aggregate marginal revenue of the entire market and compare this aggregate marginal revenue with marginal cost of total output. He will try to maximize his profits by producing output up to the level at which the marginal cost equals the aggregate marginal revenue.[608] The monopolist will be serving different markets across the globe. Therefore his total output is the total number of goods produced in all these markets. His profit is also determined by the total revenue in all these markets. The producer will distribute the total output in such a way that marginal revenue in these different markets is equal to marginal cost of whole output, so that profits will be maximized. Thus, the output is determined by the level at which the maximum profit is achieved by the producer. Upon reaching that profit the producer stops production, leaving a large section of consumers unserved. Therefore, it becomes evident that maximization of profit is the determining factor in differential pricing and not providing access to the maximum number of consumers. This becomes more evident from the fact that price will be higher in market A where the demand is less elastic than in market B where the demand is more elastic, irrespective of the income of those counties or the purchasing capacity of the consumers there.[609] When the price is lowered in a market, in order to gain the

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Also see, Richard Schmalensee, "Output and Welfare Implications of Monopolistic Third-Degree Price Discrimination", The American Economic Review, [1981], Vol. 71, No. 1, p.242, available at https://www.jstor.org/stable/1805058, (accessed on 28/11/2018) ;Joan Robinson, *The Economics of Competition*, MacMillan and Co. Limited, London, (1st Edition, 1938), pp.204-205,Simon Cowan, *When Does Third-Degree Price Discrimination Reduce Social Welfare, and When Does It Raise It?*Department of Economics Discussion Paper Series, University of Oxford, 2008, p.3, available at https://www.researchgate.net/publication/23536078_When_does_thirddegree_price_discrimination_reduce_social_welfare_and_when_does_it_raise_it, (accessed on 29/11/2018).

[607] Arthur C. Pigou, *The Economics of Welfare*, (1920), available at http://files.libertyfund.org/files/1410/Pigou_0316.pdf. (accessed on 28/11/2018). Also see; Richard Schmalensee, "Output and Welfare Implications of Monopolistic Third-Degree Price Discrimination", The American Economic Review, [1981], Vol. 71, No. 1, pp.242-247, available at https://www.jstor.org/stable/1805058, (accessed on 28/11/2018) ; Joan Robinson, *The Economics of Competition*, MacMillan and Co. Limited, London, (1st Edition, 1938) ; Simon Cowan, *When Does Third-Degree Price Discrimination Reduce Social Welfare, and When Does It Raise It?*, Department of Economics Discussion Paper Series, University of Oxford, 2008, p.3, available at https://www.researchgate.net/publication/23536078_When_does_thirddegree_price_discrimination_reduce_social_welfare_and_when_does_it_raise_it, (accessed on 29/11/2018).

[608] Joan Robinson, *The Economics of Competition*, MacMillan and Co. Limited, London, (1st Edition, 1938), p.182.

[609] Daniel Knox and Martin Richardson, "Trade policy and parallel imports", European Journal of Political Economy, [2002], Vol. 19, pp.134-135, available at https://doi.org/10.1016/S0176-2680(02)00133-7, (accessed on

maximum profit from that market, the producer is compelled to produce more products and to cater to more consumers. Thus production is increased and market expansion occurs in the case of differential pricing. This is the method in which welfare effect of maximum production occurs in differential pricing. It is thus clear that consumer welfare is not the direct objective of differential pricing.

As stated in the earlier paragraph, differential pricing is welfare enhancing only if there is increased production.[610] If the production does not increase, the welfare effect of differential pricing gets reduced.[611] This is often the case with the least developed and developing countries, since what determines the pricing pattern in each market is not the consumer need, but the market demand, or rather the market elasticity. Even in the developed countries it cannot be conclusively said that consumer access problems will be adequately solved by differential pricing on every occasion.[612] It is also the case that in differential pricing situation the developed nations are at loss in comparison to developing and least developed nations. It is due to these reasons that it is often claimed that the welfare aspects of differential pricing is very

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21/12/2018). Also see; Hal R. Varian, *Price Discrimination*, CREST Working Paper, Number 86-27, Department of Economics University of Michigan, 1987, pp.1-55, available at https://deepblue.lib.umich.edu/bitstream/handle/2027.42/101032/ECON469.pdf?sequenc, (accessed on 29/11/2018).

[610] See generally, Hal R. Varian, *Price Discrimination*, CREST Working Paper, Number 86-27, Department of Economics University of Michigan, 1987, pp.1-55, available at https://deepblue.lib.umich.edu/bitstream/handle/2027.42/101032/ECON469.pdf?sequenc, (accessed on 29/11/2018) ; Richard Schmalensee, "Output and Welfare Implications of Monopolistic Third-Degree Price Discrimination", The American Economic Review, [1981], Vol. 71, No. 1, pp. 242-247, available at https://www.jstor.org/stable/1805058, (accessed on 28/11/2018).

[611] Arthur C. Pigou, *The Economics of Welfare*, (1920), available at http://files.libertyfund.org/files/1410/Pigou_0316.pdf. (accessed on 28/11/2018). Also see ; Richard Schmalensee, "Output and Welfare Implications of Monopolistic Third-Degree Price Discrimination", The American Economic Review, [1981], Vol. 71, No. 1, p.242, available at https://www.jstor.org/stable/1805058, (accessed on 28/11/2018);Joan Robinson, *The Economics of Competition*, MacMillan and Co. Limited, London, (1st Edition, 1938), pp.204-205, Simon Cowan, *When Does Third-Degree Price Discrimination Reduce Social Welfare, and When Does It Raise It?*, Department of Economics Discussion Paper Series, University of Oxford, 2008, p.3, available at https://www.researchgate.net/publication/23536078_When_does_thirddegree_price_discrimination_reduce_social_welfare_and_when_does_it_raise_it, (accessed on 29/11/2018).

[612] Arthur C. Pigou, *The Economics of Welfare*, (1920), P. 284, available at http://files.libertyfund.org/files/1410/Pigou_0316.pdf. (accessed on 28/11/2018).

ambiguous.[613] In addition to it, in a market which is inelastic, and where only few consumers can afford a high priced product, the target group of the consumers will be the high income consumers and therefore the price will be the maximum and it is so fixed as to fetch the maximum profits.[614]In other words, the focus in every market is the affordable population.[615] The producer hardly aims at the product reaching the maximum consumers unless the market is so elastic.[616] Rather, he aims at achieving maximum profits even by serving the minimum consumers. There are multiple reasons why he does not aim at maximum reach: maximum reach

[613] *Synthesis Report On Parallel Imports*, Joint Group On Trade and Competition, OECD Report, 2002, p.12, available at http://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=COM/DAFFE/COMP/TD(2002)18/FINAL&docLanguage=En, (accessed on 29/11/2018).

[614] Sarah R. Wasserman Rajec, "Free Trade in Patented Goods: International Exhaustion for Patents", Berkeley Tech. L.J., [2014], Vol. 29, p.365, available at https://scholarship.law.berkeley.edu/cgi/viewcontent.cgi?referer=https://www.google.com/&httpsredir=1&article=2023&context=btlj, (accessed on 26/11/2018).

Also see, John Barton, *Differentiated Pricing of Patented Products*, Working Paper No. 63, Indian Council for Research on International Economic Relations, 2001, p.7, available at http://icrier.org/pdf/WP-JOHN%20BARTON.pdf, (accessed on 28/11/2018) ; Keith E. Maskus, "Ensuring Access to Essential Medicines: Some Economic Considerations", Wisconsin International Law Journal , [2002], Vol.20, pp.563- 566, available at http://hdl.handle.net/10822/521116, (accessed on 18/12/2018) ; Peter K. Yu, "The International Enclosure Movement", IND. L.J., [2007], Vol.82, Issue 4, Pp. 844-845, available at https://www.repository.law.indiana.edu/cgi/viewcontent.cgi?article=1373&context=ilj, (accessed on 15/12/2018).

[615] Sarah R. Wasserman Rajec, "Free Trade in Patented Goods: International Exhaustion for Patents", Berkeley Tech. L.J., [2014], Vol. 29, p.365, available at https://scholarship.law.berkeley.edu/cgi/viewcontent.cgi?referer=https://www.google.com/&httpsredir=1&article=2023&context=btlj, (accessed on 26/11/2018).

Also see; John Barton, *Differentiated Pricing of Patented Products*, Working Paper No. 63, Indian Council for Research on International Economic Relations, 2001, p.7, available at http://icrier.org/pdf/WP-JOHN%20BARTON.pdf, (accessed on 28/11/2018).Keith E. Maskus, "Ensuring Access to Essential Medicines: Some Economic Considerations", Wisconsin International Law Journal , [2002], Vol.20, pp.563- 566, available at http://hdl.handle.net/10822/521116, (accessed on 18/12/2018) ; Peter K. Yu, "The International Enclosure Movement", IND. L.J. [2007], Vol.82, Issue 4, pp. 844-845, available at https://www.repository.law.indiana.edu/cgi/viewcontent.cgi?article=1373&context=ilj, (accessed on 15/12/2018).

[616] Sarah R. Wasserman Rajec, "Free Trade in Patented Goods: International Exhaustion for Patents", Berkeley Tech. L.J., [2014], Vol. 29, p.365, available at https://scholarship.law.berkeley.edu/cgi/viewcontent.cgi?referer=https://www.google.com/&httpsredir=1&article=2023&context=btlj, (accessed on 26/11/2018). Peter K. Yu, "The International Enclosure Movement", IND. L.J. [2007], Vol.82, Issue 4, pp. 844-845, available at https://www.repository.law.indiana.edu/cgi/viewcontent.cgi?article=1373&context=ilj, (accessed on 15/12/2018).

means wider distribution network and additional costs.[617] Instead, if only the minimum number of people who are willing to pay the maximum price is served with the product, it can fetch him the maximum profit and he will choose it rather than going for the maximum reach. The example of Africa, where most often the prices are much higher than those in developing countries,[618] can be taken here. It is manifest, therefore, that pricing depends upon calculations of fetching maximum profit from every market and differential pricing is only a tool for achieving it. In other words, differential pricing is the need of the trader rather than that of the consumer. The result, ultimately, even under differential pricing, is market failure since it is not the market but the profit that is addressed here and production does not increase necessarily which negatives the differential pricing mechanism.

There are clear negative impacts for differential pricing on global welfare. Economists have reasonably concluded that under third-degree discrimination, output (total number of products produced) is misallocated among consumers by comparison with allocation effects at a single uniform monopoly price; the latter is superior in welfare terms.[619] This means that uniform pricing can yield more benefits to consumers than differential pricing.[620] Differential pricing has misallocation effects compared to uniform pricing because the consumers of different markets

[617] John Barton, *Differentiated Pricing of Patented Products*, Working Paper No. 63, Indian Council for Research on International Economic Relations, 2001, p.3, available at http://icrier.org/pdf/WP-JOHN%20BARTON.pdf, (accessed on 28/11/2018).

[618] See Donald G. Mcneil Jr., "Prices for Medicine Are Exorbitant in Africa, Study Says" The New York Times, June 17, (2000), available at https://www.nytimes.com/2000/06/17/world/prices-for-medicine-are-exorbitant-in-africa-study-says.html, (accessed on 2/1/2018). Also see, "25 years of essential medicines progress", Essential Drugs Monitor, WHO, Issue No.32, (2003), available at http://apps.who.int/medicinedocs/pdf/s4940e/s4940e.pdf, (accessed on 14/12/2018).

[619] Joan Robinson, *The Economics of Competition*, MacMillan and Co. Limited, London, (1st Edition, 1938), pp. 188-195 : "This is because the same goods are allocated among consumers at different prices and certain consumers are paying high for a good which has less economic value. At uniform pricing, the goods are at least received at a uniform price to all consumers and can be superior in welfare terms if the goods are accessible to a large section of consumers." Also see: Daniel J. Gifford and Robert T. Kudrle, "The Law and Economics of Price Discrimination in Modern Economies: Time for Reconciliation?", University of California Davis L. Rev., [2010] , Vol. 43, 1235, at p.1242, available at http://scholarship.law.umn.edu/faculty_articles/358?utm_source=scholarship.law.umn.edu%2Ffaculty_articles%2F358&utm_medium=PDF&utm_campaign=PDFCoverPages, (accessed on 29/11/2018).

[620] The welfare here refers to the global welfare in total. Differential pricing always benefits the consumers where the price is less, provided, there is increase in production.

pay different prices for same products originating from the same producer.[621] Misallocation effects occur when the same product is served to different consumers at different price. Price discrimination also results in inefficient allocation of resources for the same reason. A necessary condition for the achievement of distributive (consumption) efficiency is that marginal rate of substitution between any two goods must be the same for all consumers. This is not so under price discrimination. Under price discrimination there might also be difference between the kinds of products sold in the low and high priced markets. Thus differential pricing leads to misallocation effects. As a result, consumers in high priced markets may start thinking that it is ridiculous to pay more when they get it cheaper elsewhere or through the online sale.[622] The misallocation effect under discrimination can be curbed and thus overall welfare can be improved only if output expands enough to outweigh the inefficiency of different marginal prices when sales occur in both markets at the simple monopoly price.[623] However, this need not necessarily happen as the output under price discrimination, as explained in the earlier portion, is limited to the level where profit is achieved by the producer.

Thus, it is clear from the above analysis that the differential pricing is being practiced for profit maximisation of the producer and the welfare effect occurs, under certain circumstances as a

[621] Yongmin Chen and Marius Schwartz, "Differential Pricing When Costs Differ: A Welfare Analysis", The RAND Journal of Economics, [2015], Vol. 46, No. 2, p. 452, available at https://www.jstor.org/stable/43895598 (accessed on 29/11/2018). Even though the authors justify differential pricing taking into account the differences in costs of producing in different markets and price differential mechanism, they admit that in general differential pricing can lead to misallocation effects. Also see Paul Simshauser and Patrick Whish-Wilson, *Reforming reform: differential pricing and price dispersion in retail electricity markets*, Working Paper No.49 – Differential Prices, AGL Applied Economic and Policy Research, 2015, available at http://aglblog.com.au/wp-content/uploads/2015/07/No.49-Price-Discrimination.pdf, (accessed on20/12/2018).

[622] Tommaso M. Valletti and Stefan Szymanski, "Parallel Trade, International Exhaustion and Intellectual Property Rights: A Welfare Analysis" Journal of Industrial Economics, [2006], Vol. 54, No. 4, pp. 499-526, available at SSRN: https://ssrn.com/abstract=951835 or http://dx.doi.org/10.1111/j.1467-6451.2006.00298.x (accessed on 30/11/2018).

[623] Arthur C. Pigou, *The Economics of Welfare*, (1920), pp. 286-287, available at http://files.libertyfund.org/files/1410/Pigou_0316.pdf. (accessed on 28/11/2018). Also see; Richard Schmalensee, "Output and Welfare Implications of Monopolistic Third-Degree Price Discrimination", The American Economic Review, [1981], Vol. 71, No. 1, p. 242, available at https://www.jstor.org/stable/1805058, (accessed on 28/11/2018) ; Joan Robinson, *The Economics of Competition*, MacMillan and Co. Limited, London, (1st Edition, 1938), pp.204-205 ; Simon Cowan, *When Does Third-Degree Price Discrimination Reduce Social Welfare, and When Does It Raise It?*, Department of Economics Discussion Paper Series, University of Oxford, 2008, p.3, available at https://www.researchgate.net/publication/23536078_When_does_thirddegree_price_discrimination_reduce_social_welfare_and_when_does_it_raise_it, (accessed on 29/11/2018).

secondary effect of this profit maximisation process. The price and the output under differential pricing, which plays a critical role in bringing about consumer welfare, is largely depended on market structure of a nation. This compels the producer to adopt differential pricing for reaping profit. And as stated earlier, the legal prohibition on resale is the need of the producer to ensure that maximum profit is drained out from the market harming consumer's interest.[624]It is also a mechanism adopted by the producer in order to prohibit arbitrage to differentiate between the qualities of the products so that not many customers in the market of high quality high priced market get displaced. If the producer had an absolutely free hand in the matter, the division he would choose would be such that the lowest demand price in sub-market A exceeded the highest demand price in sub-market B, and so on throughout.[625] This is the most profitable way of differential pricing for the monopolist since there would be no arbitrage and profit would be maximised.[626] Even though consumers in low priced countries benefit from price discrimination as they get products at a cheaper rate, producers do not normally allow for wide differences in prices for fear of (to avoid the risk of) arbitrage. Therefore, differential pricing need not yield much benefit to the consumers in such situations. However, when the more elastic market (low priced) is not served at a price lower than that in the high priced market, such discrimination may result in welfare enhancement because though the discrimination in this case leaves the high

[624] As per Pigou, the profit of a producer expects on the selling price is calculated on the basis of the type of consumer and the number of units sold. Thus the producer definitely will have to discriminate price between countries for better profit. Price discrimination is most favourable for the producer if the sale of a unit of product is independent of the price of every other unit i.e., no one unit can replace the other. This implies that no unit made in one country can be transferred to another market. In other words, the prohibition of resale of goods sold at another country at cheaper prices is necessary so as to maximise the profit of the producer. See: Arthur C. Pigou, *The Economics of Welfare*, (1920), pp. 275-276, available at http://files.libertyfund.org/files/1410/Pigou_0316.pdf. (accessed on 28/11/2018). Further, differential pricing yields maximum profits to firms when it is able to prevent this arbitrage and because enforcement costs are shared by the states through customs enforcement (especially in the context of national exhaustion), See: Sarah R. Wasserman Rajec, "Free Trade in Patented Goods: International Exhaustion for Patents", Berkeley Tech. L.J., [2014], Vol. 29, p.336, available at https://scholarship.law.berkeley.edu/cgi/viewcontent.cgi?referer=https://www.google.com/&httpsredir=1&article=2023&context=btlj, (accessed on 26/11/2018).

[625] Arthur C. Pigou, *The Economics of Welfare*, (1920), p. 202, available at http://files.libertyfund.org/files/1410/Pigou_0316.pdf. (accessed on 28/11/2018).

[626] Arthur C. Pigou, *The Economics of Welfare*, (1920), p. 202, available at http://files.libertyfund.org/files/1410/Pigou_0316.pdf. (accessed on 28/11/2018).

priced market unchanged, output expands in the lower priced market.[627] Price discrimination makes it possible to serve the low priced market and this leads to an increase in the total output. This is an implication of welfare expansion as a result of third degree price discrimination. Because the relative demand elasticity of different markets vary, no further general proposition about the welfare effects of third degree price discrimination is possible.[628] But the underlying fact is that this welfare impact of price discrimination is a necessary, secondary outcome of the profit maximisation process of the monopolist. This means that even in the presence of parallel imports in the market, producers cannot abandon differential pricing.[629] The uniform pricing mechanism, which will be explained later in this chapter, will also not be feasible in any market as uniform pricing is a myth under the perfect competition scenario.[630] Thus presence of parallel imports merely diminishes the profit of the IP holder never really harming his total profit. It must also be understood that it is the producers own goods that is being marketed in another market and sold as parallel imports. This means that the IP holder has already received his share of profit over the product. It is apart from this profit received, that the IP holder tries to make undue profit by prohibiting parallel imports. This creates imbalance in the global welfare.

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[627] Daniel J. Gifford and Robert T. Kudrle, "The Law and Economics of Price Discrimination in Modern Economies: Time for Reconciliation?", University of California Davis L. Rev., [2010], Vol. 43, 1235, at p.1242, available at http://scholarship.law.umn.edu/faculty_articles/358?utm_source=scholarship.law.umn.edu%2Ffaculty_articles%2F358&utm_medium=PDF&utm_campaign=PDFCoverPages, (accessed on 29/11/2018).

[628] Daniel J. Gifford and Robert T. Kudrle, "The Law and Economics of Price Discrimination in Modern Economies: Time for Reconciliation?", University of California Davis L. Rev., [2010] , Vol. 43, 1235, at p.1242, available at http://scholarship.law.umn.edu/faculty_articles/358?utm_source=scholarship.law.umn.edu%2Ffaculty_articles%2F358&utm_medium=PDF&utm_campaign=PDFCoverPages, (accessed on 29/11/2018). Also see, Arthur C. Pigou, *The Economics of Welfare*, (1920), p. 202, available at http://files.libertyfund.org/files/1410/Pigou_0316.pdf. (accessed on 28/11/2018) ; Arthur C. Pigou, *The Economics of Welfare*, (1920), pp.179-202, available at http://files.libertyfund.org/files/1410/Pigou_0316.pdf. (accessed on 28/11/2018) ; Mark Armstrong, *Price Discrimination*, MPRA Paper No. 4693, Department of Economics, University College London , September 2007, pp. 23-24, available at http://mpra.ub.uni-muenchen.de/4693/, (accessed on 29/11/2018).

[629] See John Barton, *Differentiated Pricing of Patented Products*, Working Paper No. 63, Indian Council for Research on International Economic Relations, 2001, p.11, available at http://icrier.org/pdf/WP-JOHN%20BARTON.pdf, (accessed on 28/11/2018).

[630] Joan Robinson, *The Economics of Competition*, MacMillan and Co. Limited, London, (1st Edition, 1938), pp.179-202.

4.2 Parallel imports and differential pricing

The standard economic argument against parallel imports draws on the potential gains of geographic price discrimination on patent holders and consumers in low-income countries.[631] As per this argument, price discrimination itself is sufficient to bring about balance by taking care of the rights of the patent holder and the right of low value countries to access the IP product. This cannot be a conclusive situation. Most developing countries express their disagreement with the attempts to put any restrictions on parallel trade, in part over their concerns that domestic prices could actually be higher for imported goods under price discrimination in the absence of parallel imports.[632]As we have seen, differential pricing is used by the IP holder to maximise his profit and not to benefit the consumers. Therefore, ban on parallel imports will merely have the effect of maximising his profits at the cost of consumer welfare. The IP holder adjusts his profit by reaping rewards from the developed country consumers thereby overburdening them.[633] He is also equally unconcerned about the consumer needs in the inelastic markets. The differential pricing can be welfare enhancing only when they cater to more consumers at a low rate without sacrificing the economic safety of the producer.

However, as already proved, differential pricing need not cater to all the consumer needs since producer may reap profit by targeting only the affordable consumers. In fact, the increase in output is the measuring scale for welfare effects of differential pricing. The moment the producer limits the target group of consumers, the welfare impact of differential pricing erodes away.[634]

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[631] Sarah R. Wasserman Rajec, "Free Trade in Patented Goods: International Exhaustion for Patents", Berkeley Tech. L.J., [2014], Vol. 29, p.321, available at https://scholarship.law.berkeley.edu/cgi/viewcontent.cgi?referer=https://www.google.com/&httpsredir=1&article=2023&context=btlj, (accessed on 26/11/2018).

[632] Keith E. Maskus, "Competition Policy and Intellectual Property Rights in Developing Countries: Interests in Unilateral Initiatives and a WTO Agreement", (Prepared for the World Bank Global Conference on Developing Countries and the Millennium Round, Geneva, September 20-21, 1999), p.19, available at http://siteresources.worldbank.org/DEC/Resources/84797-1251813753820/6415739125181402019 2/maskus.pdf. accessed on 30/11/2018, (accessed on 21/12/2018).

[633] *The Costs and Benefits of Preventing Parallel Imports into New Zealand,* Report commissioned by the New Zealand Ministry of Economic Development, 2012, p.15, available at https://www.mbie.govt.nz/dmsdocument/2441-costs-benefits-preventing-parallel-imports-into-nz-pdf, (accessed on 30/11/2018).

[634] Arthur C. Pigou, *The Economics of Welfare*, (1920), pp. 286-287, available at

This misallocation effects are substituted by the parallel imports since it cater to the needs of both the high and low income countries at the same time. Therefore, parallel imports help to avoid the market failure arising out of limiting consumer target groups and thereby increase market efficiency. This means that price discrimination can raise welfare only under certain circumstances[635] and the presence of parallel imports is one among them. From that perspective, differential pricing can be welfare enhancing only in the presence of parallel imports. Parallel imports also does not cause loss to the producer but merely reduces the profit of the producer as it is his own once sold products for which he received his reward is being parallel imported. Banning parallel trade partitions markets and supports perfect discrimination[636], which may not be advantageous to consumers in both the elastic and inelastic markets. Consumers in economies with inelastic demand – markets where demands does not fluctuate much with the change in

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http://files.libertyfund.org/files/1410/Pigou_0316.pdf. (accessed on 28/11/2018). Also see ; Richard Schmalensee, "Output and Welfare Implications of Monopolistic Third-Degree Price Discrimination", The American Economic Review, [1981], Vol. 71, No. 1, p. 242, available at https://www.jstor.org/stable/1805058, (accessed on 28/11/2018) ;Joan Robinson, *The Economics of Competition*, MacMillan and Co. Limited, London, (1st Edition, 1938), pp.204-205 ; Simon Cowan, *When Does Third-Degree Price Discrimination Reduce Social Welfare, and When Does It Raise It?*Department of Economics Discussion Paper Series, University of Oxford, 2008, p.3, available at https://www.researchgate.net/publication/23536078_When_does_thirddegree_price_discrimination_reduce_social_welfare_and_when_does_it_raise_it, (accessed on 29/11/2018).

[635] Hal R. Varian, "Price Discrimination and social welfare", American Economic Review, [1985], Vol. 75, No: 4, pp.870-875, available at https://www.jstor.org/stable/1821366, (accessed on 1/12/2018). Also see, Arthur C. Pigou, *The Economics Of Welfare*, (1920), pp. 286-287, available at http://files.libertyfund.org/files/1410/Pigou_0316.pdf. (accessed on 28/11/2018). Richard Schmalensee, "Output and Welfare Implications of Monopolistic Third-Degree Price Discrimination", The American Economic Review, [1981], Vol. 71, No. 1, p. 242, available at https://www.jstor.org/stable/1805058, (accessed on 28/11/2018), Joan Robinson, *The Economics of Competition*, MacMillan and Co. Limited, London, (1st Edition, 1938), pp.204-205;Simon Cowan, *When Does Third-Degree Price Discrimination Reduce Social Welfare, and When Does It Raise It?*Department of Economics Discussion Paper Series, University of Oxford, 2008, p.3, available at https://www.researchgate.net/publication/23536078_When_does_thirddegree_price_discrimination_reduce_social_welfare_and_when_does_it_raise_it, (accessed on 29/11/2018).

[636] P Kanavos *et. al.*, "The economic impact of pharmaceutical parallel trade in European Union member states: A stakeholder analysis", (Special Research Paper, London School of Economics, 2004), p.37, available at http://www.lse.ac.uk/LSEHealthAndSocialCare/pdf/Workingpapers/Paper.pdf ,(accessed on 28/11/2018).

Also see ; D.Malueg, Marius Schwartz., "Parallel imports, demand dispersion and international price discrimination", Journal of International Economics, [1994], Vol.37, pp.167–195 ; Daniel Knox and Martin Richardson, "Trade policy and parallel imports", European Journal of Political Economy, [2002], Vol. 19, pp.133-151, available at https://doi.org/10.1016/S0176-2680(02)00133-7, (accessed on 21/12/2018).

price – would face higher prices under price discrimination than under uniform pricing.[637] If such countries are not significant developers of intellectual property, which may be the case most often, they are made worse off by price discrimination.

This proves that even under price discrimination loss can occur to developed countries even though there might be an expected gain for consumers of developing nations. Even under geographical price discrimination, poor consumers in low-income countries have limited access.[638] Therefore, the welfare effect of price discrimination too is very ambiguous. Therefore the argument that in order to enhance the benefit of differential pricing ban on parallel imports is a necessary condition will not hold good.

A major argument against parallel imports is that parallel imports may induce producers to adopt uniform pricing across the globe or force them to quit the market which facilitates parallel import from being served. However, the author is of the view that these two situations cannot arise. The situation of uniform pricing cannot happen across the globe for many reasons. Profitability occurs only when the revenue generated by total sales (including both sales at the lower and higher price levels) exceeds total costs (including fixed or sunk costs). As already established,[639] it is for profit maximization that the producers discriminate in prices in different markets. Firms get more profits when discriminating prices because they can serve more markets which they cannot serve otherwise.[640] Uniform pricing will not fetch maximum profit since the profit of the firm is determined by the purchasing power of consumers.[641]The producer will eventually be

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[637] P Kanavos *et. al.*, "The economic impact of pharmaceutical parallel trade in European Union member states: A stakeholder analysis", (Special Research Paper, London School of Economics, 2004), p.37, available at http://www.lse.ac.uk/LSEHealthAndSocialCare/pdf/Workingpapers/Paper.pdf ,(accessed on 28/11/2018).

[638] Sarah R. Wasserman Rajec, "Free Trade in Patented Goods: International Exhaustion for Patents", Berkeley Tech. L.J., [2014], Vol. 29, p.365, available at https://scholarship.law.berkeley.edu/cgi/viewcontent.cgi?referer=https://www.google.com/&httpsredir=1&article=2023&context=btlj, (accessed on 26/11/2018). Also see; Peter K. Yu, "The International Enclosure Movement", IND. L.J., [2007], Vol.82, Issue 4, pp. 844-845, available at https://www.repository.law.indiana.edu/cgi/viewcontent.cgi?article=1373&context=ilj, (accessed on 15/12/2018).

[639] See pp.150-160 of the thesis.

[640] Joan Robinson, *The Economics of Competition*, MacMillan and Co. Limited, London, (1st Edition, 1938), pp.179-208.

[641] Iñaki Aguirre, Simon Cowan, and John Vickers, "Monopoly Price Discrimination and Demand Curvature", The American Economic Review, [2010], Vol. 100, No. 4, pp.1601–1615, available at https://www.jstor.org/stable/27871267, (accessed on 20/12/2018).

forced to quit that market and this forces him to price high in the developed market so as to make up for the loss of market which harms the consumers in those markets. This amounts to undue use of monopoly rights, which will not be entertained in the normal case by any market. Another alternative method the monopolist may use, is by serving the elite class of consumers alone, extracting maximum profit from this class of affordable consumers alone. However, this may overburden such consumers and may also cause misallocation effects. It is also anti-competitive as it amounts to abuse of his dominant position. Moreover, in the case of an IP product, when a large section of population is left unserved by the IP holder, it may induce the concerned government to resort to the legislative freedom to issue compulsory licensing or resort to other similar remedies. Thus uniform pricing situation cannot arise due to factors such as lack of elasticity of demand, inadequate income of the consumer, lack of consumer surplus etc., which are the major factors of price determination of a product. In low income countries these factors will be at a low level and therefore IP holder will have to maintain a low price. The moment IP holder prices undue prices, the IP legislative provisions comes into picture which takes care of such undue pricing.[642] Further, IP holders will be unable to serve large portions of foreign markets if they engage in uniform pricing. Rather, they would be forced to resort to differential pricing which would increase access to products. Thus, uniform pricing is not a practical option for the producer. In addition to this, the argument of uniform pricing by the producer across the globe cannot hold good as uniform pricing is a phenomenon which arises only when there is perfect competition.[643] A perfect competition situation is an imaginary situation which will never take place in any market. Uniform pricing may also occur when the demand elasticity is less, which means that there is no much change in demand even if the price is changed or discriminated.[644] For example, in countries like Africa, where demand elasticity is very low, we can see that the producer always prefers to maintain high price.[645]

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[642] Tommaso M. Valletti and Stefan Szymanski, "Parallel Trade, International Exhaustion and Intellectual Property Rights: A Welfare Analysis", The Journal of Industrial Economics, [2006], Vol.54, pp. 499-526, available at https://www.researchgate.net/publication/284052010_Parallel_trade_international_exhaustion_and_intellectual_property_rights_A_welfare_analysis, (accessed on 21/12/2018).

[643] Joan Robinson, *The Economics of Competition*, MacMillan and Co. Limited, London, (1st Edition, 1938), p.179.

[644] Joan Robinson, *The Economics of Competition*, MacMillan and Co. Limited, London, (1st Edition, 1938), p.179.

[645] See ;Donald G. Mcneil Jr., "Prices for Medicine Are Exorbitant in Africa, Study Says" The New York Times, June,17,(2000) available at https://www.nytimes.com/2000/06/17/world/prices-for-medicine-are-exorbitant-in-

When it comes to quitting of market, the IP holder again faces the problem of IP laws. Leaving a market unserved, in the IP context, can attract two situations: one, the person may choose not to take IP protection in that market which leaves anyone to produce the IP product in the market at a lower price. The second situation is when he takes IP protection, but does not cater to the needs of consumers through local manufacturing or through imports. In such a situation, the local manufacturing mandate could be used to make him work in the county or even the IP can be revoked for the reason that the consumers are not given access to the products. Therefore, the problem of quitting the market also does not arise.

Further, if parallel trade is permitted, why does the producer make low priced goods available in some markets when he knows that they will be parallel traded?[646] Even in a situation which permits parallel imports, the producer makes low priced goods available in some markets, knowing fully well that these products may be parallel traded. This reveals the practical necessity of the producer to engage in third degree price discrimination in any situation. This necessarily follows from the fact that it is the market size and structure which determines the price to be maintained by the producer in any market and not the consumer welfare[647] and not even the presence of parallel trade. Even with a rule of national exhaustion and price discrimination, many pharmaceutical companies have not entered the lower income countries and due to vast disparities among the population within some countries make the companies target only such affordable population, instead of lowering prices.[648] This further establishes the fact that

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africa-study-says.html, (accessed o 22/12/2018). Also see, "25 years of essential medicines progress", Essential Drugs Monitor, WHO, Issue No.32, (2003), available at http://apps.who.int/medicinedocs/pdf/s4940e/s4940e.pdf, (accessed on 14/12/2018).

[646] Tommaso M. Valletti and Stefan Szymanski, "Parallel Trade, International Exhaustion and Intellectual Property Rights: A Welfare Analysis", The Journal of Industrial Economics, [2006], Vol.54, p.501, available at https://www.researchgate.net/publication/284052010_Parallel_trade_international_exhaustion_and_intellectual_property_rights_A_welfare_analysis, (accessed on 21/12/2018).

[647] Frank Müller-Langer, "Does Parallel Trade Freedom Harm Consumers in Small Markets?", Croatian Economic Survey, [2008], No.11, pp.11-41, available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1885539, (accessed on 02/12/2018).

[648] Peter K. Yu, "The International Enclosure Movement", IND. L.J. [2007], Vol.82, Issue 4, pp. 844-845, available at https://www.repository.law.indiana.edu/cgi/viewcontent.cgi?article=1373&context=ilj, (accessed on 15/12/2018). ,Also see; Keith E. Maskus, "Ensuring Access to Essential Medicines: Some Economic Considerations", Wisconsin International Law Journal , [2002], Vol.20, p.566, available at http://hdl.handle.net/10822/521116, (accessed on 18/12/2018) (explaining that sometimes "pharmaceuticalfirms and their distributors in poor countries may find it more profitable to sell drugs in low volumes and high prices to

differential pricing aims at profit rather than consumer welfare. Therefore banning parallel imports is not to maximise the welfare effect to consumers but to maximise the profits incurred to the producer which, it must be reiterated, is not the aim of the IP law. Banning parallel imports will help enhancing profit of the firm but the allowing parallel imports can improve the consumer welfare more than from than in the situation of differential pricing. It is at this point one must look into the aim of IP regime. Is it simply to increase incentive to the IP holder that the system exists? Or does the IP regime encompass consumer welfare within its objectives? It is for the dissemination of knowledge to the public and providing reasonable access to the consumers that the IP system provides incentive to the IP holders. Thus banning of parallel imports only helps in enhancing profit of the IP holder that he attains in differential pricing. Serving only the elite class in a low priced market which also is an inelastic market will also not be profitable as the net profit will only decrease catering for only small section of consumers as for differential pricing to be profitable in an low priced market where price of product is low due to low purchasing capacity of the consumers, monopolist will have to cater more consumers and can be profitable only if the market is inelastic. Therefore, it becomes evident that the benefits of differential pricing will not wither away even in the presence of parallel imports.

4.3. Parallel trade and economic efficiency

The parallel trade would unquestionably benefit the country to which they are imported. This is because the goods become cheaper in that country. However, the question of economic efficiency of parallel import cannot be answered merely from the perspective of the importing nation. The economic position of IP holder and the global welfare should be considered when one considers economic efficiency of parallel imports. Various criticisms are raised against parallel imports and its economic efficiency. This section tries to address these issues and attempts to examine whether parallel import is in fact economically efficient.

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wealthier patients with price-inelasticdemand rather than in highvolumes at low prices to poorer patients"). Also see ; Sarah R. Wasserman Rajec , "Regulatory responses to international patent exhaustion", in Irene Calboli and Edward Lee *Research handbook on intellectual property exhaustion and parallel imports,* Edward Elgar*,* Cheltenham,[2016], pp.281-282, available at https://umich.instructure.com/courses/177029/files/5372374/download?verifier=4rSQQMUyzFDsDL54pVxVMxOqu6WqdWpqbARDFZi2, (accessed on 21/12/2018).

It is also an accepted fact that parallel trade can benefit consumers of developed countries as goods are received at a cheaper rate from the low income countries.[649] Supporters of parallel imports maintain that it is important to be able to purchase products from the cheapest possible sources (free trade argument), thus favouring an open regime for PI.[650] In their view, more than the issue of the nature of efficiency being promoted, what needs to be stressed is the public welfare. The positive aspect of PI is the control it may have on monopoly pricing by the IP holder. Whether or not such imports actually take place, the threat that they might go for it, could force the manufacturers to lower prices. It is evident that policymakers, especially in developing countries, would place a higher weight on affordability of IP products such as medicines and other essential products than on promoting R&D abroad.[651] Further, the restriction of parallel imports to encourage the differential pricing mechanism to fetch maximum profits, must also be viewed from the aspect of economics of free trade. As already stated, the moment parallel

[649] Sarah R. Wasserman Rajec, "Free Trade in Patented Goods: International Exhaustion for Patents", Berkeley Tech. L.J., [2014], Vol. 29, pp.317-376, available at https://scholarship.law.berkeley.edu/cgi/viewcontent.cgi?referer=https://www.google.com/&httpsredir=1&article=2023&context=btlj, (accessed on 26/11/2018).

Also see; P Kanavos *et. al.*, "The economic impact of pharmaceutical parallel trade in European Union member states: A stakeholder analysis", (Special Research Paper, London School of Economics, 2004), p.34, available at http://www.lse.ac.uk/LSEHealthAndSocialCare/pdf/Workingpapers/Paper.pdf ,(accessed on 28/11/2018). Also see generally; *Restrictions on the Parallel Importation of Books*, Research Report, Australian Productivity Commission, Cannebera, 2009, available at https://www.pc.gov.au/inquiries/completed/books/report/books.pdf, (accessed on 22/12/2018); *Parallel Importing, A Theoretical and Empirical Investigation, Report to the Ministry of Commerce*, prepared by the New Zealand Institute of Economic Research, Select Committee on Trade and Industry Tenth Special Report, (1998), available at https://publications.parliament.uk/pa/cm199899/cmselect/cmtrdind/797/79704.htm.

[650] Keith E. Maskus , *Parallel Imports In Pharmaceuticals: Implications For Competition And Prices In Developing Countries*, Final Report to World Intellectual Property Organization, 2001, p.2, available at https://www.wipo.int/export/sites/www/about-ip/en/studies/pdf/ssa_maskus_pi.pdf, (accessed on 4/12/2018). Also see; Daniel Knox and Martin Richardson, "Trade policy and parallel imports", European Journal of Political Economy, [2002], Vol. 19, p.140, available at https://doi.org/10.1016/S0176-2680(02)00133-7, (accessed on 21/12/2018) ; Frank Müller-Langer, "Does Parallel Trade Freedom Harm Consumers in Small Markets?", Croatian Economic Survey, [2008], No.11, pp.11-41, available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1885539, (accessed on 02/12/2018) ; Frederick M. Abbot, "First Report(Final) to the Committee on International Trade Law of the International Law Association on the Subject of Parallel Importation", Journal of International Economic Law, [1998], Vol. 1, No. 4, p.635, available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=915046, (accessed on 4/11/2018).

[651] Frederick M. Abbot, "First Report(Final) to the Committee on International Trade Law of the International Law Association on the Subject of Parallel Importation", Journal of International Economic Law, [1998], Vol. 1, No. 4, pp. 607-636.,https://papers.ssrn.com/sol3/papers.cfm?abstract_id=915046, (accessed on 4/11/2018).

imports are restricted; it amounts to restriction of freedom to trade, which in general, is considered not to be enhancing consumer welfare.

Although some studies find that parallel trade in general may be beneficial, particularly for high-priced countries since they get cheaper goods,[652]there is a counter argument to the effect that parallel trade fails to promote dynamic efficiency by disincentivizing innovation as a result of reduced profits. On a first glance it may appear that there is a conflict between the competing objectives of promoting dynamic efficiency by incentivizing innovation and furthering static or allocative efficiency by permitting parallel trade.[653] This is because parallel trade is not necessarily an innovation-driven activity and its development might have the effect of weakening the innovative capacity of the originator manufacturers. In other words, it may be said that parallel trade increases economic integration and furthers static efficiency rather than dynamic efficiency.[654] This does not necessarily mean that parallel imports affect the dynamic efficiency

[652] P Kanavos *et. al.*, "The economic impact of pharmaceutical parallel trade in European Union member states: A stakeholder analysis", (Special Research Paper, London School of Economics, 2004), p.34, available at http://www.lse.ac.uk/LSEHealthAndSocialCare/pdf/Workingpapers/Paper.pdf , (accessed on 28/11/2018).Also see ; Sarah R. Wasserman Rajec, "Free Trade in Patented Goods: International Exhaustion for Patents", Berkeley Tech. L.J., [2014], Vol. 29, pp.317-376, available at https://scholarship.law.berkeley.edu/cgi/viewcontent.cgi?referer=https://www.google.com/&httpsredir=1&article=2023&context=btlj, (accessed on 26/11/2018) ; *Restrictions on the Parallel Importation of Books*, Research Report, Australian Productivity Commission, Cannebera, 2009, available at https://www.pc.gov.au/inquiries/completed/books/report/books.pdf, (accessed on 22/12/2018); *Parallel Importing, A Theoretical and Empirical Investigation, Report to the Ministry of Commerce*, prepared by the New Zealand Institute of Economic Research, Select Committee on Trade and Industry Tenth Special Report, (1998), available at https://publications.parliament.uk/pa/cm199899/cmselect/cmtrdind/797/79704.htm(accessed on 22/12/2018); Christopher Stothers, *Parallel Trade in Europe: Intellectual Property, Competition and Regulatory Law*, HART Publishing, North America and Portland, (2007), p.362.

[653] P Kanavos *et. al.*, "The economic impact of pharmaceutical parallel trade in European Union member states: A stakeholder analysis", (Special Research Paper, London School of Economics, 2004), p.25, available at http://www.lse.ac.uk/LSEHealthAndSocialCare/pdf/Workingpapers/Paper.pdf ,(accessed on 28/11/2018).

[654] P Kanavos *et. al.*, "The economic impact of pharmaceutical parallel trade in European Union member states: A stakeholder analysis", (Special Research Paper, London School of Economics, 2004), p.26, available at http://www.lse.ac.uk/LSEHealthAndSocialCare/pdf/Workingpapers/Paper.pdf ,(accessed on 28/11/2018). Advocates of strong international patent rights support a global policy of banning PI, arguing that if such trade were widely allowed it would reduce profits in the research-intensive sectors and ultimately slow down innovation. See for example, Frank Müller-Langer, "Does Parallel Trade Freedom Harm Consumers in Small Markets?", Croatian Economic Survey, [2008] No.11, , pp.11-41, available at

of a market. It might not bring about dynamic efficiency but it also does not hamper dynamic efficiency.[655] It is accepted that the parallel import restrictions tend to increase profits of the IP holder which could bring about dynamic efficiency. However, merely bringing dynamic efficiency at the cost of consumer welfare cannot be a optimal standard for welfare.[656]Arbitrage would increase welfare since the gain in consumer surplus would exceed the value of lost profits.[657]There is also an observation in a study that the admissibility of parallel trade mitigates the opportunity for one government to free-ride on the protection of IPR granted by another.[658] This is because when parallel trade is prohibited and if the manufacturer charges exorbitant prices on the products, the government will take measures to control the prices so as to provide goods at a low price to local consumers at the same time allowing enjoyment of innovation.[659]This might also disincentivise the counterfeiting of products. The study also

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https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1885539, accessed on 02/12/2018., Barfield and Groombridge, "The Economic Case for Copyright Owner Control over Parallel Imports"**,** Journal of World Intellectual Property, [1998], Vol. 1, pp. 903–939, available at https://onlinelibrary.wiley.com/doi/pdf/10.1111/j.1747-1796.1998.tb00041.x, (accessed on 22/12/2018); J.S Chard and C.J. Mellor, "Intellectual Property Rights and Parallel Imports", World Economy, [1989], Vol. 12, pp. 69–83 ;Patricia M. Danzon, and Adrian Towse, "Differential Pricing for Pharmaceuticals: Reconciling Access, R&D and Patents", International Journal of Health Care Finance and Economics, [2003], Vol.3 (3), pp.183-205, available at http://dx.doi.org/10.1023/A:1025384819575 , (accessed on 21/12/2018).

[655] *Study of Parallel Importing*, prepared for the Ministry of Commerce and the Department of Justice of New Zealand, (1994), 34, referred to by Louise Longdin, "Copyright: The Last Trade Barrier in a Globalised World?", p.28, available at http://www.copyright.bbk.ac.uk/contents/conferences/2006/cplongdin.pdf, (accessed on 21/12/2018).
The study concluded that the empirical evidence was not only inconclusive but that it would probably always remain so, however great the resources expended on gathering and assessing it and that they could therefore make no definitive recommendation.

[656] The lesson for parallel import policy is that even if restricting parallel imports may increase the returns to innovation and lead to greater creative effort, these benefits should always be weighed against the costs to consumers. Greater creative output at very high consumer prices is not an optimal outcome from society's point of view. See : *The Costs and Benefits of Preventing Parallel Imports into New Zealand,* Report commissioned by the New Zealand Ministry of Economic Development, 2012, pp.14-15, available at https://www.mbie.govt.nz/dmsdocument/2441-costs-benefits-preventing-parallel-imports-into-nz-pdf, (accessed on 30/11/2018).

[657] Hal R. Varian, "Price Discrimination and social welfare", American Economic Review, [1985], Vol. 75, No: 4, pp.870-875, available at https://www.jstor.org/stable/1821366, (accessed on 1/12/2018).

[658] Gene M. Grossman and Edwin L.-C. Lai , "Parallel imports and price controls", RAND Journal of Economics, [2008], Vol. 39, No. 2, p.380, available at https://pdfs.semanticscholar.org/bcf6/95b4b28c09e563b5d8fea1df910fe5f76655.pdf., (accessed on 22/12/2018).

[659] Gene M. Grossman and Edwin L.-C. Lai , "Parallel imports and price controls", RAND Journal of Economics, [2008], Vol. 39, No. 2, p.380, available at

observes that deregulation of parallel imports generates both an increase in consumer surplus in the innovative country and an increase in the world pace of innovation.[660]Thus, the more innovative country may face no trade-off at all between static and dynamic gains in its choice of regime for exhaustion of IPR. The more innovative country gains from parallel trade, whereas the less innovative country loses.[661] Thus, allowing parallel imports leads to innovation and consumer surplus in a developed innovative country and thus gains from parallel trade.[662]

Another important outcome of the presence of parallel trade is that it compels the producer to produce more goods at lesser price so as to serve more consumers and to avoid parallel imports. This increased production benefits the nation by enabling the consumers to get goods at a cheaper rate. Thus the benefit of differential pricing gets further enhanced by parallel imports. The loss sustained by the IP holder, if any, is not actually loss but merely a decrease in the profits that he would have accrued if resale was prohibited. The ban on parallel imports would

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https://pdfs.semanticscholar.org/bcf6/95b4b28c09e563b5d8fea1df910fe5f76655.pdf., (accessed on 22/12/2018).

[660] Gene M. Grossman and Edwin L.-C. Lai , "Parallel imports and price controls", RAND Journal of Economics, [2008], Vol. 39, No. 2, pp.378-402, available at https://pdfs.semanticscholar.org/bcf6/95b4b28c09e563b5d8fea1df910fe5f76655.pdf., (accessed on 22/12/2018).

[661] Gene M. Grossman and Edwin L.-C. Lai , "Parallel imports and price controls", RAND Journal of Economics, [2008], Vol. 39, No. 2, pp.378-402, available at https://pdfs.semanticscholar.org/bcf6/95b4b28c09e563b5d8fea1df910fe5f76655.pdf., (accessed on 22/12/2018).

[662] Gene M. Grossman and Edwin L.-C. Lai , Parallel imports and price controls, RAND Journal of Economics Vol. 39, No. 2, Summer 2008, p. 381. The authors state as follows: "By allowing parallel imports, North dulls the incentives in South for free-riding on its protection of IPR. This argument does not require that South be a single, large economy, as we initially assume. In fact, our results extend readily to a setting with several or many countries in South. The size of a typical country in South enters our analysis in several ways. If such a country is small (for example, because there are many such countries), there will be fewer consumers there to benefit from faster world innovation. But there will also be fewer consumers to be harmed by high local prices. These two effects of country size offset one another in our model, and so they do not affect a government's incentives in setting its price ceilings. The size of a country in South can also affect the leverage that its government has over world innovation and the risk it faces that its local market will not be served. The policies of a small country have little effect on R&D investment in a world without parallel trade, because each firm captures only a tiny share of its profits in such a market. Therefore, in a regime of national exhaustion of IPR in North, the free-rider problem quickly grows more severe as the number of countries in South expands. In contrast, when arbitrage is possible, a country that strictly controls prices impinges upon profit opportunities not only in its own small market but also in other, larger markets to which the goods can be shipped. Accordingly, even a small country has considerable leverage over world innovation in such a setting. Note too that innovating firms may well be tempted to cut off supply from a very small market when goods can be shipped from there to North, but such firms have no reason to withhold supply from small markets in the absence of parallel trade. For these reasons, we find that North's preference for international exhaustion of IPR extends to a world with multiple symmetric Southern countries and even to a world in which the typical such country is vanishingly small."

simply result in increasing the profit of the IP holder by allowing him to maximize his profits by prohibiting resale. Parallel imports cannot have serious adverse impacts on the IP holder since the parallel imported product is the product of the IP holder himself and he has already received his share of profit upon the first sale.

Maskus and Chen examine the nature of contractual relationships between a domestic manufacturer and foreign distributor to determine when parallel trade will be optimal.[663] They show that the manufacturer will take account of the threat of parallel trade when fixing wholesale prices, and might force the manufacturer to raise the wholesale price above marginal cost, which creates high prices, leading to reduced social welfare.[664] Encouraging parallel trade, according to them, can raise welfare, at least in part, if it reduces the incentive to create such distortions.[665] The distortions such as unavailability in market and high prices can be taken care of by the IP regime. If transportation costs are so high that parallel trade is not feasible, the manufacturer can easily price discriminate.[666] As parallel imports begin to compete with the products distributed by the manufacturer, the manufacturer starts raising the wholesale price above marginal cost to

[663] Keith E. Maskus and Yongmin Chen, "Vertical Price Control and Parallel Imports: Theory and Evidence", Review of International Economics, [2004] ,Vol.12(4), pp.551–570, available at https://econpapers.repec.org/article/blareviec/v_3a12_3ay_3a2004_3ai_3a4_3ap_3a551-570.htm, (accessed on 20/12/2018).

[664] Keith E. Maskus and Yongmin Chen, "Vertical Price Control and Parallel Imports: Theory and Evidence", Review of International Economics, [2004], Vol.12(4), pp.551–561, available at https://econpapers.repec.org/article/blareviec/v_3a12_3ay_3a2004_3ai_3a4_3ap_3a551-570.htm, (accessed on 20/12/2018).Also see; Frank Müller-Langer, "Does Parallel Trade Freedom Harm Consumers in Small Markets?", Croatian Economic Survey, [2008], No.11, p.24, available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1885539, (accessed on 02/12/2018).

[665] Keith E. Maskus and Yongmin Chen, "Vertical Price Control and Parallel Imports: Theory and Evidence", Review of International Economics, [2004], Vol.12(4), pp.551–561, available at https://econpapers.repec.org/article/blareviec/v_3a12_3ay_3a2004_3ai_3a4_3ap_3a551-570.htm, (accessed on 20/12/2018). Also see; Frank Müller-Langer, "Does Parallel Trade Freedom Harm Consumers in Small Markets?", Croatian Economic Survey, [2008], No.11, p.24, available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1885539, (accessed on 02/12/2018).

[666] Keith E. Maskus and Yongmin Chen, "Vertical Price Control and Parallel Imports: Theory and Evidence", Review of International Economics, [2004], Vol.12(4), pp.551–561, available at https://econpapers.repec.org/article/blareviec/v_3a12_3ay_3a2004_3ai_3a4_3ap_3a551-570.htm, (accessed on 20/12/2018). Also see; Frank Müller-Langer, "Does Parallel Trade Freedom Harm Consumers in Small Markets?", Croatian Economic Survey, [2008], No.11, p.24, available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1885539, (accessed on 02/12/2018).

deter parallel trade, thus creating vertical distortions.[667] But when parallel trade cannot be avoided in equilibrium, it has good welfare properties as it reallocates goods between the countries: in this case a reduction in the cost of conducting parallel trade increases social welfare**.**[668] However, as it has been argued before, price discrimination is a necessary step for the monopolist and thus arbitrage and parallel trade thus cannot be avoided which will then result in the benefit of the consumers and total social welfare.

Despite all the economic and non-economic arguments against parallel trade, most developing economies prefer not to restrict parallel trade. One of the reasons is that the national exhaustion rule maybe characterised as a trading cost that hinders efficient downstream sales and uses of products since it requires authorization for each resale.[669] Furthermore, many nations see opportunities as parallel exporters. This position reflects their concern that banning parallel imports would invite abusive behaviour in their markets from the part of foreign rights holders.[670] This is another reason for justifying parallel trade. For e.g.,prior to entering the E.U., Sweden operated a system of international exhaustion, permitting importers to source parallel traded goods from anywhere in the world.[671] In a study conducted by the Swedish competition

[667] Keith E. Maskus and Yongmin Chen, "Vertical Price Control and Parallel Imports: Theory and Evidence", Review of International Economics, [2004], Vol.12(4), p. 560, available at https://econpapers.repec.org/article/blareviec/v_3a12_3ay_3a2004_3ai_3a4_3ap_3a551-570.htm, (accessed on 20/12/2018).

[668] Keith E. Maskus and Yongmin Chen, "Vertical Price Control and Parallel Imports: Theory and Evidence", Review of International Economics, [2004], Vol.12(4), p. 551-560, available at https://econpapers.repec.org/article/blareviec/v_3a12_3ay_3a2004_3ai_3a4_3ap_3a551-570.htm, (accessed on 20/12/2018).

[669] Sarah R. Wasserman Rajec, "Free Trade in Patented Goods: International Exhaustion for Patents", Berkeley Tech. L.J., [2014], Vol. 29, p.330, available at https://scholarship.law.berkeley.edu/cgi/viewcontent.cgi?referer=https://www.google.com/&httpsredir=1&article=2023&context=btlj, (accessed on 26/11/2018).

[670] P Kanavos *et. al.*, "The economic impact of pharmaceutical parallel trade in European Union member states: A stakeholder analysis", (Special Research Paper, London School of Economics, 2004), p.37, available at http://www.lse.ac.uk/LSEHealthAndSocialCare/pdf/Workingpapers/Paper.pdf ,(accessed on 28/11/2018).

[671] Tommaso M. Valletti and Stefan Szymanski, "Parallel Trade, International Exhaustion and Intellectual Property Rights: A Welfare Analysis", The Journal of Industrial Economics, [2006], Vol.54, pp. 499-526, available at https://www.researchgate.net/publication/284052010_Parallel_trade_international_exhaustion_and_intellectual property_rights_A_welfare_analysis, (accessed on 21/12/2018). Also see ; SeçilTutkun, "Exhaustion of Industrial Property Rights in The European Union and Its Implications on The Application of this Principle in Turkey", (A Thesis Submitted To The Graduate School Of Social Sciences Of Middle East Technical University, 2005), p.103, available at https://etd.lib.metu.edu.tr/upload/12606973/index.pdf, (accessed on 20/12/2018); Pernilla Larsson, *Parallel Imports - Effects of the Silhouette Ruling*, Swedish Competition Authority, Report Series, 1999, pp.1-161, available at

authority, it was estimated that parallel traded goods in sectors such as motor cycle spare parts, tyres, clothing, footwear, pharmaceuticals, sports equipment and snow scooters were between 10 and 30% cheaper than domestically sourced goods and that the elimination of parallel trade from outside the E.U. had increased domestic prices by between 0.4 and 5% on an average.[672] The economic analysis suggests that allowing parallel imports by restricting the possibility of price discrimination will increase overall consumer welfare worldwide if it results in an increase of production.[673] The report finally concluded that in Sweden the consumer benefits of parallel trade outweighed the arguments against the parallel trade.[674] Danish Inter- Ministerial working group in Denmark reached a similar conclusion to that of Sweden and concluded that there

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http://www.konkurrensverket.se/globalassets/english/publications-and-decisions/parallel-imports---effects-of-the-silhouette-ruling.pdf, (accessed on 5/12/2018).

[672] Pernilla Larsson, *Parallel Imports - Effects of the Silhouette Ruling*, Swedish Competition Authority, Report Series, 1999, pp.1-161, available at http://www.konkurrensverket.se/globalassets/english/publications-and-decisions/parallel-imports---effects-of-the-silhouette-ruling.pdf, (accessed on 5/12/2018). Also see; Tommaso M. Valletti and Stefan Szymanski, "Parallel Trade, International Exhaustion and Intellectual Property Rights: A Welfare Analysis", The Journal of Industrial Economics, [2006], Vol.54, pp. 499-501, available at https://www.researchgate.net/publication/284052010_Parallel_trade_international_exhaustion_and_intellectual property_rights_A_welfare_analysis, (accessed on 21/12/2018). Also see; Kerin M. Vautier, "Economic Considerations on Parallel Imports", in Christopher Heath, *Parallel Imports In Asia,* Max Plank Series on Asian Intellectual Property Law, Vol. 9, Kluwer Law International, Netherlands, (2004),p.8.

[673] Pernilla Larsson, *Parallel Imports - Effects of the Silhouette Ruling*, Swedish Competition Authority, Report Series, 1999, pp.1-161, available at http://www.konkurrensverket.se/globalassets/english/publications-and-decisions/parallel-imports---effects-of-the-silhouette-ruling.pdf, (accessed on 5/12/2018). Also see; Christopher Stothers, *Parallel Trade in Europe: Intellectual Property, Competition and Regulatory Law*, HART Publishing, North America and Portland, (2007), p.362.

[674] The report however warned that even though the consumers of the developed country will have a definite welfare increase, the consumers of the low priced countries may face a situation of a price hike if the monopolist decides to increase the price in low pried countries. However, this will definitely reduce the market power and profit of the monopolist in the developing and underdeveloped countries and thus can bring down the price yet again. See ; *Parallel Imports A Swedish Study on Effects of the Silhouette Ruling* , Swedish Competition Authority, 1999, available at http://www.europarl.europa.eu/hearings/20010410/juri/3_goranson.pdf , (accessed on 22/12/2018) ; Also see Pernilla Larsson, *Parallel Imports - Effects of the Silhouette Ruling*, Swedish Competition Authority, Report Series, 1999, pp.1-161, available at http://www.konkurrensverket.se/globalassets/english/publications-and-decisions/parallel-imports---effects-of-the-silhouette-ruling.pdf, (accessed on 5/12/2018); Christopher Stothers, *Parallel Trade in Europe: Intellectual Property, Competition and Regulatory Law*, HART Publishing, North America and Portland, (2007), p.362.

would significant reduction in price in Denmark for products and considerable increase of consumer welfare if parallel trade in allowed.[675]

Australia is another developed nation which had opened its door to parallel imports.[676] Australian Government Productivity Commission produced a report regarding the restrictions on the parallel imports of books.[677]It suggested that the way parallel imports restrictions (PIRs) can assist copyright holders is similar, in some respects, to the effects of other import restrictions which apply to some other industries. Tariffs, for example, cushion domestic industries from exposure to international competitive pressure. They increase the price of competing imports and thereby provide room for local producers to lift their prices, albeit at the expense of local consumers. Likewise, Parallel imports restrictions also cushion domestic copyright holders from at least direct international competition (other than via online booksellers), potentially allowing them to charge higher prices for their goods in the Australian market.[678] The report found that the prices of the books priced in Australia and other countries like U.S. and U.K. had substantial differences wherein the price in the Australian market was substantially high compared to others.[679] The Commission has concluded that the PIRs place upward pressure on book prices and that, at times, the price effect is likely to be substantial.[680] The magnitude of the effect will vary over time and across book genres.[681] Most of the benefits of PIR protection accrue to

[675] Danish Patent and Trademark Office, Industry Policy in Denmark: New Trends in Industrial Property Rights (The Danish Ministry of Trade and Industry, Copenhagen, 1999) pp. 41-2, referred to by Christopher Stothers, *Parallel Trade in Europe: Intellectual Property, Competition and Regulatory Law*, HART Publishing, North America and Portland, (2007), p.363.

[676] Louise Longdin, "Parallel Importing Post TRIPS: Convergence and Divergence in Australia and New Zealand", The International and Comparative Law Quarterly, [2001], Vol. 50, No. 1, pp.54-89, available at https://www.jstor.org/stable/761461, (accessed on 20/1/22018).

[677] *Restrictions on the Parallel Importation of Books*, Research Report, Australian Productivity Commission, Cannebera, 2009, available at https://www.pc.gov.au/inquiries/completed/books/report/books.pdf.

[678] *Restrictions on the Parallel Importation of Books*, Research Report, Australian Productivity Commission, Cannebera, 2009, p.4.6, available at https://www.pc.gov.au/inquiries/completed/books/report/books.pdf.,(accessed on 20/1/22018).

[679] *Restrictions on the Parallel Importation of Books*, Research Report, Australian Productivity Commission, Cannebera, 2009, p.4.1, available at https://www.pc.gov.au/inquiries/completed/books/report/books.pdf. (accessed on 20/1/22018).

[680] *Restrictions on the Parallel Importation of Books*, Research Report, Australian Productivity Commission, Cannebera, 2009, p.4.21, available at https://www.pc.gov.au/inquiries/completed/books/report/books.pdf. (accessed on 20/1/22018).

[681] *Restrictions on the Parallel Importation of Books*, Research Report, Australian Productivity Commission,

publishers and authors, while demand for local printing also increased.[682] While most of the costs are met by consumers, who fund these benefits in a non-transparent manner through higher book prices.[683] Moreover, such restrictions also cause economic inefficiencies and a significant transfer of income from Australian consumers to overseas authors and publishers.[684] The commission, after considering industry feedback and analysis, recommended that the PIR provisions be repealed. Another interesting aspect to be noted is the way the Commission equates PIRs with Tariffs, suggesting that PIR is a concept antithetical to free trade.

New Zealand was another developed nation to relax the restrictions on parallel imports. The decision came after two studies commissioned from a private group of economists, only the second of which unequivocally came down in favour of lifting the ban on parallel importing.[685]The study also found that the prices of the books in New Zealand were higher compared to that of United Kingdom, United States and Australia.[686] The study concluded that the prices of the commodity would fall and the consumer choice would increase with the lift of ban on parallel imports.[687] The study also found that although blocking counterfeit imports is

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Cannebera, 2009, p.4.21, available at https://www.pc.gov.au/inquiries/completed/books/report/books.pdf. (accessed on 20/1/22018).

[682] *Restrictions on the Parallel Importation of Books*, Research Report, Australian Productivity Commission, Cannebera, 2009, p.XIV, available at https://www.pc.gov.au/inquiries/completed/books/report/books.pdf. (accessed on 20/1/22018).

[683] *Restrictions on the Parallel Importation of Books*, Research Report, Australian Productivity Commission, Cannebera, 2009, p.XIV, available at https://www.pc.gov.au/inquiries/completed/books/report/books.pdf. (accessed on 20/1/22018).

[684] *Restrictions on the Parallel Importation of Books*, Research Report, Australian Productivity Commission, Cannebera, 2009, p.XIV, available at https://www.pc.gov.au/inquiries/completed/books/report/books.pdf. (accessed on 20/1/22018).

[685] Louise Longdin, "Parallel Importing Post TRIPS: Convergence and Divergence in Australia and New Zealand", The International and Comparative Law Quarterly, [2001], Vol. 50, No. 1, p.61, available at https://www.jstor.org/stable/761461, (accessed on 20/1/22018).

[686] *The Impact of Parallel Importing on Publishing in New Zealand*, Report to Australian Publishers Association, 2009, p.8, available at https://www.pc.gov.au/inquiries/completed/books/submissions/subdr513-attachment1.pdf., (accessed on 5/12/2018). Also see ; Louise Longdin, "Parallel Importing Post TRIPS: Convergence and Divergence in Australia and New Zealand", The International and Comparative Law Quarterly, [2001], Vol. 50, No. 1, p.61, available at https://www.jstor.org/stable/761461, (accessed on 20/1/22018) ; HazboSkoko , "Theory and Practice of Parallel Imports: The New Zealand Case", p.5, available at http://athene.riv.csu.edu.au/~hskoko/parallel%20imports/pimppaper.pdf, (accessed on 5/12/2018).

[687] HazboSkoko , "Theory and Practice of Parallel Imports: The New Zealand Case", p.5, available at

assisted by the existence of parallel importing restrictions, this is not the primary purpose of such restrictions and that there may be ways of achieving that result at a lower cost to the economy as a whole than of imposing a blanket ban on parallel imports.[688]

In U.K., the Select committee on Trade and Industry conducted another study. The report suggested that benefits of parallel trade depended upon kinds of sectors the trade took place.[689] The report also suggested that except in the areas of pharmaceuticals and music industries, the presence of parallel trading would increase the consumer welfare. It should be noted that these two sectors are the most dominant economic sectors of U.K. The report therefore was widely criticized as the Committee took a protectionist approach towards UK industries.[690] The U.K. Government, however, responded by agreeing to adopt international exhaustion in the area of trademarks but not for copyright.

The IRISH competition authority too produced an excellent study in 1999 on parallel imports and its economic effects.[691] The report suggested two negative effects of prohibiting parallel trade: the negative effects by way of restricting benefits of parallel trade and as a competitive restraint on prices within the community.[692] The report categorically stated that there was

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http://athene.riv.csu.edu.au/~hskoko/parallel%20imports/pimppaper.pdf, (accessed on 5/12/2018).Louise Longdin, "Parallel Importing Post TRIPS: Convergence and Divergence in Australia and New Zealand", The International and Comparative Law Quarterly, [2001], Vol. 50, No. 1, p.63, available at https://www.jstor.org/stable/761461, (accessed on 20/1/22018).

[688] Louise Longdin, "Parallel Importing Post TRIPS: Convergence and Divergence in Australia and New Zealand", The International and Comparative Law Quarterly, [2001], Vol. 50, No. 1, p.63, available at https://www.jstor.org/stable/761461, (accessed on 20/1/22018).

[689] See generally ; *Appendix, Select Committee on Trade and Industry*, Tenth Special Report , 1998-99, available at https://publications.parliament.uk/pa/cm199899/cmselect/cmtrdind/797/79704.htm (accessed on 5/12/2018). Also see; Christopher Stothers, *Parallel Trade in Europe: Intellectual Property, Competition and Regulatory Law*, HART Publishing, North America and Portland, (2007), pp.364-365.

[690] Christopher Stothers, *Parallel Trade in Europe: Intellectual Property, Competition and Regulatory Law*, HART Publishing, Oxford and Portland, Oregon, (2007), p. 365.

[691] P.Kenny and P. McNutt, *Competition, Parallel Imports and Trademark Exhaustion : Two Wrongs From a Trademark Right*, Discussion Paper No:8, IRISH Competition Authority, Dublin, 1999, as referred to by Christopher Stothers, *Parallel Trade in Europe: Intellectual Property, Competition and Regulatory Law*, HART Publishing, North America and Portland, (2007), p.366.

[692].P.Kenny and P. McNutt, Competition, Parallel Imports and Trademark Exhaustion: Two Wrongs From a Trademark Right, Discussion Paper No:8 (IRISH Competition Authority, Dublin, 1999.) as referred to by Christopher Stothers, *Parallel Trade in Europe: Intellectual Property, Competition and Regulatory Law*, HART Publishing, North America and Portland, (2007), p.366.

nothing to prove that prohibition of parallel trade could reduce counterfeiting.[693]The conclusion of the report was supporting Governments' adoption of international exhaustion as its benefits to the consumers outweighed losses.

From the above analysis it is clear that if arbitrage does not induce any market to close, it is always welfare enhancing, as it improves the allocation of goods among customers.[694] On the other hand, for a given level of quality, generally the manufacturer gets higher profits without parallel trade than with parallel trade.[695] Therefore, it is clear that the ban on parallel trade is advocated merely for enhancing the profit of the manufacturer.[696] It should also be taken in to account that no single study has established that parallel trade can only bring in negative

[693] P.Kenny and P. McNutt, Competition, Parallel Imports and Trademark Exhaustion: Two Wrongs From a Trademark Right, Discussion Paper No:8 (IRISH Competition Authority, Dublin, 1999.) as referred to by Christopher Stothers, *Parallel Trade in Europe: Intellectual Property, Competition and Regulatory Law*, HART Publishing, North America and Portland, (2007), p.366.

[694] Tommaso M. Valletti and Stefan Szymanski, "Parallel Trade, International Exhaustion and Intellectual Property Rights: A Welfare Analysis", The Journal of Industrial Economics, [2006], Vol.54, p.503, https://www.researchgate.net/publication/284052010_Parallel_trade_international_exhaustion_and_intellectual property_rights_A_welfare_analysis, (accessed on 21/12/2018).

[695] Tommaso M. Valletti and Stefan Szymanski, "Parallel Trade, International Exhaustion and Intellectual Property Rights: A Welfare Analysis", The Journal of Industrial Economics, [2006], Vol.54, p.505, https://www.researchgate.net/publication/284052010_Parallel_trade_international_exhaustion_and_intellectual _property_rights_A_welfare_analysis, (accessed on 21/12/2018).However, certain studies have concluded that parallel imports can bring profit to IP holder see; Noriaki Matsushima & Toshihiro Matsumura, "Profit-Enhancing Parallel Imports," Open Economies Review, Springer, [2010], Vol. 21(3), pp. 433-447, available at https://ideas.repec.org/a/kap/openec/v21y2010i3p433-447.html, (accessed on 20/1/2/2018); Simon P. Anderson and Victor A. Ginsburgh, "International pricing with costly consumer arbitrage", Review of International Economics, [1999], p.7, pp.126–139, available at http://economics.virginia.edu/sites/economics.virginia.edu/files/anderson/1373.pdf, (accessed on 21/12/2018).Reza Ahmadi, B Rachel Yang, "Parallel imports: challenges from unauthorised distribution channels" Marketing Science, [2000], Vol.19(3), pp.279-294, available at www.jstor.org/stable/193190 (accessed on 21/12/2018).

[696] The literatures, however, are of the opinion that the impact of arbitrage is to dilute the incentives of the monopolist to invest in product innovation (quality). As quality also affect consumer surplus, international arbitrage negatively affects buyers as well by delivering an inferior product. See Tommaso M. Valletti and Stefan Szymanski, "Parallel Trade, International Exhaustion and Intellectual Property Rights: A Welfare Analysis", The Journal of Industrial Economics, [2006], Vol.54, pp. 499-526, at p.503. p.505, p.513, available at https://www.researchgate.net/publication/284052010_Parallel_trade_international_exhaustion_and_intellectual _property_rights_A_welfare_analysis, (accessed on 21/12/2018).David A.Malueg and Marius Schwartz, "Parallel imports, demand dispersion, and international price discrimination", Journal of International Economics, [1994], Vol.37, pp.167–195. This however is only a proposition as it is not mandatory that the IP owners need not necessarily innovate and in flow of low quality products are also not a necessary thing.

impacts.[697] As stated above, it is not only the developed country, which is being served by parallel imports that gets benefit from the parallel imports. The developing countries where the production takes place also share the benefits of parallel imports. The export revenue of the developing countries also gets increased. Parallel imports can also benefit the manufacturer since if parallel imports are banned, the alternative which the governments may choose would be price control measures which would obviously harm the manufacturer and the consumer.[698] In brief, parallel imports further both the interest of the developed and developing nations while also not creating an aggregate loss to the monopolist. Thus parallel imports enhance total welfare.

4.4. Parallel Imports and Competition

The economic aspect of parallel imports will be incomplete without looking into the competition aspect of parallel imports. As stated earlier, parallel imports, are goods produced by the IP holder and bought by the parallel importer in one market and sold in another market, generally where the IP holder sells the same kind of goods through another distribution channel. Thus, the parallel importer competes in the same market as the IP holder, and conducts a parallel business

[697] See for eg: Tommaso M. Valletti and Stefan Szymanski, "Parallel Trade, International Exhaustion and Intellectual Property Rights: A Welfare Analysis", The Journal of Industrial Economics, [2006], Vol.54, pp. 499-526, available at https://www.researchgate.net/publication/284052010_Parallel_trade_international_exhaustion_and_intellectual_property_rights_A_welfare_analysis, (accessed on 21/12/2018), it has been said that "On the face of it, parallel trade brings significant benefits to consumers in high valuation markets, but our analysis shows that any ex post consumer benefit must be traded off against the reduction in ex ante incentives to invest. However, this trade-off is diluted when the monopolist is able to offer more than one product variety and generics are present in the market. The nature of the generic in this example is therefore crucial. When dealing with goods protected by trademark, generics are quite common, for example unbranded jeans, or coffee, or perfumes with lesser brand names. Moreover, in such cases it is not unusual to see the trademark owner offer branded alternatives that differ significantly in quality. However, in the case of goods protected by patents then during the life of the patent, generics that copy the protected good are in fact illegal. Thus the possibility of a reasonable generic substitute for a good protected by patent is relatively small, unlike the case of branded goods. This suggests that policy on international exhaustion might optimally differ according to the type of intellectual property right considered." Also see; Hal R. Varian, "Price Discrimination and social welfare", American Economic Review, [1985], Vol. 75, No: 4, pp.870-875, available at https://www.jstor.org/stable/1821366, (accessed on 1/12/2018), P Kanavos *et. al.*, "The economic impact of pharmaceutical parallel trade in European Union member states: A stakeholder analysis", (Special Research Paper, London School of Economics, 2004), pp.1-209, available at http://www.lse.ac.uk/LSEHealthAndSocialCare/pdf/Workingpapers/Paper.pdf ,(accessed on 28/11/2018).

[698] Frederick M. Abbott, *Parallel Importation: Economic and social welfare dimensions*, Prepared for the Swiss Agency for Development and Cooperation (SDC), (2007), p.9, available at https://www.iisd.org/pdf/2007/parallel_importation.pdf, (accessed on 27/11/2018).

with the IP holder. Parallel imports flow from low priced countries to high priced countries, and is the result of the ability of the manufacturer to use price discrimination.[699] As already seen, the differential pricing mechanism occurs due to various factors such as government policies on prices, regulatory requirements, technological level, environmental standards, labor costs, labor skills, material costs, government subsidies and taxation systems in different markets.[700]In addition, the exchange rate movements between the countries also induce parallel trade.[701] If the exchange rate between countries is high, the arbitrage cost between the countries will also be high and parallel trade may not take place. Parallel importer provides intra-band competition in the market,[702] which can ultimately result in welfare of the consumers due to the in increased access and affordability. Before going into the aspect of how parallel imports bring in intra-band competition and welfare to the consumers, one must look into the interplay between IP and competition so as to have a background of the importance of competition aspect in IP.

4.4.1. Intellectual property Law and Competition law interface

Intellectual property provides limited monopoly to the IP holder for enabling him to exploit his intellectual creation. An equally important objective of IP protection is to cater to the maximum consumer access of the IP protected products.[703] At the same time, the competition law aims at regulating the use of IP rights when these rights are the source of market power.[704] IP protection creates a situation similar to monopoly since generally there will be only one player; i.e., the IP holder, in the market. Unlimited market power with the IP rights can lead to abuse of monopoly and it is the responsibility of competition law to avoid it. Any property right may be assigned as

[699] Frederick M. Abbott, *Parallel Importation: Economic and social welfare dimensions*, Prepared for the Swiss Agency for Development and Cooperation (SDC), (2007), p.5, available at https://www.iisd.org/pdf/2007/parallel_importation.pdf, (accessed on 27/11/2018).

[700] See thesis part on differential pricing.

[701] TeodoraCosac, "Vertical Restraints and Parallel Imports with Differentiated Products", (2003), p.2, available at http://econwpa.repec.org/eps/io/papers/0401/0401006.pdf, (accessed on 5/12/2018).

[702]Kerin M. Vautier, "Economic Considerations on Parallel Imports", in Christopher Heath, *Parallel Imports In Asia,* Max Plank Series on Asian Intellectual Property Law, Vol. 9, Kluwer Law International, Netherlands, (2004),p.6.

[703] Pierre Régibeau and Katharine Rockett, "The Relationship Between Intellectual Property Law and Competition Law: An Economic Approach", University of Essex and CEPR, Revised, [2004], p.8, available at https://pdfs.semanticscholar.org/30e4/ca11a16b4161df4356697b855e9999f8d122.pdf (accessed on 5/12/2018).

[704] Pierre Régibeau and Katharine Rockett, "The Relationship Between Intellectual Property Law and Competition Law: An Economic Approach", University of Essex and CEPR, Revised, [2004], p.2, available at https://pdfs.semanticscholar.org/30e4/ca11a16b4161df4356697b855e9999f8d122.pdf (accessed on 5/12/2018).

soon as the property is created, while competition law may intervene much later, only when the property right has become a source of market power.[705] It is often believed that certain monopoly power is needed for intellectual property to be effective. But the same can lead to certain inefficiencies such as improper allocation of resources. The role of the competition law is to set at right such misallocation/improper allocation. On the other hand, even when competition leads to efficient allocation of resources, it can lead to reduced incentive to the IP holder. Therefore, a balance needs to be struck between IP and competition to ensure the maximum efficiency.

Intellectual property rights are granted i) to incentivizeinnovation; ii) to encourage disclosure; iii) to promote commercialization of technology through licensing; and iv) to increase dynamic efficiency.[706] At the same time, the primary goals of competition law are :i) to promote enhancement of efficiency in the market; ii) to promote consumer welfare; iii) to avoid conglomeration of economic power; and iv) to protect smaller firms from anti-competitive agreements.[707] It may appear that there is an apparent conflict between the objectives of IP and competition laws.[708] It may not be necessarily so. There exists a possibility of balancing these apparently conflicting interests and maximum economic efficiency can be ensured if the right balance is struck between the two. While striking a balance, care should be taken not to forget the common goal of consumer welfare, which both these systems look forward to achieve. While the IP system aims to achieve this goal through providing access to IP goods as a *quid pro quo* to the incentive provided by IP, competition law brings in price competition and furthers access and affordability to the consumers.

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[705] Pierre Régibeau and Katharine Rockett, "The Relationship Between Intellectual Property Law and Competition Law: An Economic Approach", University of Essex and CEPR, Revised, [2004], p.25, available at https://pdfs.semanticscholar.org/30e4/ca11a16b4161df4356697b855e9999f8d122.pdf (accessed on 5/12/2018).

[706] Abir Roy and Jayant Kumar, *Competition Law in India*, Eastern Law House, Kolkota, (1st Edition, 2008), p.170.

[707] SalilArora, *Does Commercial Exploitation of Intellectual Property Rights Inherently Result in Anti-Competitive Practices?*, Research Paper submitted to the Competition Commission of India, 2012, p.8, available at http://citeseerx.ist.psu.edu/viewdoc/download;jsessionid=2F1A4EC50229C1A33CBF4345E43F2DAF?doi=10.1.1.467.9183&rep=rep1&type=pdf , (accessed on 5/12/2018).

[708] Gesner Oliveira and Thomas Fujiwara, "Intellectual Property And Competition As Complementary Policies: A Test Using An Ordered probit Model" , p.3, available at http://www.Wipo.Int/Export/Sites/Www/Ipcompetition/En/Studies/Study_Ip_Competition_Oliveira.Pdf, (accessed on 5/12/2018).

4.4.2. The Concept of Economic efficiency

Both competition and intellectual property aims at enhancing consumer welfare through strengthening increasing the total economic efficiency of the market. The total economic efficiency is said to be the sum total of static and dynamic efficiencies.[709] Static and dynamic efficiency are two dimensions of an efficiency goal.[710] Static efficiency leads to efficient market mechanism which in turn results in efficient allocation of resources, while dynamic efficiency increases the overall welfare through innovation in the market.[711] Static efficiency is attained when consumers and producers make their decisions, taking into account the true opportunity cost of the resources involved.[712] Dynamic efficiency, on the other hand, relates to any kind of investment decision. While it clearly covers the development of improved machines, products or methods of production – e.g.,by way of research & development – it also includes the creation of physical assets.[713]

Dynamic efficiency in promotes consumer welfare through introduction of new products or processes which is a result of innovation. Dynamic efficiency promotes competition from the new commodity from the new supplies.[714] It is considered that innovation drives competition, which ultimately leads to the bringing in of new products and in long run to bringing down

[709] Josef Drexl, "Is there a 'more economic approach' to intellectual property and competition law?" , in Josef Drexl *Research Handbook on Intellectual Property and Competition Law*, Edward Elgar Publishing Limited, United Kingdom, (2008), pp.27-53.

[710] Olav Kolstad, "Competition Law and Intellectual Property Rights – Outline of an Economics-Based Approach", in *Research Handbook on Intellectual Property and Competition Law*, Edited by Josef Drexl, Edward Elgar Publishing Limited, United Kingdom, (2008), p.5.

[711] Sumanjeet Singh, "Intellectual Property Rights and Their Interface with Competition Policy: In Balance or in Conflict?", (Paper presented at Communication Policy Research South Conference (CPRsouth5), Xi'an, China, December 6th-8th, 2010), available at SSRN: https://ssrn.com/abstract=1724463 or http://dx.doi.org/10.2139/ssrn.1724463, (accessed on 20/12/2018).

[712] Pierre Régibeau and Katharine Rockett, "The Relationship Between Intellectual Property Law and Competition Law: An Economic Approach", University of Essex and CEPR, Revised, [2004], p.5, available at https://pdfs.semanticscholar.org/30e4/ca11a16b4161df4356697b855e9999f8d122.pdf (accessed on 5/12/2018).

[713] Pierre Régibeau and Katharine Rockett, "The Relationship Between Intellectual Property Law and Competition Law: An Economic Approach", University of Essex and CEPR, Revised, [2004], p.6, available at https://pdfs.semanticscholar.org/30e4/ca11a16b4161df4356697b855e9999f8d122.pdf (accessed on 5/12/2018).

[714] Joseph A.Schumpeter, *Capitalism, Socialism and Democracy,* Taylor & Francis e-Library, United Kingdom, (2003), p.33, available at https://eet.pixelonline.org/files/etranslation/original/Schumpeter,%20Capitalism,%20Socialism%20and%20Democracy.pdf, (accessed on 21/12/2018).

prices.[715] However, when it stresses on innovation, the price competition may be kept in abeyance.[716] While Dynamic efficiency is promoted through monopolistic practices like intellectual property, it may also result in decrease in allocative efficiency. This can reduce the consumer welfare as it can hamper the consumer access to product.[717]The developmental role of dynamic efficiency greatly owes to Schumpeter. He is of the view that dynamic efficiency foregoes perfect competition as perfect competition reduces the profit of the IP holder and thus reduces innovation.

However the proponents of competition are of the view that competition also can bring in innovation due to the pressure of the large number of market players.[718] Further, the producers will also be compelled to cut down the prices of the products and to cater to more consumers for profit making. It is, therefore, argued that competition as the driving force of the market mechanism furthers both static and dynamic efficiency.[719] But it is a fact that competition need

[715] J. Gregory Sidak and David J. Teece, "Dynamic Competition in Anti Trust Law", Journal of Competition Law & Economics, [2009], Vol. 5(4), p.600, available at https://www.criterioneconomics.com/docs/dynamic-comp1.pdf, (accessed on 5/12/2018).

[716] J. Gregory Sidak and David J. Teece, "Dynamic Competition in Anti Trust Law", Journal of Competition Law & Economics, (2009), Vol. 5(4), p.600, available at https://www.criterioneconomics.com/docs/dynamic-comp1.pdf, (accessed on 5/12/2018).

[717] Schumpeter admits that monopoly prices might lead to higher price and lower output in the market. See Joseph A.Schumpeter, *Capitalism, Socialism and Democracy,* Taylor & Francis e-Library, United Kingdom, (2003), pp.100-102, available at https://eet.pixelonline.org/files/etranslation/original/Schumpeter,%20Capitalism,%20Socialism%20and%20Democracy.pdf, (accessed on 21/12/2018).However he explains that the profits reaped will tide over the exceptional unfavorable situations. See Joseph Schumpeter admits that monopoly prices might lead to higher price and lower output in the market. See Joseph A. Schumpeter, *Capitalism, Socialism and Democracy,* Taylor & Francis e-Library, United Kingdom, (2003), p.90, available at https://eet.pixelonline.org/files/etranslation/original/Schumpeter,%20Capitalism,%20Socialism%20and%20Democracy.pdf, (accessed on 21/12/2018).

[718] As stated by U.S. Federal Trade Commission: "Competition can stimulate innovation. Competition among firms can spur the invention of new or better products or more efficient processes. Firms may race to be the first to market an innovative technology. Companies may invent lower cost manufacturing processes, thereby increasing their profits and enhancing their ability to compete. Competition can prompt firms to identify consumers' unmet needs and develop new products or services to satisfy them." See *To Promote Innovation: The Proper Balance of Competition and Patent Law and Policy : A Report by the Federal Trade Commission*, Federal Trade Commission, October, 2003, p.1, available at https://www.ftc.gov/sites/default/files/documents/reports/promote-innovation-proper-balance-competition-and-patent-law-and-policy/innovationrpt.pdf, (accessed on 5/12/2018).

[719] Olav Kolstad, "Competition law and intellectual property rights – outline of an economics-based approach", in

not necessarily maximise both static and dynamic efficiencies.[720] Competition can stimulate innovation only in a small scale as the competitive market system itself limits the capital available for innovation for the firms. Competition, apart from the allocative and dynamic efficiency, can also be an important source of productive efficiency.[721]

The key issue is not to maximise the static or dynamic efficiency, but to maximise the sum total of both static and dynamic efficiency. In other words, it means that there must be a balance between static and dynamic efficiency in any market system. If dynamic efficiency alone is promoted innovation will prominently be promoted and if static efficiency alone is promoted, allocative efficiency will be predominantly promoted.[722] Therefore, what should be furthered is the balance between both.[723] Thus the sole objective of IP is not just bringing in dynamic efficiency alone but to ultimately ensure consumer welfare.[724] Therefore a common ground which maximises both static and dynamic efficiency in a balanced manner must be figured out, especially in the context of intellectual property system. It is at this juncture the theory of complementarity gets importance.

Josef Drexl, *Research Handbook on Intellectual Property and Competition Law*, Edward Elgar Publishing Limited, United Kingdom, (2008), p.5.

[720] Olav Kolstad, "Competition law and intellectual property rights – outline of an economics-based approach", in Josef Drexl, *Research Handbook on Intellectual Property and Competition Law*, Edward Elgar Publishing Limited, United Kingdom, (2008), p.5.

[721] Gesner Oliveira and Thomas Fujiwara, "Intellectual Property and Competition as Complementary Policies: A Test Using An Ordered probit Model" , p.2, available at http://www.Wipo.Int/Export/Sites/Www/Ipcompetition/En/Studies/Study_Ip_Competition_Oliveira.Pdf, (accessed on 5/12/2018).

[722] Olav Kolstad, "Competition law and intellectual property rights – outline of an economics-based approach", in Josef Drexl, *Research Handbook on Intellectual Property and Competition Law*, Edward Elgar Publishing Limited, United Kingdom, (2008), pp.5-8.

[723] Gesner Oliveira and Thomas Fujiwara, "Intellectual Property and Competition as Complementary Policies: A Test Using An Ordered probit Model" , p.2, http://www.Wipo.Int/Export/Sites/Www/Ipcompetition/En/Studies/Study_Ip_Competition_Oliveira.Pdf, (accessed on 5/12/2018). Also see Olav Kolstad, "Competition law and intellectual property rights – outline of an economics-based approach", in Josef Drexl, *Research Handbook on Intellectual Property and Competition Law*, Edward Elgar Publishing Limited, United Kingdom, (2008), p.5.

[724] *To Promote Innovation: The Proper Balance of Competition and Patent Law and Policy : A Report by the Federal Trade Commission*, Federal Trade Commission, October 2003, available at https://www.ftc.gov/sites/default/files/documents/reports/promote-innovation-proper-balance-competition-and-patent-law-and-policy/innovationrpt.pdf, (accessed on 5/12/2018).

4.4.3. The Theory of Complementarity

The major proponents of the theory are Joseph Drexl and Olav Kostad[725]and they basetheir arguments on the jurisprudence evolved by the European Commission harmonising the principles of competition with the interests of the intellectual property right holders and the requirements of innovation.[726] The theorypropounds that both competition and intellectual property have the common goal of promoting consumer welfare and ensuring efficient allocation of resources.[727] As stated earlier, promoting innovation and ensuring access to products in an affordable manner is the aim of an efficient market system as well as that of the intellectual property regime. This balance is advocated by theory of complementarity through harmonising the objectives of both intellectual property and competition, taking in to consideration the necessity of both the systems to work parallelly.[728] Hence, a system of innovation can only be expected to work if both IPRs maintain incentives to innovate by preventing free-riding and competition law safeguards competitive pressure.[729] Theory of complementarity stresses that

[725] Olav Kolstad, "Competition law and intellectual property rights – outline of an economics-based approach", in Josef Drexl, *Research Handbook on Intellectual Property and Competition Law*, Edward Elgar Publishing Limited, United Kingdom, (2008), Josef Drexl, "Innovation as a Parameter of Competition and its Implications for Competition Law Application", (Paper Presented at Max Plank Institute of Competition on 11th ASCOLA Conference 2016: "The Role(s) of Innovation in Competition Analysis" 30 June-2 July 2016), Josef Drexl, "Is there a 'more economic approach' to intellectual property and competition law?" , in Josef Drexl*Research Handbook on Intellectual Property and Competition Law*, Edward Elgar Publishing Limited, United Kingdom, (2008)

[726] European Commission, Communication from the Commission — Guidelines on the application of Article 101 of the Treaty on the Functioning of the European Union to technology transfer agreements, [2014] OJ C 89/3, para. 7 states: "The fact that intellectual property laws grant exclusive rights of exploitation does not imply that intellectual property rights are immune from competition law intervention. Article 101 of the Treaty is in particular applicable to agreements whereby the holder licenses another undertaking to exploit its intellectual property rights. Nor does it imply that there is an inherent conflict between intellectual property rights and the Union competition rules. Indeed, both bodies of law share the same basic objective of promoting consumer welfare and an efficient allocation of resources. Innovation constitutes an essential and dynamic component of an open and competitive market economy. Intellectual property rights promote dynamic competition by encouraging undertakings to invest in developing new or improved products and processes. So does competition by putting pressure on undertakings to innovate. Therefore, both intellectual property rights and competition are necessary to promote innovation and ensure a competitive exploitation thereof."

[727] European Commission, Communication from the Commission — Guidelines on the application of Article 101 of the Treaty on the Functioning of the European Union to technology transfer agreements, [2014] OJ C 89/3, para. 7.

[728] Josef Drexl, "Innovation as a Parameter of Competition and its Implications for Competition Law Application", (Paper Presented at Max Plank Institute of Competition on 11th ASCOLA Conference 2016: "The Role(s) of Innovation in Competition Analysis" 30 June-2 July 2016), p.15. Also see : European Commission, Communication from the Commission — Guidelines on the application of Article 101 of the Treaty on the Functioning of the European Union to technology transfer agreements, [2014] OJ C 89/3, para. 7.

[729] Josef Drexl, "Innovation as a Parameter of Competition and its Implications for Competition Law Application",

competitive process which leads to innovation should be protected.[730]The emphasis of the analysis of complementarity should be on the given market situation and factors that induce firms to be innovative.[731] This is the balance that theory of complementarity tries to achieve. The balance to be found between competition and IPR is by protecting the incentive to innovate for the IPR holder on one hand and ensuring access and affordability of the product to the consumer on the other. What IP does is to balance the loss in price competition with the positives of dynamic efficiency. But IP need not bring in static competition. The rationale behind the intellectual property protection should be to strike a balance between static and dynamic efficiency.[732] It is generally felt that intellectual property protection can bring about innovation and thereby ensure a better life and consumer welfare. However, it may also lead to market power. IPRs designate boundaries within which competitors may exercise legal exclusivity over their innovation using its monopolistic power. In principle, it can create market power by limiting static competition and thus promoting investments in innovation.[733] Absolute monopoly may lead to dynamic efficiency but it is not a necessary condition as such. The notion that 'large' market share is necessary for innovation to take place[734] cannot be completely accepted as innovation can also happen in competitive market[735] or can also take place through small

(Paper Presented at Max Plank Institute of Competition on 11th ASCOLA Conference 2016: "The Role(s) of Innovation in Competition Analysis" 30 June-2 July 2016), p.15. Also see : European Commission, Communication from the Commission — Guidelines on the application of Article 101 of the Treaty on the Functioning of the European Union to technology transfer agreements, [2014] OJ C 89/3, para. 7.

[730] Olav Kolstad, "Competition law and intellectual property rights – outline of an economics-based approach", in Josef Drexl, *Research Handbook on Intellectual Property and Competition Law*, Edward Elgar Publishing Limited, United Kingdom, (2008), pp.7-8.

[731] Josef Drexl, "Is there a 'more economic approach' to intellectual property and competition law?" , in Josef Drexl*Research Handbook on Intellectual Property and Competition Law*, Edward Elgar Publishing Limited, United Kingdom, (2008), pp.27-53.

[732] Olav Kolstad, "Competition law and intellectual property rights – outline of an economics-based approach", in Josef Drexl, *Research Handbook on Intellectual Property and Competition Law*, Edward Elgar Publishing Limited, United Kingdom, (2008), p.7.

[733] Olav Kolstad, "Competition law and intellectual property rights – outline of an economics-based approach", in Josef Drexl, *Research Handbook on Intellectual Property and Competition Law*, Edward Elgar Publishing Limited, United Kingdom, (2008), p.7.

[734] Joseph A.Schumpeter, *Capitalism, Socialism and Democracy,* Taylor & Francis e-Library, United Kingdom, (2003), pp.100-102, available at https://eet.pixelonline.org/files/etranslation/original/Schumpeter,%20Capitalism,%20Socialism%20and%20Democracy.pdf, (accessed on 21/12/2018).

[735] J. Gregory Sidak and David J. Teece, "Dynamic Competition in Anti Trust Law, Journal of Competition Law &

firms.[736] The aim of IP is not merely to provide market exclusivity but also to promote dissemination of knowledge and to provide access to the products of creativity to the public, ultimately bringing in consumer welfare.

IP, being a monopoly, is driven by profit motive. This negative part of IP can be rectified through parallel imports as parallel imports can add a competition dimension to the IP framework. The above propositions have a significant effect on economy in the context of parallel imports. It is admitted that parallel imports may not bring in perfect competition as there are no multiple players who produce similar goods. It is merely the products of the producer (IP holder) himself, sold at a lower price elsewhere that competes with the IP holder's product in another market. This does not dull the incentive to the IP holder as in the case of a perfect competition.[737] Therefore parallel imports act as a balancing mechanism between static and dynamic efficiency. As it is the once rewarded product of the producer himself that comes into the secondary market, it does not unreasonably hamper the profits of the producer. Moreover, it can bring in allocative efficiency which improves access to consumers. Parallel imports, thus, merely distribute the products of the IP holder in a more efficient way.

Parallel imports can also facilitate intra brand competition as it brings in the same products of the IP holder from a cheaper market to a high priced market, due to the price differences in the product in those markets. Thus parallel imports induce the manufacturer to reduce the price of his products and also to increase the production since the presence of parallel imports can increase the market size. Since parallel importer does not significantly affect the profit of the IP

Economics, [2009], Vol. 5(4), p.597, available at https://www.criterioneconomics.com/docs/dynamic-comp1.pdf, (accessed on 5/12/2018).

[736] This fact was once acknowledged by Schumpeter himself in his early work Joseph A. Schumpeter, *Theory of Economic Development : An Enquiry Into Profits, Capital*, *Credit, Interest, and Business Cycle*, Trans. Redvers Opie, available at https://mail.google.com/mail/u/0/?tab=rm#search/sheethalms999%40gmail.com/FMfcgxwBVMjZmrpsNJwqzfbNTTBgVDnC?projector=1&messagePartId=0.1. This opinion was later changed as to downplay small firms from the purview of innovation in the Joseph A. Schumpeter, *Capitalism, Socialism and Democracy*.

[737] Even Schumpeter was not against competition but was against perfect competition. The dynamic efficiency in Schumpeter's' perspective will bring about competition even in price n the long run and he was totally against perfect competition as it might hinder the innovations., see Joseph A.Schumpeter, *Capitalism, Socialism and Democracy,* Taylor & Francis e-Library, United Kingdom, (2003), pp.103-107, available at https://eet.pixelonline.org/files/etranslation/original/Schumpeter,%20Capitalism,%20Socialism%20and%20Democracy.pdf, (accessed on 21/12/2018).

holder, as we have already seen, it strikes a proper balance by enhancing consumer welfare without adversely affecting the IP holder. Since the objective of a balanced IP regime is to provide limited monopoly to IP holder by providing him an incentive for retaining his creative efforts while facilitating consumer welfare, parallel imports has to be promoted. Thus, even if it is admitted that the parallel imports does not induce dynamic efficiency, it certainly does bring in static efficiency, much needed for the IP system to be effective, and thus furthers the theory of complementarity.

4.4.4. International Exhaustion as a tool to counter anti-competitive practices

Exhaustion is an inbuilt tool in the IP system to limit the over exploitation of IP rights and to restrain the IP holder from abusing the rights conferred. The abuse of IP rights can occur in different forms and the normal anti-trust principles are equally applicable in cases of abuses of IP rights as well. Generally two kinds of competition exist between products in a market: inter-brand[738] and intra-band[739]. Restriction on these forms of competition amounts to abuse of IP rights and can hamper consumer welfare. Exhaustion doctrine in intellectual property law restrains firms from preventing competition among different sellers of the same product under the same brand. Thus, it restrains firms from restraining intra-band competition.[740] Restraint on intra-band competition can occur in the IP context mainly in two ways; one is through limiting the scope of exhaustion to a national or regional level, and the other is through restrictive agreements forced upon the consumers by IP holders. International exhaustion is the only form of exhaustion which can overcome the restraint on intra-brand competition.

[738] Inter Band competition refers to the competition between suppliers or dealers selling brands of the same or equivalent goods; for example when manufacture A (producing brand A washing powder) faces competition from manufacture B (producing brand B washing powder), brands A and B will be competing each other, in retail outlets owned by retailers X, Y, Z.

[739] Intra-brand competition is the competition between different retailers selling the same brand;An excellent example for intra-band competition is parallel imports.

[740] Eleanor M.Fox, "Parallel Imports, The Intraband/Inter brand Competition Paradigm, and the Hidden Gap Between Intellectual Property Law and Antitrust", Fordham International Law Journal, [2001], Vol. 25, Issue 4 Article 5, p.1, available at https://ir.lawnet.fordham.edu/cgi/viewcontent.cgi?article=1841&context=ilj, (accessed on 6/12/2018).

Intra-band competition also has a role in facilitating free trade. Competition between intra-band products has a close connection with free movement of goods. Competition generally occurs in a market where there are multiple players distributing the same or substitute products to the consumers. This can be enhanced when there is free movement of goods across the nations. One among the positive aspects of free trade is that it can facilitate competition across the globe. When it comes to parallel imports it is the foreign goods of the IP holder himself that is competing with the domestic goods of the IP holder. Since a ban on parallel imports eliminates intra-band competition it works against the principles of free trade.[741] In other words, national or regional exhaustion leads to segmentation of markets, prohibiting free trade and stifling competition. When a country follows national or regional exhaustion, it practically results in territorial restriction of IP goods. If the aim of the WTO framework, built on the philosophy of free trade is to create a common global market, the form of exhaustion which logically supports it would be international exhaustion. When a genuine product is prohibited from entering into a market, this amounts to segmentation of markets rather than market integration and therefore cannot be encouraged in the free trade regime.[742]

Intra band competition could be blocked even by using territorial restrictions placed on the transfer of such goods by IP holders. These restrictions are often anti-competitive as they restrict intra-band competition.[743] They are often called vertical restraints.[744] Therefore it is necessary to treat the vertical restraints placed by IP holders to prohibit parallel imports from another country as anti-competitive. Various methods such as territorial restrictions, resale price maintenance, refusal to deal, determining prices of objects etc., are used by the IP holder for prohibiting parallel imports. They also create trade barriers between nations.[745] The sanctity of these

[741] Nancy T Gallini and Aidan Hollis, "A Contractual Approach to the Grey Market", Institute for Policy Analysis, University of Toronto, [1996], p.2, available at http://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.200.4827&rep=rep1&type=pdf, (accessed on 6/12/2018).

[742] *ConstenSaRL and Grundig GmbH* v. *Commission*, (1966), Case 56/64, [1966] ECR 299.

[743] Kerin M. Vautier, "Economic Considerations on Parallel Imports", in Christopher Heath, *Parallel Imports In Asia,* Max Plank Series on Asian Intellectual Property Law, Vol. 9, Kluwer Law International, Netherlands, (2004),p.6.

[744] Kerin M. Vautier, "Economic Considerations on Parallel Imports", in Christopher Heath, *Parallel Imports In Asia,* Max Plank Series on Asian Intellectual Property Law, Vol. 9, Kluwer Law International, Netherlands, (2004),p.5.

[745] Kathy Y Lee, *The WTO Dispute Settlement and Anti-Competitive Practices: Lessons Learnt From Trade Disputes*, Working Paper (L) 10/05 , The University of Oxford Centre for Competition Law and Policy, p.4, available at https://www.law.ox.ac.uk/sites/files/oxlaw/cclp_l_10-05.pdf, (accessed on 6/12/2018).

agreements should be analysed from the perspective of competition principles. The broader question to be addressed here is whether intellectual property owners are restricting the proprietary rights of the consumers by using post sale contracts which can hamper competition, in the guise of exercising their IP rights. Do such restrictions placed by the IP owners' amount to abuse of dominant position? The author takes the view that it does.

Therefore, it is necessary to properly appreciate the concept of abuse of dominant position so as to apply the same to the cases of exhaustion of intellectual property rights. When an IP holder uses his IP rights for market segmentation, what happens in effect is abuse of IP rights and abuse of dominant position.[746] A Position of economic strength enjoyed by an undertaking, which bestows it with the power to behave independently of its competitors and thereby enables it to prevent effective competition in the relevant market, itis called a dominant position.[747] When such a dominant position is actually used by an undertaking to prevent fair competition, it amounts to abuse of that position. For example, in *United Brands v. Commission*,[748] a restriction was placed upon reselling bananas. The commission held that the restriction amounted to export ban, and therefore anti-competitive. Therefore restriction on reselling capacity of a consumer can amount to anti-competitive practice in the general sense. Restricting the right of a purchaser of an IP good to resell the same, which is a property right attained by him, using IP rights must certainly be covered under abuse of his dominant position conferred to him by the IP protection. IP protection is a restricted monopoly granted to the IP holder to encourage further creativity. Using this restricted right, instead, as a leverage to invade the genuine property rights of the consumer or any person who lawfully purchased the product from the IP holder leads to an acute stage of abuse of dominancesince the IP holder has already received his share of reward from selling the product.[749] Thus such restrictive practices are anti-competitive and this argument can be substantiated by the case laws of both EU and U.S.

When we analyse the case laws on vertical restrictions placed by the IP holders from U.S. and E.U. jurisdictions it could be observed that European courts downplays these vertical restraints

[746] *Deutsche GrammophonGesellschaftmbH*v. *Metro-SB-Großmärkte GmbH & Co. KG,* [1971] ECR 487.
[747] *United Brands* v. *Commission of European Communities* , Case27/76 ,[1978] ECR 173.
[748] *United Brands* v. *Commission of European Communities*, Case27/76, [1978] ECR 173.
[749] *Astra Zeneca*, Dec 2006/857/EC, [2006] OJ L332/24.

based on the effect of market segmentation whereas the U.S. courts relies more on the anti-competitive effect of these agreements on the consumers as well as the market. However, the common approach underlying the decisions from both these jurisdictions is that such restrictions adversely affect intra-band competition and consumer welfare through non-recognition of international exhaustion.

4.4.4.1 The EU approach to parallel imports within the Union in the context of free trade and competition vis-à-vis and consumer welfare:

European Union was created so as to have an integrated market within Europe where goods flow across frontiers without any hindrances. This was also for encouraging competition in the European markets. Therefore, the EU competition principles directly declare certain mode of agreements as *per se* illegal. Article 101 of TFEU, for example, prohibits certain types of agreements which are trade restrictive or anti-competitive as incompatible with the internalmarket.[750] This means that any agreement which affects, distorts or restricts trade between nations inside EU is anti-competitive. Therefore whether restriction on parallel imports through contractual restrictions amounts to anti-competitive agreement is what needs to be analysed. In order to determine whether certain restrictions have anti-competitive effect, the primary analysis to be done is to check whether such restrictions partition the common market of Europe affecting free trade among member states.[751] If the answer is negative, the next question

[750] Art. 101 of TFEU, 2007: 1. The following shall be prohibited as incompatible with the internalmarket: all agreements between undertakings, decisions by associations of undertakings and concerted practices which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the internalmarket, and in particular those which: (a) directly or indirectly fix purchase or selling prices or any other trading conditions; (b) limit or control production, markets, technical development, or investment; (c) share markets or sources of supply; (d) apply dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage; (e) make the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.

[751] Art.101 of TFEU, 2007. Also see ; Dmitry A. Kuptsov, "Parallel Trade in the European Union: Competition Law Aspects", (Master Thesis , Faculty of Law, Lund University , 2013), p.20, http://lup.lub.lu.se/luur/download?func=downloadFile&recordOId=3806275&fileOId=3806277, (accessed on 6/12/2018).

to be addressed is whether the object of the restriction is to stifle competition in some way or the other.[752]

In *Consten&Grundig v. Commission of European Communities*[753], among the various issues addressed by the court two main issues relevant for our analysis are whether ban on parallel imports amount to market segmentation and whether prohibition of intra-band competition hamper general competition policy, amounting to anti-competitive behaviour. Court opined that the restriction of intra-band competition through vertical restraints such as territorial restriction or sole distributorship agreements hampers competition.[754]The court further stated that such agreements partitioned the market by creating trade barriers, which is against the spirit of an integrated market.[755] The court went on to say that even if it is proven that there is an increase in the amount of trade between nations due to the vertical restrictions placed, this does not mean that there is no restraint on freedom of trade and competition and thus affecting the trade between the nations in a bad way.[756] The court categorically stated that there is no need to take in to account the concrete effects of an agreement, once it appears that it has as its object theprevention, restriction or distortion of competition.[757] The court found that the agreement was very restrictive since it imposed ban on exporting of those trademark products other than by the sole proprietor himself. This protection was in addition to the trademark protection that is already granted to the mark and restrains any third party from parallel importing.[758] The court reiterated the ill effects of such anti-competitive agreements which give opportunities to charge

[752] Art.101 of TFEU, 2007. Also see; Dmitry A. Kuptsov, "Parallel Trade in the European Union: Competition Law Aspects", (Master Thesis , Faculty of Law, Lund University , 2013), p.20, http://lup.lub.lu.se/luur/download?func=downloadFile&recordOId=3806275&fileOId=3806277, (accessed on 6/12/2018).

[753] (1966) Case 56/64, [1966]ECR 299.Consten was granted exclusive license to sell products of Grundig in France and was also restricted through agreement not to export any products to any other territory and assured Consten that no other exclusive dealers of Grundig in other nations would enter or import into France so as to compete with Consten. However, goods were parallel traded by the into France and thus Consten sued the parallel importer. The European Commission ruled that the agreement between Grundig and Consten were anti-competitive. Thus plaintiffs went for appeal before the ECJ.

[754] *Consten&Grundig*v. *Commission of European Communities*, (1966) Case 56/64, [1966] ECR 299.

[755] *Consten&Grundig*v. *Commission of European Communities*, (1966) Case 56/64, [1966]ECR 299.

[756] *Consten&Grundig*v. *Commission of European Communities*, (1966) Case 56/64, [1966]ECR 299.

[757] *Consten&Grundig*v. *Commission of European Communities*, (1966) Case 56/64, [1966]ECR 299.

[758] *Consten&Grundig v. Commission of European Communities*, (1966) Case 56/64, [1966]ECR 299.

different prices for the same products in different countries, as a result of the protection they enjoy from competition and the consequential isolation of markets.[759]

In *Deutsche GrammophonGesellschaftmbH v Metro-SB-Großmärkte GmbH & Co. KG*.,[760] even while acknowledging regional exhaustion, the ECJ stressed the point that IP owners cannot be granted rights to prohibit the resale of a product which was once sold in any member state of the European community, as it will amount to segmentation of markets and will be against the spirit of single market.[761]

One of the common methods used to counter parallel imports is the exclusive dealing arrangements. The exclusive dealing arrangements compelled the distributors not to sell the goods outside a particular territory. In *Hasselblad case*,[762] the Competition Commission of Europe held that any agreement to restrict parallel trade is anti-competitive. The agreement between the sole distributor and the manufacturer was to protect sole distributors from imports, which were mainly parallel imports. The commission held that the practice amounted to concerted price practice.[763]It was held that the agreement was entered so as to prevent parallel

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[759] *Consten & Grundig* v. *Commission of European Communities*, (1966) Case 56/64, [1966]ECR 299. "The situation as ascertained above results in the isolation of the French market and makes it possible to charge for the products in question prices which are sheltered from all effective competition. In addition, the more producers succeed in their efforts to render their own makes of product individually distinct in the eyes of the consumer, the more the effectiveness of competition between producers tends to diminish. Because of the considerable impact of distribution costs on the aggregate cost price, it seems important that competition between dealers should also be stimulated. The efforts of the dealer are stimulated by competition between distributors of products of the same make. Since the agreement thus aims at isolating the French market for Grundig products and maintaining artificially, for products of a very well-known brand, separate national markets within the Community, it is therefore such as to distort competition in the Common Market."

[760] [1971] ECR 487. The company Deutsche Grammophone restricted its subsidiaries from selling outside the territory allotted to them. The defendants which was cut off from the distribution channel by Gramaphone, bought goods from another distributor who sold at a different price in another state and resold the same to consumers at a price different from that fixed by Gramaphone in Germany.

[761] *Deutsche GrammophonGesellschaftmbH*v. *Metro-SB-Großmärkte GmbH & Co. KG,*[1971] ECR 487.

[762] Hasselblad 82/367/EEC , { 1982} OJ L161/18.

[763] Under Art. 81 of the EC Treaty (Currently Article 101 of TFEU, 2007,) reads: The following shall be prohibited as incompatible with the common market: all agreements between undertakings, decisions by associations of undertakings and concerted practices which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the common market, and in particular those which:

(a) directly or indirectly fix purchase or selling prices or any other trading conditions;

imports and the consequential competition among the distributors of Hasselblad. This altered the natural market condition which would have resulted from the free movement of goods.[764] It also held that, the concerted practices such as those used in the case at hand, to counter parallel imports affected the free movement of goods within nations. The partitioning of markets, the court felt, had substantial effect on the prices at which the consumers receive the goods.[765] It concluded that any measures to restrict the access to products to consumers or curtail the freedom to resell, cause trade distortions and affect consumer welfare and free trade.[766]

Similarly, in *National Panasonic case*,[767]the Commission held that the agreement not to export their goods to any other markets amounted to anti-competitive practice.[768] The commission was

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(b) limit or control production, markets, technical development, or investment;
(c) share markets or sources of supply;
(d) apply dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;
(e) make the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.

1. Any agreements or decisions prohibited pursuant to this Article shall be automatically void.
2. The provisions of paragraph 1 may, however, be declared inapplicable in the case of:- any agreement or category of agreements between undertaking:

- any decision or category of decisions by associations of undertakings;

- any concerted practice or category of concerted practices,
which contributes to improving the production or distribution of goods or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit, and which does not:
(a) impose on the undertakings concerned restrictions which are not indispensable to the attainment of these objectives;
(b) afford such undertakings the possibility of eliminating competition in respect of a substantial part of the products in question. Also see ;Dec 82/367 Hasselblad { 1982} OJ L161/18.

[764] Hasselblad 82/367/EEC , { 1982} OJ L161/18.

[765] Hasselblad 82/367/EEC , { 1982} OJ L161/18.

[766] Hasselblad 82/367/EEC , { 1982} OJ L161/18.

[767] National Panasonic, 82/853/EEC, [1982] OJ L 354/28. The National Panasonic imposed export prohibition on on exclusive dealers which was challenged before the commission.

[768] Similar decisions were held in Johnson and Johnson [1980] OJ L 377/16, Viho/Toshiba, [1991] OJ L377/16. It was even held that even absolute territorial protection within a state can amount to anti-competitive behaviour, see *Pronuptia de Paris* v.*Pronuptia de Paris IrmgardSchillgallis*[1986] ECR 353. Also see ; Christopher Stothers, *Parallel Trade in Europe: Intellectual Property, Competition and Regulatory Law*, HART Publishing, Oxfod and Portland, Oregon, (2007).

concerned about the anti-competitive effect of the agreement such as isolation of markets leading to market segmentation.

The extent to which the rights of an IP holder can be extended was examined in the case Centrafarm BV and Others v Sterling Drug.[769] Sterling argued that for the protection of IP free movement of goods can be restricted. The court held that the derogations from the free movement of goods principles in the name of IP should be just for protecting the rights of the patentee which constitute the specific subject matter of the property. The specific subject matter of the property , as ECJ defined is"the guarantee that the patentee, to reward the creative effort of the invention, has the exclusive right to use an invention with a view to manufacturing industrial products and putting them into circulation for the first time, either directly or by grant of licenses to third parties, as well as to oppose infringements." The ECJ further admitted that when it is maintained that the right is not exhausted even after putting the product in circulation in a nation it can create barriers to free movement of goods.[770] The court answered in negative the question whether a patent holder has the right to restrict the importation of products from another nation utilising the price differences that exist between nations due to many factors. It held that it was the duty of any state to protect competition in the market. According to the ECJ, the existence of price differences, or importations taking place due to the same, cannot be a ground for restricting free movement of goods.[771]In *Sandoz ProdottiSpA v. Commission*[772], also the agreement to prevent parallel trade was held to be anti-competitive.

In GlaxoSmithKline Services Unlimited, formerly GlaxoWellcomeplc v. Commission of the European Communities[773], the European court of Third Chamberaddressed the dual pricing scheme – the Glaxo fixed low prices for domestic market but high price for exported products – adopted by the Glaxo Smith Kline. It was observed by the court that the aim of the pricing mechanism was to make parallel imports less favorable to parallel importers. The European Commission initially observed that for a unified market of pharmaceutical products, free

[769] 1974, ECR 1147. The patent holder, Sterling Inc., prohibited resale of products by Centrafarm in Great Britain, which was acquired outside Britain.
[770] *Centrafarm BV and Others* v. *Sterling Drug*, 1974 ECR 1147.
[771] Centrafarm Bv and Others v. Sterling Drug, 1974 ECR 1147.
[772] [1990] ECR I- 45.
[773] [2006]ECR I-2969.

movement of pharma products across the borders was necessary and that the trade barriers created by restrictive agreements cannot be encouraged. In general, the court observed that the pricing scheme was anti-competitive. Any agreement to partition the integrated market was held to be anti-competitive. The court also stated that competition law, which aims at consumer welfare, cannot be expected to protect the commercial interests of the producer to such an extent enabling him to refuse to place the products in the market.[774] In Astra Zeneca case[775] also, the same position was taken as the restriction on parallel trade by Astra Zeneca was held to be anti-competitive on the ground that it amounted to abuse of dominant position.

In Sot.LéloskaiSia EE and Others v GlaxoSmithKline AEVE FarmakeftikonProïonton[776] the defendants Glaxo Smith Kline reduced its production of medicines so as to downplay parallel imports. The court held that refusal to meet the orders of existing customers by an undertaking occupying a dominant position in the market in the production of a given product constituted abuse of dominant position under Article 82 of EC treaty. Under this provision, such a conduct would have to be treated as one intended to eliminate a trading party as a competitor. Glaxo argued that parallel imports reduced the incentive of the IP holder to invest in R&D and that parallel imports do not benefit the consumers since the major profit is taken by the parallel importer. The court examined various stages of the process to have a proper understanding of the issue. The Court observed that if a purchaser or distributor orders a good, in the normal commercial practice the IP holder has the obligation to supply him, irrespective of any other objections raised.[777] Here, while delivering such a statement, the court was concerned regarding the accessibility issue of patent protected goods. The court held that parallel imports bring in some amount of welfare to the ultimate consumers as they receive the products at a lower price

[774] *GlaxoWellcomeplc* v. *Commission* **,**[2006]ECR I-2969.

[775] *Astra Zeneca*, Dec 2006/857/EC, [2006] OJ L332/24.

[776] Joined Cases C-468/06 to C-478/06, the defendants Glaxo Smith Kline was supplying medicines to the appellants, who were the distributors of Glaxo. Glaxo altered its distribution chain and reduced the production of the medicines and did not meet the necessary needs demanded by the distributors. The appellants challenged the reduction in production of medicines and the alteration of distribution chains as abuse of dominant position.

[777] *Sot.LéloskaiSia EE and Others* v. *GlaxoSmithKline AEVE FarmakeftikonProïonton*, Joined Cases C-468/06 to C-478/06, para 49 states; "an undertaking in a dominant position for the purpose of marketing a product – which cashes in on the reputation of a brand name known to and valued by consumers – cannot stop supplying a long-standing customer who abides by regular commercial practice, if the orders placed by that customer are in no way out of the ordinary." See also judgment *United Brands and United Brands Continentaal* v *Commission*

than the price in their own home market.[778] According to the court, the presence of parallel imports puts pressure on the IP holder or his licensee to lower the prices in an irrationally high priced market. The court further held that where a medicine is protected by a patent, the only form of competition which can be envisaged during the term of patent protection is the price competition existing between parallel traders and national distributors.[779] The court also observed that a total ban or a restriction on parallel imports would have the effect of partitioning the market, which might hinder the free movement of goods between nations.[780] Such actions, the court felt, would hamper competition in a very serious manner.[781]

Thus, it is clear that the judicial opinion in EU mandated exhaustion within EU as it facilitated competition and free trade within EU and thereby enhanced consumer welfare. However, the double standard of the EU becomes clear when they refuse to extend the same benefit, arising out of intra-band competition and parallel imports, to consumers at a global level. If the logic of the EU is applied to the global market situation in the free trade context, international exhaustion has to become the global norm.

4.4.4.2. Parallel imports and Competition: Judicial decisions from U.S.

The initial case laws which paved way for the development of the exhaustion doctrine were delivered based on the rule against restraint on alienation and freedom of trade. The freedom of trade was recognised by the courts since the restraints created anti-competitive effects in the market. In *Adams v. Burke*,[782] the court held that no restriction as to the place of sale or the use of the product sold could be prescribed by the IP holder as a condition upon a purchaser of an IP good, as the authorised first sale had already put an end to his rights granted by the congress, and the product had come out of the monopoly of the IP holder. Once the purchaser became the owner of the IP good he could not be restricted from any further use of the machine, including

[778] *Sot.LéloskaiSia EE and Others* v. *GlaxoSmithKline AEVE FarmakeftikonProïonton*, Joined Cases C-468/06 to C-478/06.
[779] *Sot.LéloskaiSia EE and Others* v. *GlaxoSmithKline AEVE FarmakeftikonProïonton*, Joined Cases C-468/06 to C-478/06.
[780] *Sot.LéloskaiSia EE and Others* v. *GlaxoSmithKline AEVE FarmakeftikonProïonton*, Joined Cases C-468/06 to C-478/06.
[781] *Sot.LéloskaiSia EE and Others* v. *GlaxoSmithKline AEVE FarmakeftikonProïonton*, Joined Cases C-468/06 to C-478/06.
[782] 84 U.S. 455 (1873).A coffin lid had a patent and was sold to a distributor with a territorial restriction.

the resale of it. Similarly, in *Keeler v. Standard Folding Bed Co*[783] the U.S. Supreme Court held that upon the purchase of the patented item, the buyer couldresell the product anywhere in the U.S. as it had passed outside the monopoly of the patent holder and restricting the same was anti-competitive. The court added that this prohibition on such restraints was universal, i.e., unrestricted in time and place.[784]*United States v. Univis Lens Co*. is another case in which the S.C. held that resale price maintenance by IP holder was anti- competitive since IP rights on the sold product ended upon first sale.

In *AnsulCo.v. Uniroyal*[785], it was held that a patent holder was not allowed to impose customer restrictions upon the purchasers of the patented product holding that such vertical restrictions were illegal per se as upon the first sale of the product the rights of the IP owner gets exhausted. In *Motion Picture Patents Co. v. Universal Film Mfg. Co*.,[786] also the court held that the practice of implementing user restrictive licenses by the Patent holder was on the increase and that the single unconditional sale exhausted the right of the patent owner to vend the product again and rendered the product free of every restriction. The court gave this judgment overruling the decision in *Henry v. A.B. Dick Co*.[787] which held that any reasonable restriction not inherently violative of law was valid, provided the purchaser had notice that he bought only a qualified right of use.[788] In *Straus v. Victor*, the court held that a notice attached to a sold patented product could not restrict the application of exhaustion. The court observed that the IP holder, upon leaving possession of the patented product, had secured the full price due to him and refused to treat the transaction as a license agreement.[789] The court disapproved the restraint placed through the license agreement and stated that such restraints placed on the purchaser by the IP holder in the guise of exercising IP rights were, in effect, harming public interest.[790]

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[783] 157 U.S. 659 (1895).
[784] 157 U.S. 659, 667 (1895).
[785] 306 F. Supp. 541.
[786] 243 U.S. 502 (1917).
[787] 224 U.S. 1 (1912).
[788] 224 U.S. 1 (1912).
[789] 243 U.S. 490, p.499.
[790] 243 U.S. 490., "Courts would be perversely blind if they failed to look through such an attempt as this 'License Notice' thus plainly is to sell property for a full price, and yet to place restraints upon its further alienation, such as

The court, in these cases, stressed that the rights granted by IP could not go beyond what is considered "reasonable" to protect them, and if it went beyond, anti-trust laws should intervene. The courts, thus, took a negative stand against post- sale restrictions. Therefore, it is clear from the above analysis of the initial case law in U.S. that the U.S. courts were initially against all post sale restraints on IP products. The anti-competitive effect of such extensions of the IP rights was the concern raised by the courts in all those cases.

However, in the Supreme Court decisions of *Kirtsaeng v. John Wiley & sons, Inc.*,[791] and Lexmark,[792] one could experience/feel the reversal of philosophy and a revisit to the original principle of international exhaustion, in pursuance of the objective of consumer and global welfare. In *Kirtsaeng v. John Wiley & sons, Inc.*, the court looked into the alleged infringement of copyright on importation of books published in Thailand by John Wiley into U.S. and its sale thereby Kirstaeng. Kirstaeng purchased these books in Thailand and thereafter resold it in the U.S. The court examined the impact of competition created in U.S. by this secondary market of low priced books and the extent to which the consumers were benefitted from the same. The court observed that the freedom to resell encouraged competition which was to the advantage of the consumers[793]and held that the anti-trust law and copyright law aims not to segment the markets.[794] Even in the dissenting opinion it was accepted that International exhaustion subjects copyright-protected works to competition from lower priced imports and to that extent benefits consumers.[795]

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have been hateful to the law from Lord Coke's day to ours, because obnoxious to the public interest. The scheme of distribution is not a system designed to secure to the plaintiff and to the public a reasonable use of its machines, within the grant of the patent laws, but is in substance and in fact a mere price- fixing enterprise, which, if given effect, would work great and widespread injustice to innocent purchasers, for it must be recognized that not one purchaser in many would read such a notice, and that not one in a much greater number, if he did read it, could understand its involved and intricate phraseology, which bears many evidences of being framed to conceal rather than to make clear its real meaning and purpose"

[791] 568 U.S. 519 (2013)**.**

[792] 581 U. S. 1523 (2017).

[793] 568 U.S. 519 (2013).

[794] 568 U.S. 519 (2013).

[795] 568 U.S. 519 (2013) of the dissent by Ginsburg. In the dissent however, the judge opined that the U.S. legislature favored national exhaustion in order to protect the industrial needs of profit making which would result in increased money for R&D and thus benefit U,S, in the long run,

In Impression Products, Inc. v.Lexmark Int'l, Inc.,[796] Lexmark sold printer cartridges using two distribution models: one mode was to sell certain cartridges at full price to the consumers without any restrictions attached on its reselling or use, and the other was to sell cartridges at a reduced price and to restrict the usage to a single use only. Lexmark sued Impressions for reselling the cartridges in the U.S. at a lower price after purchasing them from other markets or by importing used cartridges from other countries. The court addressed both the issues separately: regarding the issue of resale within U.S. of the cartridges sold by Lexmark within U.S., the court held that contractual restriction cannot be used to prevent resale, once the product has been sold. [797] It added that even when a patentee sells an item under an express restriction, he could not retain patent rights in that product.[798]The court quoting *Quanta* Computers[799] held that "authorized sale . . . took its products outside the scope of the patent monopoly" and could not be restricted through contracts.[800] It further explained that the doctrine of exhaustion is a check on the monopoly rights granted to the IP holder and the right to use sell, or import an item exists independently of the Patent Act and goes with the object when it is sold to the consumer.[801] According to the court, Patent exhaustion reflects the principle that when an item passes into commerce it should not be shaded by a legal cloud on title as it moves through the marketplace. Regarding the second issue of resale of imported goods also the court categorically supported international exhaustion relying on the common law rule of rule against restraint on alienation. The U.S. Supreme Court, thus, in Lexmark reverted to the old position of international exhaustion.

Thus, the U.S. courts too have started taking a firm position that banning parallel imports can be anti-competitive. The U.S. courts have based their philosophy on exhaustion on common law principle of rule against restraint on alienation so as to do away any restraint on trade and

[796] 581 U.S. 1523 (2017).

[797] 581 U. S. 1523 (2017), The single-use/no-resale restrictions in Lexmark's contracts with customers may have been clear and enforceable under contract law, but they do not entitle Lexmark to retain patent rights in an item that it has elected to sell.

[798] 581 U. S. 1523 (2017).

[799] *Quanta Computer, Inc*. v. *LG Electronics, Inc*., 553 U.S. 617.

[800]581 U.S. 1523 (2017).

[801] The court stated: "As a result, the sale transfers the right to use, sell, or import because those are the rights that come along with ownership, and the buyer is free and clear of an infringement lawsuit because there is no exclusionary right left to enforce." See; 581 U.S. 1523 (2017).

facilitate free trade. Therefore there are common elements in the conceptualization of exhaustion both in the EU and the U.S. decisions. Both the EU and the U.S. have started recognizing parallel imports and international exhaustion as the mandates of free trade.

4.5 Conclusion

The economic analysis of parallel imports makes it clear that the international exhaustion can be the only mode of exhaustion that can be welfare enhancing in the global scenario. The differential pricing mechanism adopted by the producers is to increase the profits of the producer and the welfare enhancement of the consumers is merely an effect of the differential pricing mechanism. We have also seen that the differential pricing mechanism is a necessary mechanism for the producers to create profit. Even if the parallel imports are admitted into the market, the producers will not stop from adopting the differential pricing mechanism. Uniform pricing, as explained in this chapter, is not a feasible solution in a global scale but a false threat from the producers as no concrete evidence exists as to the same and further depends on various other factors.[802] The ban on parallel imports merely will enable to maximise the profit rather than providing for any consumer welfare. The presence of parallel imports helps to provide access to goods at affordable prices. The producers do not incur any kind of loss in the market as the parallel imported products have received adequate reward for the production of that product. Further, the parallel imports increase the production of goods in a country as more consumers consume more goods. From the studies of different nations analysed above, it is clear that the studies have concluded that the presence of parallel imports only provides for consumer welfare and helps in decreasing the prices of the intellectual property goods. Economic efficiency of the economy is furthered by the parallel imports. The dynamic efficiency of the intellectual property system is not affected by the presence of parallel imports. Theory of complementarity explained in the chapter is the best economically efficient mechanism for furthering consumer welfare in the global context as well as national economy. If the intellectual property owners are allowed to ban parallel imports, it would create anti-competitive effect. The agreements restricting the free movement of goods in the market will definitely result in restricting intra-band competition in

[802] National Economic Research Associates (NERA) (1997), Survey of Parallel Trade, referred to by Kerin M. Vautier, "Economic Considerations on Parallel Imports", in Christopher Heath, *Parallel Imports In Asia,* Max Plank Series on Asian Intellectual Property Law, Vol. 9, Kluwer Law International, Netherlands, (2004),p.6.

the market thus amounting to abuse of dominant position, as we had seen in the judicial decisions of the European and American jurisdictions. Therefore, parallel imports are economically efficient.

Chapter V

Digital Exhaustion

5. Introduction

The digital medium poses many additional challenges to the concept of exhaustion. Intellectual property, as we know, is often considered an intangible property.[803] However, this is a debatable concept, since for the purpose of exercising the rights of the owner of intellectual property, it is essential to give tangible existence to the so called "intangible property".[804] The tangible intellectual product alone can determine the contours of the rights of the creator. But still the IP good contains an intangible element in it, which can be identified as the intellectual property embedded in every IP product. Thus, as we have already discussed, the IP product has two owners; the owner of the intellectual property, who owns the intangible element, and the purchaser of IP good, who owns only the tangible product. The moment the intangible element gets fixed, it becomes a tangible object.[805]This implies that, upon the selling of the product containing IP to a consumer, the tangible product becomes the absolute property of the consumer and the owner of the IP ceases to have any control over the sold IP good. This is the basis of exhaustion principle. However, in the context of digital medium, the distinction as to tangible and intangible gets further blurred as the IP product itself is mostly in the intangible form, until fixed in a tangible medium. Moreover, it becomes very difficult to differentiate the boundaries of control exercised by both the IP holder and the purchaser of the IP good due to the blurring of the differences between various IP rights resulting from the peculiar nature of the medium.

The application of principle of exhaustion, as we have already seen, is not as simple as it appears and unfortunately there is no international consensus on the concept of exhaustion. The problem gets aggravated in the digital context both because of the nature of the digital product and because of the ease with which copies can easily move between countries. The digital work can

[803] Kelvin King, "The Value of intellectual property, intangible assets and Goodwill", JIPR, [2002], Vol.7, pp.245-248, available at http://nopr.niscair.res.in/bitstream/123456789/4919/1/JIPR%207%283%29%20245-248.pdf., (accessed on 12/12/2018).

[804] Georg Frederich Hegel, *Philosophy of right*, trans. S.W Dyde, Batoche Books, Kitchener, (2001), p.56.

[805] *Tata Consultancy Services* v. *State of Andhra Pradesh*, AIR 2005 SC 371.

be easily copied and distributed globally, without in any way affecting its quality.[806] The emergence of internet made dissemination further easier. Moreover, in the digital context every use of the digital IP good results in the reproduction of the IP good and the differences between the rights becomes obscure. This adds to the confusion with respect to the concept of exhaustion. Easiness in copying and distribution without affecting the quality of the copies is another complexity which the exhaustion principle needs to address in the digital context. The fact that the digital products and the IP appear to be intangible adds to the confusion.[807]With the advent of the modern technologies, copyright products are mostly transferred in digital format rather than in the physical format. Copyright products are purchased and sold in the online market on a large scale.[808] Therefore, this chapter aims to analyse the importance of exhaustion principle and the additional challenges it faces in the digital context.

5.1 Challenges to digital exhaustion

As already seen, the challenges posed by the digital technology to the concept of exhaustion are manifold. The most important question to be addressed is whether exhaustion principle can be applied in the digital era. The primary problem posed is by the medium per se. Unlike the

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[806] Guy A. Rub**, "**Rebalancing Copyright Exhaustion"*,* Emory L.J., [2015], Vol. 64, pp.741-817, available at http://law.emory.edu/elj/_documents/volumes/64/3/articles/rub.pdf, (accessed on 6/12/2018). Also see; Nicola Lucchi, *Digital Media & Intellectual Property Management of Rights and Consumer Protection in a Comparative Analysis*, Springer, Berlin, p.70, available at https://works.bepress.com/nicola_lucchi/4/, (accessed on 14/12/2018). Ruth Anthony Reese, "The First Sale Doctrine in the Era of Digital Networks", B.C.L. Rev. 577, [2003], Vol.44, p.620, available at https://lawdigitalcommons.bc.edu/cgi/viewcontent.cgi?referer=https://www.google.com/&httpsredir=1&article=2233&context=bclr (accessed on 6/12/2018).

[807] *DMCA Section 104 Report*, A Report of the Register of Copyrights Pursuant to §104 of the Digital Millennium Copyright Act, U.S. Copyright Office, 2001, p.xix, available at https://www.copyright.gov/reports/studies/dmca/sec-104-report-vol-1.pdf , (accessed on 6/12/2018).
However, in the authors view, the intangibility of digital products is a baseless argument put forth by copyright owners to put up resistance to the application of exhaustion to the digital IP products. No copyright product can be intangible as it could be capable of protection only if the expression of it is clearly identifiable.

[808]Aaron Perzanowski and Jason Schultz, "Reconciling intellectual property and personal property", Notre Dame L. Rev. 1211, [2015], Vol. 90, p.1214, available at: http://scholarship.law.nd.edu/ndlr/vol90/iss3/6, (accessed on 7/12/2018). Also see; Richard Watt, "An Empirical Analysis of the Economics of Copyright: How Valid Are the Results of Studies in Developed Countries for Developing Countries?" The Economics of Intellectual Property, p.65, available at https://www.wipo.int/edocs/pubdocs/en/wipo_pub_1012-chapter3.pdf , (accessed on 23/12/2018).

tangible contents, the online medium makes unauthorized copying and distribution very easy.[809] Majority of works are now being distributed through online medium and this has resulted in the increase in the unauthorized distribution of works.[810] In other words, it has been argued that unlike in the analog context where the owners used to distribute their works such as the phonograms, CD's etc., in the physical form, the online digital medium makes unauthorized distribution much easier, increasing the cost the intellectual owner needs to incur in taking effective measures to reduce the same, and reducing the efficacy of the overall copyright system.[811]

Apart from the confusion created by the digital format itself, there are other types of confusions posed by the nature of transfer of IP goods from person to person. In the context of physical copies, for example a book, upon selling, that copy of the book does not remain with the seller. It moves from the hand of the seller to the buyer and the seller cannot keep that copy. However, the

[809] Peter S. Menell, "Governance of Intellectual Resources and disintegration of Intellectual Property in the Digital Age", Berkeley Tech. L.J. 1523, [2011], Vol. 26, p.1540,
available at https://scholarship.law.berkeley.edu/cgi/viewcontent.cgi?article=1921&context=btlj, (accessed on 6/12/2018). Also see; Monica L. Dobson, "ReDigi and the Resale of Digital Media: The Courts Reject a Digital First Sale Doctrine and Sustain the Imbalance between Copyright Owners and Consumers," Akron Intellectual Property Journal, [2014], Vol. 7, Iss. 2, Article 3, p.192,
available at: http://ideaexchange.uakron.edu/akronintellectualproperty/vol7/iss2/3, (accessed on 6/12/2018).

[810] Stanley J. Liebowitz, "File-Sharing: Creative Destruction or Just Plain Destruction?" , The Journal of Law & Economics, [2006], Vol. 49, No. 1, p.2, p.17, available at
http://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.320.601&rep=rep1&type=pdf, (accessed on 6/12/2018). Also see; Peter S. Menell, "Governance of Intellectual Resources and disintegration of Intellectual Property in the Digital Age", Berkeley Tech. L.J. 1523, [2011], Vol. 26, p.1540,
available at https://scholarship.law.berkeley.edu/cgi/viewcontent.cgi?article=1921&context=btlj, (accessed on 6/12/2018), Monica L. Dobson, "ReDigi and the Resale of Digital Media: The Courts Reject a Digital First Sale Doctrine and Sustain the Imbalance between Copyright Owners and Consumers," Akron Intellectual Property Journal, [2014], Vol. 7, Iss. 2, Article 3, p.192,
available at: http://ideaexchange.uakron.edu/akronintellectualproperty/vol7/iss2/3, (accessed on 6/12/2018).

[811] Peter S. Menell, "Governance of Intellectual Resources and disintegration of Intellectual Property in the Digital Age", Berkeley Tech. L.J. 1523, [2011], Vol. 26, pp.1540-41,
available at https://scholarship.law.berkeley.edu/cgi/viewcontent.cgi?article=1921&context=btlj, (accessed on 6/12/2018). Also see;Stanley J. Liebowitz, "File-Sharing: Creative Destruction or Just Plain Destruction?" , The Journal of Law & Economics, [2006], Vol. 49, No. 1, pp. 1-28, available at
http://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.320.601&rep=rep1&type=pdf, (accessed on 6/12/2018); Aaron Perzanowski& Jason Schultz, "Legislating Digital Exhaustion", Berkeley Tech. L.J. 1535, [2014], Vol.29, p.1536, available at
https://scholarship.law.berkeley.edu/cgi/viewcontent.cgi?article=2061&context=btlj, (accessed on 15/12/2018).

digital format makes it easier for the copyright holder or the purchaser of the product to transfer it and at the same time allows keep a copy of the same. The possibility of the purchaser reselling a digital copy, retaining the copy he purchased in digital format questions the traditional framework of exhaustion doctrine since under the doctrine of exhaustion it should be the legally purchased product that must be transferred to the other person upon resale and no copies shall be made or resold.[812]If so, such distribution, it is argued, is not saved by the exhaustion principle.

Moreover, in the digital context there is a lot of difference in the nature of transfer since every use of the purchased copy ends up in the reproduction of the work. The digital copy that is transferred is different from the copy in the hands of the sender. It is a copy made from the original that is being transferred to the user. Thus different copies are created when it is transferred further by the persons who receive it and the digital copies could be easily multiplied and transferred to any number of persons. It should be kept in mind that the reproduction right of the author does not get exhausted under the exhaustion principle. In the copyright context only the distribution right gets exhausted and this enables the purchaser of a legally purchased copy of the copyrighted work to further distribute that copy to any person without any restrictions. However, it does not allow him to reproduce the work. In the digital medium, when a work is transferred or sold to another person, it is not necessarily the purchased copy of the work that is being transferred to the other person but a copy of the same. It is possible that the copy of the work purchased by the consumer still remains with the consumer and what is sold is a reproduced copy.[813]

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[812] Molly Shaffer Van Houweling, "Exhaustion and the Limits of Remote-Control Property", Denv. L. Rev. 951, [2016], Vol.93, p.952, available at http://static1.1.sqspcdn.com/static/f/276323/27253933/1474324079933/93.4_951+Van+Houweling.pdf?token=tBZYkcVWiiF2pBr5pocoUJoYCkk%3D, (accessed on 6/12/2018).Also see; *DMCA Section 104 Report*, A Report of the Register of Copyrights Pursuant to §104 of the Digital Millennium Copyright Act, U.S. Copyright Office, 2001, pp.97-100, available at https://www.copyright.gov/reports/studies/dmca/sec-104-report-vol-1.pdf , (accessed on 6/12/2018).Aaron Perzanowski& Jason Schultz, "Legislating Digital Exhaustion", Berkeley Tech. L.J. 1535, [2014], Vol.29, p.1537, available at https://scholarship.law.berkeley.edu/cgi/viewcontent.cgi?article=2061&context=btlj, (accessed on 15/12/2018).

[813] Sage V. Heuvel, "Fighting the First Sale Doctrine: Strategies for a Struggling Film Industry", Mich. Telecomm. & Tech. L. Rev. 661, [2012], Vol.18, p.662, available at http://repository.law.umich.edu/mttlr/vol18/iss2/7?utm_source=repository.law.umich.edu%2Fmttlr%2Fvol18%2Fiss2%2F7&utm_medium=PDF&utm_campaign=PDFCoverPages, (accessed on 21/12/2018). Also see ;Aaron Perzanowski and Jason Schultz, "Digital Exhaustion", UCLA L. Rev. 889, (2010), Vol.58, p.938, available at

The threat posed by the secondary market in the digital context is often pointed out as another concern. It is also important to note that while transferring, unlike in the case of a physical copy, the nature and quality of the copy does not get diminished in the case of a digital copy.[814] Therefore, the secondary market problem gets intensified in the digital context, due to this special feature of the medium.[815]Thus, unlike a book or a cassette the quality of which erodes with each use, limiting its life, a digital file can be used indefinitely in the absence of accidental erasure or corruption from a virus.[816] Works in digital format can be reproduced flawlessly, and disseminated to nearly any point on the globe instantly and at negligible cost.[817] Since the used product has the same quality as the original one and it is easier to transfer it at minimal cost, the owner of copyright is worried about the reduction of revenue from the primary market. It is feared that this will add to the threat from the secondary market. Copyright owners are also concerned that consumers who resell their digital media will charge lower prices for their "used"

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https://scholarship.law.berkeley.edu/cgi/viewcontent.cgi?article=2246&context=facpubs, (accessed on 23/12/2018).

[814] Victor F. Calaba, "Quibbles 'n Bits: Making a Digital First Sale Doctrine Feasible", Mich. Telecomm. Tech. L. Rev. 1, [2002], Vol.9, p.8, available at https://repository.law.umich.edu/cgi/viewcontent.cgi?referer=https://www.google.com/&httpsredir=1&article=1134&context=mttlr, (accessed on 6/12/2018). Also see; Aaron Perzanowski and Jason Schultz, "Reconciling intellectual property and personal property", Notre Dame L. Rev. 1211, [2015], Vol. 90, p.1259, available at: http://scholarship.law.nd.edu/ndlr/vol90/iss3/6 (accessed on 7/12/2018).

[815] *DMCA Section 104 Report*, A Report of the Register of Copyrights Pursuant to §104 of the Digital Millennium Copyright Act, U.S. Copyright Office, 2001, p.11, available at https://www.copyright.gov/reports/studies/dmca/sec-104-report-vol-1.pdf , (accessed on 6/12/2018).

[816] Keith Kupferschmid, "Lost in Cyberspace: the Digital Demise of the First-Sale Doctrine", J. Marshall J. Computer & Info. L. 825, [1998], Vol.16, p.832, available at https://repository.jmls.edu/cgi/viewcontent.cgi?article=1253&context=jitpl. (accessed on 6/12/2018).

[817] *DMCA Section 104 Report*, A Report of the Register of Copyrights Pursuant to §104 of the Digital Millennium Copyright Act, U.S. Copyright Office, 2001, p. xix,, available at https://www.copyright.gov/reports/studies/dmca/sec-104-report-vol-1.pdf , (accessed on 6/12/2018). Also see; Victor F. Calaba, "Quibbles 'n Bits: Making a Digital First Sale Doctrine Feasible", Mich. Telecomm. Tech. L. Rev. 1, [2002], Vol.9, p.8, available at https://repository.law.umich.edu/cgi/viewcontent.cgi?referer=https://www.google.com/&httpsredir=1&article=1134&context=mttlr, (accessed on 6/12/2018).Also see; Aaron Perzanowski and Jason Schultz, "Reconciling intellectual property and personal property", Notre Dame L. Rev. 1211, [2015], Vol. 90, p.1259, available at: http://scholarship.law.nd.edu/ndlr/vol90/iss3/6 (accessed on 7/12/2018).

product which will have the same quality as the original one, causing copyright owners to be edged out of their own market.[818]

Copyright holders adopt different methods to evade exhaustion; e.g., by eliminating personal property interests of the consumers on a purchased product, defining the transaction as license rather than sale.[819] In situations where there is sale, the argument that what is being transferred is a copy of the purchased product rather than the legally purchased product online, almost negates the application of exhaustion in the digital context. The issue of digital piracy mooted by the copyright owners against exhaustion has also ended up in the rampant usage of technological protection in the form of access controls and copy controls.[820]Application of copy control measures, in fact in many circumstances, prevents even the original purchaser from using the copy to its full extent.

Therefore, an important question to be addressed is if it is necessary to refuse the application of exhaustion doctrine in digital context. Can the online transfer of any material take place without reproduction of the work? Another equally important question is should the objectives of copyright, the dissemination of knowledge and consumer welfare, change with medium, depending upon the changes on commercial implications resulting from the peculiar nature of that medium? The ultimate objective of this chapter is to explore if digital exhaustion would cause any real threat to the copyright holder. Should the doctrine of exhaustion be excluded in the digital context? Or can it be accepted that the doctrine of exhaustion holds good even in digital context?

This chapter aims at analyzing the above questions by examining the above mentioned challenges of digital exhaustion. It also addresses the question whether any precautions are

[818] Monica L. Dobson, "ReDigi and the Resale of Digital Media: The Courts Reject a Digital First Sale Doctrine and Sustain the Imbalance between Copyright Owners and Consumers," Akron Intellectual Property Journal, [2014], Vol. 7, Iss. 2, Article 3, pp.189-190,
available at: http://ideaexchange.uakron.edu/akronintellectualproperty/vol7/iss2/3, (accessed on 6/12/2018).
[819] See for eg: *MAI Systems Corporation* v. *Peak Computers Inc*, 991 F.2d 511 (9th Cir. 1993), *United States v. Wise* 550 F.2d 1180 (9th Cir. 1977).
[820] Justin Graham, "Preserving the Aftermarket in Copyrighted Works: Adapting the First Sale Doctrine to the Emerging Technological Landscape", Stan.Tech. L. Rev. 1, (2002), pp.2-32, available at https://heinonline.org/hol-cgi-bin/get_pdf.cgi?handle=hein.journals/stantlr2002&section=2, (accessed on 21/12/2018).

required to be taken when one applies the doctrine of exhaustion to the digital context. The next portion of the chapter attempts to answer the above mentioned aspects in detail.

5.1.1. The issue of tangibility of digital product and exhaustion

Property has been referred as "that sole and despotic dominion which one man claims and exercises over the external things of the world, in total exclusion of the right of any other individual in the universe."[821] However, property can be transferred between persons resulting in change of ownership, which is the basis of economic trading. Upon transfer of ownership, the new owner exercises complete ownership over the object and thus excludes others, including the prior owner, from interfering with the enjoyment of the property by him. This is the foundation of the doctrine of exhaustion of intellectual property rights. The attempt here is to see if this can be different in digital context. In other words, the question to be addressed is whether the laws of exhaustion in the tangible medium can be logically and practically extended to digital context, without any changes.

The presumption that the laws of exhaustion applies only to tangible physical copies is the root cause of such confusion. This presumption gets further extended to the argument that digital copies are intangible in nature and thus cannot be subjected to the rules of exhaustion as there are problems posed by the medium per se, which the traditional exhaustion principle has never faced. The challenge posed by the digital medium per se is the ease of copying and distributing the copyrighted work. However, merely because the technology enables easy copying or unauthorised distribution, does not call for rejection of exhaustion principle in the digital context since such distribution amounts to infringement and copyright law can take care of such violations of law just like it is taking care of unauthorised distribution in the non-digital context. Moreover, the digital era has also extended many positive contributions to the copyright owner. Digital medium makes it easy for the copyright owners to disseminate their works to a larger public much faster, at cheaper distribution cost enhancing their reach to more and more consumers at much cheaper rates.

[821] William Blackstone, *Commentaries on the Laws of England*, Clarendon Press, Oxford, (1765), p.2.

It is pertinent to discuss the WIPO Internet Treaties which are WCT and WPPT, since both the treaties tries to bring in the artificial distinction between tangible and digital copy when it comes to the application of exhaustion doctrine. Article 6 of WCT, dealing with the Right to distribute in the digital context confers on the copyright owner the right to distribute the work and their copies by way of sale or other modes of transfers.[822] The treaty also states that nothing in the Treaty will affect the freedom of the parties to determine the conditions under which exhaustion of rights applies after first sale or other transfer of ownership of the original copy of the work. However, the footnote 5 to Article 6 clarifies that the copies of original work referred under Article 6 is applicable exclusivelyto fixed copies that can be put into circulation as tangible objects.[823] This is being interpreted as a limitation on the exhaustion doctrine, limiting its application to tangible medium alone. Similar provision exists in WIPO Performances and Phonograms Treaty.[824]

The argument that application of the exhaustion rule depends on the medium in which the work is transferred springs from the ignorance of the philosophy of exhaustion. As already seen in chapter one,[825] the very objective of the doctrine is to enable the user to enjoy, without any restriction, the property rights in the copy he purchased and on which he enjoys absolute ownership, regardless of the medium in which the copy exists. The copyright law cannot distinguish between analog and digital formats for the purpose of exhaustion.[826] This is because the common law principle of restraint on alienation cannot be limited to physical copies alone. It is true that the courts have tried to differentiate between tangible physical copy and intangible IP rights in the initial case laws which became foundational for the evolution of the exhaustion doctrine. But the intention behind the courts in doing so was to differentiate between the rights of

[822] Art. 6 (1) of WCT, 1996.

[823] Agreed statements concerning Art. 6 and Art.7 of WCT, 1996: As used in these Articles, the expressions "copies" and "original and copies," being subject to the right of distribution and the right of rental under the said Articles, refer exclusively to fixed copies that can be put into circulation as tangible objects.

[824] Agreed Statement concerning Articles 2*(e)*, 8, 9, 12, and 13 of WCT, 1996 **:** As used in these Articles, the expressions "copies" and "original and copies," being subject to the right of distribution and the right of rental under the said Articles, refer exclusively to fixed copies that can be put into circulation as tangible objects.

[825] Chapter one of the thesis, pp. 8-44.

[826] *DMCA Section 104 Report*, A Report of the Register of Copyrights Pursuant to §104 of the Digital Millennium Copyright Act, U.S. Copyright Office, 2001, p.23, available at https://www.copyright.gov/reports/studies/dmca/sec-104-report-vol-1.pdf , (accessed on 6/12/2018).

the copyright owner and the rights of the purchaser of the copyrighted work with respect to the sold copy of the work, and was not to limit the application of the doctrine of exhaustion to works distributed in tangible medium alone.[827] The counter question to be raised against the demand for excluding the doctrine of exhaustion in the digital context is whether copyright owners should be granted absolute control over the copies which are sold by them merely because the medium is intangible. This would amount to granting absolute monopoly to the copyright holder in the digital context encroaching in to the rights of the purchaser to the unrestricted enjoyment of the property he purchased.

Further, the moment the copy is downloaded to a computer, it becomes a tangible copy.[828] Therefore, all the rules pertaining to tangible medium start applying then onwards.[829] If it is demanded that the download should be restricted to a CD or floppy, then the user in each downloads will have to download it to the CD causing huge financial and transactions costs. Restricting user to enjoy the basic rights over a product which he owns is equal to granting absolute monopoly rights to copyright holder. When the work is disseminated online, considering the online content as intangible medium is nonsensical as intangible intellectual property can be given existence through tangible medium only and the dissemination of the work through online medium should be considered as dissemination through tangible medium.

5.1.2. Reproduction right and Digital transfers of works

The most significant challenge posed by the digital medium to the doctrine of exhaustion is that every use of digital work results in the creation of a copy of the work and ends up in the reproduction of the work, the right which does not get exhausted under the doctrine of

[827] *See; Bloomer* v. *McQueen* 55 U.S. 539 (1852),*Mitchell* v. *Hawley* 83 U.S. (16 Wall.) 544, *Bobbs-Merrill Co.* v. *Strauss* 210 U.S. 339 (1908).

[828] *DMCA Section 104 Report*, A Report of the Register of Copyrights Pursuant to §104 of the Digital Millennium Copyright Act, U.S. Copyright Office, 2001, p.45, available at https://www.copyright.gov/reports/studies/dmca/sec-104-report-vol-1.pdf , (accessed on 6/12/2018).
Also see ; *Tata Consultancy Services* v. *State Of Andhra Pradesh*, AIR 2005 SC 371

[829] *DMCA Section 104 Report*, A Report of the Register of Copyrights Pursuant to §104 of the Digital Millennium Copyright Act, U.S. Copyright Office, 2001, p.45, available at https://www.copyright.gov/reports/studies/dmca/sec-104-report-vol-1.pdf , (accessed on 6/12/2018).

exhaustion.[830] Making of any copy by persons other than the right holder can amount to infringement. However, when it comes to the digital medium, upon every use or transfer that occurs in digital medium, a copy of the original work is created and it is that copy which gets transferred to the purchaser.[831] This is an inherent problem of the digital medium. Since under the first sale doctrine, the defense can be taken only for transfer of legally purchased work, a strong argument is available for those who are against the concept of exhaustion when a copy other than the one which is purchased is being transferred on sale.

The exhaustion doctrine (as per the current notion) has two major conditions to follow: (1) transfer should be of a legal copy (ii) the transfer should constitute a change of ownership. The digital media poses a challenge to both these conditions. The first condition is being thwarted by the mere nature of the digital medium while the second condition can be defeated by the owner of copyright through his monopolistic acts.[832]

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[830] Aaron Perzanowski and Jason Schultz, "Digital Exhaustion", Digital Exhaustion, UCLA L. Rev. 889, [2010], Vol.58, p.902, available at https://scholarship.law.berkeley.edu/cgi/viewcontent.cgi?article=2246&context=facpubs, (accessed on 23/12/2018).
Also see; *DMCA Section 104 Report*, A Report of the Register of Copyrights Pursuant to §104 of the Digital Millennium Copyright Act, U.S. Copyright Office, 2001, p.87, available at https://www.copyright.gov/reports/studies/dmca/sec-104-report-vol-1.pdf ,(accessed on 6/12/2018);*MAI Systems Corporation v. Peak Computers Inc*, 991 F.2d 511 (9th Cir. 1993).

[831] Keith Kupferschmid, "Lost in Cyberspace: the Digital Demise of the First-Sale Doctrine", J. Marshall J. Computer & Info. L. 825, [1998], Vol.16, p.834, available at https://repository.jmls.edu/cgi/viewcontent.cgi?article=1253&context=jitpl. (accessed on 6/12/2018). Also see; Aaron Perzanowski and Jason Schultz, "Digital Exhaustion", Digital Exhaustion, UCLA L. Rev. 889, [2010], Vol.58, p.902, available at https://scholarship.law.berkeley.edu/cgi/viewcontent.cgi?article=2246&context=facpubs, (accessed on 23/12/2018).Also see; *DMCA Section 104 Report*, A Report of the Register of Copyrights Pursuant to §104 of the Digital Millennium Copyright Act, U.S. Copyright Office, 2001, p.87, available at https://www.copyright.gov/reports/studies/dmca/sec-104-report-vol-1.pdf ,(accessed on 6/12/2018)

[832] See; Ruth Anthony Reese, "The First Sale Doctrine in the Era of Digital Networks", B.C.L. Rev. 577, [2003], Vol.44, p.620, available at https://lawdigitalcommons.bc.edu/cgi/viewcontent.cgi?referer=https://www.google.com/&httpsredir=1&article=2233&context=bclr (accessed on 6/12/2018). Also see; John A. Rothchild, "The Incredible Shrinking First-Sale Rule: Are Software Resale Limits Lawful?", Rutgers Law Review , [2004], Vol. 57, Number 1, available at https://digitalcommons.wayne.edu/cgi/viewcontent.cgi?article=1350&context=lawfrp, (accessed on 7/12/2018); Aaron Perzanowski and Jason Schultz, "Digital Exhaustion", Digital Exhaustion, UCLA L. Rev. 889, [2010], Vol.58, p.902, available at https://scholarship.law.berkeley.edu/cgi/viewcontent.cgi?article=2246&context=facpubs, (accessed on 23/12/2018).

Regarding the first limitation regarding the transfer of a legal copy, the argument raised is that the copy transferred in an online context is not the copy possessed by the user but a copy of the copy possessed. Unlike in a transaction where a tangible copy changes hands, online distributions naturally result in reproduction of the target software on the recipient's computer memory even if the sender subsequently deletes the original software copy that it transferred to the recipient.[833] Therefore, it is argued that the exhaustion doctrine does not apply in its traditional sense to the online context. In 1995 a task force was set up[834] under the Clinton administration which released a report known as a "White Paper".[835] The white paper suggested that the first sale doctrine should not apply to online transfer since it would directly infringe the exclusive rights of reproduction and distribution of the copyright owner.[836] The report was driven by the concern over the ease of copying and reproduction and distribution in the digital context. It claimed that "the first sale doctrine does not allow the transmission of a copy of a work, because, under current technology the transmitter transmits not the original copy of the work but a reproduced copy while the recipient of the transmission obtains a reproduction of the original

[833] Ruth Anthony Reese, "The First Sale Doctrine in the Era of Digital Networks", B.C.L. Rev. 577, [2003], Vol.44, p.612, available at
https://lawdigitalcommons.bc.edu/cgi/viewcontent.cgi?referer=https://www.google.com/&httpsredir=1&article=2233&context=bclr (accessed on 6/12/2018).
Aaron Perzanowski& Jason Schultz, "Legislating Digital Exhaustion", Berkeley Tech. L.J. 1535, [2014], Vol.29, p.1547, available at https://scholarship.law.berkeley.edu/cgi/viewcontent.cgi?article=2061&context=btlj, (accessed on 15/12/2018).

[834] In February 1993, President Clinton formed the Information Infrastructure Task Force (IITF) to articulate and implement the Administration's vision for the National Information Infrastructure (NII) to develop comprehensive telecommunications and information policies. See; Bruce A. Lehman and Ronald H. Brown, *Intellectual Property and the National Information Infrastructure: The Report of the Working Group on Intellectual Property Rights*, United States, Information Infrastructure Task Force, (Sept. 1995), p.1, available at
https://groups.csail.mit.edu/mac/classes/6.805/articles/int-prop/nii-report-sept95.txt., (accessed on 25/12/2018).

[835] Bruce A. Lehman and Ronald H. Brown, *Intellectual Property and the National Information Infrastructure: The Report of the Working Group on Intellectual Property Rights*, United States, Information Infrastructure Task Force, (Sept. 1995), available at https://groups.csail.mit.edu/mac/classes/6.805/articles/int-prop/nii-report-sept95.txt., (accessed on 25/12/2018).

[836] The report stated that "The rationale for these exceptions may apply to other types of works as more types of works become available in digital form and the "nexus" of rental and reproduction of those works "may directly and adversely affect the ability of copyright holders to exercise their reproduction and distribution rights under the Copyright Act." Bruce A. Lehman and Ronald H. Brown, *Intellectual Property and the National Information Infrastructure: The Report of the Working Group on Intellectual Property Rights*, United States, Information Infrastructure Task Force, (Sept. 1995), p.91,
available at https://groups.csail.mit.edu/mac/classes/6.805/articles/int-prop/nii-report-sept95.txt., (accessed on 25/12/2018).

copy (*i.e.*, a *new* copy), rather than the copy owned by the transmitter" and the user still retains the original work.[837] The report concluded that the language of the Copyright Act, the legislative history and the case law make it clear that the doctrine is applicable only to those situations where the owner of a particular copy disposes of physical possession of that particular copy.[838]Such a finding equivalent to suggesting the law makers to shut the doors of exhaustion to online transmission as it suggested that exhaustion is applicable only if the technology utilized allows the transmission of a copy without making an unlawful reproduction -- *i.e.*, without the original owner retaining a copy. In such a situation alone the first sale doctrine would apply since then the transmission would not be an infringement.[839]The report also rejected the forward–delete method as this does not offer a solution to the reproduction right issue.[840] The reason attributed for the rejection was that even if the consumer who transfers a legally purchased copy through online subsequently deletes the same from his computer, the copy which is transferred is still a reproduced copy and not the copy he purchased. This observation in the white paper makes it clear that the issue of violation of reproduction right is the crux of the problem as far as online exhaustion is concerned.

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[837] "It seems clear that the first sale model in which the copyright owner parts company with a tangible copy should not apply with respect to distribution by transmission, because transmission by means of current technology involves both the reproduction of the work and the distribution of that reproduction. In the case of transmissions, the owner of a particular copy of a work does not "dispose of the possession of that copy or phono record." A copy of the work remains with the first owner and the recipient of the transmission receives another copy of the work." See ; Bruce A. Lehman and Ronald H. Brown, *Intellectual Property and the National Information Infrastructure: The Report of the Working Group on Intellectual Property Rights*, United States, Information Infrastructure Task Force, (Sept. 1995), p.95.

[838] Bruce A. Lehman and Ronald H. Brown, "*Intellectual Property and the National Information Infrastructure: The Report of the Working Group on Intellectual Property Rights"*, United States, Information Infrastructure Task Force, (Sept. 1995), p.92.

[839]Amazon obtained a Patent for secondary market for digital objects in U.S. which makes sure that the seller does not keep a copy as the copy is automatically deleted from the computer.Amazon patent (United States Patent 8,364,595,) available at
https://patentimages.storage.googleapis.com/09/28/25/54ba132d0de701/US8364595.pdf,
(accessed on 25/12/2018).

[840] The question is not whether there exists the same number of copies at the completion of the transaction. The question is whether the transaction when viewed as a whole violates one or more of the exclusive rights, and there is no applicable exception from liability. In this case, the white paper thought, a reproduction of the work takes place in the receiving to the computer. To apply the first sale doctrine in such a case would vitiate the reproduction right.

It must be kept in mind that the issue of reproduction is not a new problem in the online context. For example, using a computer program itself results in the automatic creation of a copy. However, such a copy is held to be an incidental copy produced incidental to the use of a computer programme.[841] They were considered to be incidental copies since they were automatically produced upon the use of the computer programme. Similarly in the case of online transfers of copyrighted materials, reproduction of the copy is automatically made due to the very nature of the digital medium. Logic similar to that of incidental copies should be applied to the issue of exhaustion vis-à-vis transfers taking place in the digital medium. If the argument that it is a reproduced copy that is being transferred is accepted, it will create a situation wherein no online transfer is possible by persons other than the copyright holder or his agents. This amounts to granting undue monopoly to the copyright holder. Therefore, the reproduction taking place upon transfer should be considered as incidental to use/transfer.

To substantiate this point one can take the aid of §.117under the U.S. Copyright Act, which speaks about the copies that are made incidental to the using of the computer program.[842]The section exempts from infringement the creation of incidental copies by the owner of the copy for utilization of the computer program[843] or for archival purposes, or for lease, sale or other transfer of this additional copy made to any person, provided that such transfer is along with the computer program from which such copies were made, and is only as part of the lease or sale of that computer program.[844] This section brings out solutions for two important problems: the problem of reproduction when the computer program is installed in a computer and the problem

[841] See §.117 of the U.S. Copyright Act, 1976.

[842] §.117(a) of the U.S. Copyright Act, 1976 : Making of Additional Copy or Adaptation by Owner of Copy.— Notwithstanding the provisions of section 106, it is not an infringement for the owner of a copy of a computer program to make or authorize the making of another copy or adaptation of that computer program provided:
(1) that such a new copy or adaptation is created as an essential step in the utilization of the computer program in conjunction with a machine and that it is used in no other manner, or
(2) that such new copy or adaptation is for archival purposes only and that all archival copies are destroyed in the event that continued possession of the computer program should cease to be rightful.
(b) Lease, Sale, or Other Transfer of Additional Copy or Adaptation.— Any exact copies prepared in accordance with the provisions of this section may be leased, sold, or otherwise transferred, along with the copy from which such copies were prepared, only as part of the lease, sale, or other transfer of all rights in the program. Adaptations so prepared may be transferred only with the authorization of the copyright owner.

[843] *Sony Computer Entertainment, Inc.* v.*Connectix Corp.*, 203 F.3d 596, (9th Cir. 2000).

[844]§.117 of U.S. Copyright Act, 1976.

of first sale of such incidental copies. However, this defense under § 117 is available only to the owners of the copy.[845] The first sale doctrine also is applicable only in the case of transfer of 'ownership' in the copy of computer programme.[846] § 117(b) provides that the owner of a copy of a computer program does not infringe the owner's copyright in that copy when the owner of the copy transfers that copy of the program in original form as long as the copy owner does not retain any copies of that program after the transfer and transfers all rights of the copy owner in that program.[847] This observation is important in the digital context. The primary reason for the objection against exhaustion in digital context rests upon infringement of reproduction right. If one could enact a provision similar to§.117(b)in the software context, application of the same could be extended to other digital works as well.

It is pertinent in this context to note that section 109 of the U.S. Act dealing with exhaustion in general applies also to computer software. Section 109 does not restrict its operation to any particular form of work.[848] Therefore, it is within the statutory framework to extend the principle

[845]§. 117 of the U.S. Copyright Act, 1976. Also see ; Robert A. Kreiss, "Section 117 of the Copyright Act", B.Y.U. L. REV. 1497, [1991], p.1498, pp.1523-25 available at https://digitalcommons.law.byu.edu/lawreview/vol1991/iss4/2, (accessed on 21/12/2018).

[846] Raymond T. Nimmer, "Copyright First Sale and the Overriding Role of Contract", Santa Clara L. Rev. 1311, [2011], Vol.51, p.1312, available at: http://digitalcommons.law.scu.edu/lawreview/vol51/iss4/8 , (accessed on 7/12/2018)

[847] §.117 (b) of U.S. Copyright Act, 1976: "Lease, Sale, or Other Transfer of Additional Copy or Adaptation— Any exact copies prepared in accordance with the provisions of this section may be leased, sold, or otherwise transferred, along with the copy from which such copies were prepared, only as part of the lease, sale, or other transfer of all rights in the program. Adaptations so prepared may be transferred only with the authorization of the copyright owner."Also see; Petra Heindl, *A Comparative Analysis of Online Distribution of Software in the United States and Europe: Piracy or Freedom of "First Use"?,* TTLF Working Papers, No. 6, Stanford – Vienna Transatlantic Technology Law Forum**,** 2010, available at http://www.law.stanford.edu/program/centers/ttlf/papers/heindl_wp6.pdf, (accessed on 25/12/2018).

[848]§. 17 U.S. Code § 109 - Limitations on exclusive rights: Effect of transfer of particular copy or phonorecord(a) Notwithstanding the provisions of section 106(3), the owner of a particular copy or phonorecord lawfully made under this title, or any person authorized by such owner, is entitled, without the authority of the copyright owner, to sell or otherwise dispose of the possession of that copy or phonorecord. For further analysis see chapter 1 of the thesis. Also see ; *DMCA Section 104 Report,* A Report of the Register of Copyrights Pursuant to §104 of the Digital Millennium Copyright Act, U.S. Copyright Office, 2001, p.23, available at https://www.copyright.gov/reports/studies/dmca/sec-104-report-vol-1.pdf , (accessed on 6/12/2018), it says "The statute does not distinguish between analog and digital copies. Consequently, it does not matter whether the work is embodied in an analog videocassette or a digital DVD – the copyright owner's distribution right with respect to that particular copy is extinguished once ownership of the copy has been transferred, and the new owner is entitled to dispose of that copy as he desires."

of exhaustion also to online medium and nothing prevents the courts from extending the protection of S.109 to the digital context. The issue of reproduction can also be taken care of using technological protection measures which will be discussed in detail in the coming sections. The white paper has failed to understand the exact implications of the exhaustion doctrine in digital world and its impact on consumer welfare. The context and public welfare principles in which the U.S. courts evolved the concept of exhaustion in the copyright regime were also overlooked by the White paper.

Another problem with regard to the reproduction issue is that the digital era makes it easy for the user to retain additional copies even after transfer to another user. In the online context, unlike exhaustion in the physical context, selling of the copy need not always result in the absolute disposal or alienation of the digital product as the seller has the option to retain a copy.[849]The issue cannot be purely termed as an entirely new one. Even in the tangible context, the user has the ability to keep additional copies with him and could distribute the same. However, in the digital context the chances of such practice are much higher due to the absence of any impact on the quality of the product while making copies. In both these contexts, the act amounts to infringement of copyright. As stated earlier, in the digital context, maintaining additional copies could be done with ease. This problem in the modern days can be cured using technological protection measures.[850] The Forward- delete method is often stated as a solution for this issue of keeping an additional copy.[851] The method means that no copy shall be maintained after the copy has been transferred to another user.[852] Recently, Amazon was granted patent for secondary

[849] See for eg: §.17 U.S. Code § 109 - Limitations on exclusive rights: Effect of transfer of particular copy or phonorecord(a) Notwithstanding the provisions of section 106(3), the owner of a particular copy or phonorecord lawfully made under this title, or any person authorized by such owner, is entitled, without the authority of the copyright owner, to sell or otherwise *dispose of the possession of that copy* or phonorecord..

[850] See for example the technology in Amazon patent (United States Patent 8,364,595,) available at https://patentimages.storage.googleapis.com/09/28/25/54ba132d0de701/US8364595.pdf, (accessed on 25/12/2018), which was a patent granted for Secondary market for digital objects, wherein the patentees used technology which automatically deleted the copy from the sender upon transfer to the patentee's digital market.

[851]*DMCA Section 104 Report*, A Report of the Register of Copyrights Pursuant to §104 of the Digital Millennium Copyright Act, U.S. Copyright Office, 2001, p.82, available at https://www.copyright.gov/reports/studies/dmca/sec-104-report-vol-1.pdf , (accessed on 6/12/2018).

[852] Amazon Patent for secondary market (United States Patent 8,364,595,) available at https://patentimages.storage.googleapis.com/09/28/25/54ba132d0de701/US8364595.pdf, (accessed on 25/12/2018). The technology ensures that no copy is maintained after transfer as it automatically deletes the copy.

digital market where used books and songs were being sold. The software used by Amazon deleted the copy that was being transferred from the user's computer to the Amazon site.[853] This ensures that no copy is maintained after transfer. In brief, the emergence of digital technology need not alter the application of Copyright Act.[854]

5.1.3. Impact of Secondary markets in the Digital World:

The second major concern is the problem of secondary markets which is raised as a challenge to exhaustion even in the analogue context.[855] The world is increasingly moving in the direction of digital works. Currently, authors of books, music, film, etc. are increasingly depending on digital technology for dissemination of their works to the public.[856] This creates a potential distribution chain for the copy right holders. The biggest argument raised against secondary markets is the financial loss that will occur to the primary market of the copyright holder due to this secondary market.[857] Though the secondary markets provide income as well as access and affordability to

[853] Amazon Patent for Secondary market for digital objects (United States Patent 8,364,595,), available at https://patentimages.storage.googleapis.com/09/28/25/54ba132d0de701/US8364595.pdf, (accessed on 25/12/2018).

[854] *Twentieth Century Music Corp.* v. *Aiken*, 422 U.S. 151, 158 (1975).

[855] P. Sean Morris, "Beyond Trade: Global Digital Exhaustion in International Economic Regulation", Campbell L. Rev. 107, [2014], Vol.36, pp.134-137,available at https://scholarship.law.campbell.edu/cgi/viewcontent.cgi?article=1575&context=clr, (accessed on 12/122018). Also see; Aaron Perzanowski and Jason Schultz, "Digital Exhaustion", Digital Exhaustion, UCLA L. Rev. 889, [2010], Vol.58, pp. 890-896, available at https://scholarship.law.berkeley.edu/cgi/viewcontent.cgi?article=2246&context=facpubs, (accessed on 23/12/2018);

DMCA Section 104 Report, A Report of the Register of Copyrights Pursuant to §104 of the Digital Millennium Copyright Act, U.S. Copyright Office, 2001, available at https://www.copyright.gov/reports/studies/dmca/sec-104-report-vol-1.pdf , (accessed on 6/12/2018);

Theodore Serra, "Rebalancing at Resale: Redigi, Royalties, and the Digital Secondary Market", Boston University Law Rev. 1753, [2013], Vol.93, p. 1785, http://www.bu.edu/bulawreview/files/2013/10/SERRA_Resale.pdf, (accessed on 7/12/2018).

[856] In America sales of music has been on the rise with the advent of the digital technology like I tunes. Similarly, 20% of the book market is being served by the e-books. see: Laurie Segall, "Digital Music Sales Top Physical Sales", CNN MONEY Tech, Jan. 5, 2012, available at https://money.cnn.com/2012/01/05/technology/digital_music_sales/index.htm, (accessed on 7/12/2018).Also see; Andi Sporkin, "Book stats 2013 Now Available", Ass'n of am.Publishers , May 15, 2013, available at http://publishers.org/press/103, (accessed on 7/12/2018).

[857]Nengimote Daphne Diriyai**,** "To Be or Not To Be? Constructing a Digital Exhaustion Doctrine in the EU and US",

consumers and has high significance in any economy, it also poses challenges to the concept of exhaustion. Secondary market problem gets aggravated when it comes to the digital medium due to the special features of that medium and lower prices for their "used" copy on resale, as such factors may result in great loss to the copyright owners, especially because the "used copy" retains the same quality as the original.[858] Thus, it is feared that the secondary market has the capability to edge the copyright owner out of his market. In other words, the fact that unlike the works in the print and analogue media that erodes with each use, a digital file can be used indefinitely is the main reason for the apprehension about the severity of challenge posed by secondary markets in the digital context. An added concern, as already mentioned, is that the works in digital format can be reproduced flawlessly, and disseminated to nearly any point on the globe instantly and at negligible cost.[859]

It is true that the quality of the digital copies does not erode away in the course of time. This means that the secondary market in the digital market is more of a threat to the copyright holder than in the analogue context. However, the nature of economic investment for the copyright holder in the digital world should also be analysed. The major economic aspect which should never be overlooked is that, in the digital context both distribution and resale becomes easy and less expensive for the copyright holder.[860] The copyright owner does not incur much cost for

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(Thesis, Tilburg University, 2014), p.39, available at http://arno.uvt.nl/show.cgi?fid=132801 , (accessed on 7/12/2018). Also see; Theodore Serra, "Rebalancing at Resale: Redigi, Royalties, and the Digital Secondary Market", Boston University Law Rev. 1753, [2013], Vol.93, p. 1785, available at http://www.bu.edu/bulawreview/files/2013/10/SERRA_Resale.pdf, (accessed on 7/12/2018).Also see: Ruth Anthony Reese, "The First Sale Doctrine in the Era of Digital Networks", B.C.L. Rev. 577, [2003], Vol. 44 pp. 586-587, available at https://lawdigitalcommons.bc.edu/cgi/viewcontent.cgi?referer=https://www.google.com/&httpsredir=1&article=2233&context=bclr. (accessed on 6/12/2018).

[858] Wolfgang Kerber, *Exhaustion of digital goods: An economic perspective*, Joint Discussion Paper Series in Economics, No. 23-2016, p.16, available at http://www.uni-maburg.de/fbo2/makro/forschung/magkspapers, (accessed on 7/12/2018). Also see; John A. Rothchild, "The Incredible Shrinking First-Sale Rule: Are Software Resale Limits Lawful?", Rutgers Law Review,[2004], Vol. 57 *,* Number 1, available at https://digitalcommons.wayne.edu/cgi/viewcontent.cgi?article=1350&context=lawfrp, (accessed on 7/12/2018).

[859] *DMCA Section 104 Report*, A Report of the Register of Copyrights Pursuant to §104 of the Digital Millennium Copyright Act, U.S. Copyright Office, 2001, p.xix, available at https://www.copyright.gov/reports/studies/dmca/sec-104-report-vol-1.pdf , (accessed on 6/12/2018).

[860] William M. Eandes Richard A. Posner , The Economic Structure of Intellectual Property Law, (2003), p.313, available at https://www.amherst.edu/system/files/media/1592/Landes_Posner.pdf, (accessed on 21/12/2018).

publishing and the cost of material resources required for making multiple copies and distributing them in the digital medium also is insignificant as there would be a master copy from which multiple copies could be made and sent to a large number of consumers in no time by a click on the computer.[861]Reduced transaction cost is another contributing factor. This implies that the nature of the primary market and secondary market changes when it comes to the digital medium. Highlighting just the case of secondary market forgetting the advantages that the digital era provides for the primary market cannot be justified. Therefore, the argument of economic loss to the copyright holder caused by secondary market cannot be accepted without other supportive evidences.

Now, even if the consumers are willing to buy it from the primary market at a higher price, the fact that they will be unable to resell them if they want to do so will naturally discourage the consumers from purchasing more. This makes them attracted more towards services like online streaming of works which are much cheaper.[862] Thus, the sales of the primary market also will be affected by the prohibition of resale of purchased products.[863] On the other hand, if resale is allowed, the fact that the users can recoup some of the money that they have spent from the secondary market will encourage them to buy the product.[864]Thus the availability of secondary

[861] Ruth Anthony Reese, "The First Sale Doctrine in the Era of Digital Networks", B.C.L. Rev. 577, [2003], Vol.44, p.621-622, available at https://lawdigitalcommons.bc.edu/cgi/viewcontent.cgi?referer=https://www.google.com/&httpsredir=1&article=2233&context=bclr , (accessed on 6/12/2018).

[862] Kristin Cobb, "The Implications of Licensing Agreements and The First Sale Doctrine on U.S. and EU Secondary Markets for Digital Goods", Duke Journal of Comparative & International Law, [2014], Vol. 24, pp.529-556, at p.539, available at https://scholarship.law.duke.edu/cgi/viewcontent.cgi?article=1408&context=djcil, (accessed on 6/12/2018).

[863] For instance, in 2013, sales for electronic books only grew 5%, in part due to consumers' inability to give away or resell electronic books. See; Kristin Cobb, "The Implications of Licensing Agreements and The First Sale Doctrine on U.S. and EU Secondary Markets for Digital Goods", Duke Journal of Comparative & International Law, [2014], Vol. 24, pp.529-556, at p.530, available at https://scholarship.law.duke.edu/cgi/viewcontent.cgi?article=1408&context=djcil, (accessed on 6/12/2018).

[864] Lawrence J. Glusman, "It's My Copy, Right? Music Industry Power to Control Growing Resale Markets in Used Digital Audio Recordings", WIS. L. REV. 709, [1995], p.716, available at https://heinonline.org/HOL/LandingPage?handle=hein.journals/wlr1995&div=27&id=&page=, (accessed on 7/12/2018). Also see; Aaron Perzanowski and Jason Schultz, "Digital Exhaustion", Digital Exhaustion, UCLA L. Rev. 889, [2010], Vol.58, p.894, available at https://scholarship.law.berkeley.edu/cgi/viewcontent.cgi?article=2246&context=facpubs, (accessed on 23/12/2018).

market may even boost up the primary market of copyright owners for the following reasons: (i) the primary market may get more popularity due to presence of the secondary market;[865] (ii) secondary market can enable the copyright holder to slightly increase their prices as consumers can partly recoup their investments from the secondary market;[866] (iii) consumers will be drawn away from live streaming technologies as they will have the capacity to purchase from the primary market;[867] and (iv) the circulation in secondary market largely depends on the circulation in the primary market and therefore, ensuring more sales in the primary market can enhance the profit of the copyright owner.[868]It should also be noted that the secondary market is a kind of price discrimination mechanism that operates for the welfare of the consumers. If the claim of the intellectual property right holders that price discrimination is a mechanism to facilitate access to consumers is true, genuine secondary markets should not be impeded. Since digital exhaustion creates platform competition, banning of resale is anti-competitive. In the absence of secondary market, the consumers are not afforded the benefits of a competitive market and there is no pressure on prices of copyrighted works. Any intellectual property regime should be framed in such a way as to incorporate competition aspects into it as to balance the incentive of the IP owner at the same time bring in consumer welfare.

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[865] Kristin Cobb, "The Implications of Licensing Agreements and The First Sale Doctrine on U.S. and EU Secondary Markets for Digital Goods", Duke Journal of Comparative & International Law, [2014], Vol. 24, pp.529-556, at pp.529-530, available at https://scholarship.law.duke.edu/cgi/viewcontent.cgi?article=1408&context=djcil, (accessed on 6/12/2018). Also see; Guy A. Rub**, "**Rebalancing Copyright Exhaustion"*,* Emory L.J., (2015), Vol. 64, p.781, available at http://law.emory.edu/elj/_documents/volumes/64/3/articles/rub.pdf, (accessed on 6/12/2018).

[866] Lawrence J. Glusman, "It's My Copy, Right? Music Industry Power to Control Growing Resale Markets in Used Digital Audio Recordings", WIS. L. REV. 709, [1995], p.716,
available at https://heinonline.org/HOL/LandingPage?handle=hein.journals/wlr1995&div=27&id=&page=,
(accessed on 7/12/2018). Also see; Aaron Perzanowski and Jason Schultz*,* "Digital Exhaustion", Digital Exhaustion, UCLA L. Rev. 889, [2010], Vol.58, p.894, available at
https://scholarship.law.berkeley.edu/cgi/viewcontent.cgi?article=2246&context=facpubs, (accessed on 23/12/2018).

[867] I tunes faced a decline in the profit derived from the online market and the reason was attributed to the online streaming mechanism. The online streaming mechanism can be used to communicate any form of copyrighted work. See: Kristin Cobb, "The Implications of Licensing Agreements and The First Sale Doctrine on U.S. and EU Secondary Markets for Digital Goods", Duke Journal of Comparative & International Law, [2014], Vol. 24, pp.529-556, at p.539, available at https://scholarship.law.duke.edu/cgi/viewcontent.cgi?article=1408&context=djcil, (accessed on 6/12/2018).

[868] Aaron Perzanowski and Jason Schultz, "Reconciling intellectual property and personal property", Notre Dame L. Rev. 1211, [2015], Vol. 90, p.1260, available at: http://scholarship.law.nd.edu/ndlr/vol90/iss3/6 (accessed on 7/12/2018).

A secondary market, though digital, remains second best and seldom do new releases appear in the secondary markets as soon as it appears in the primary market and therefore, not much loss occurs to the copyright holder.[869]Further, the primary market of the copyright holder is not affected much by the secondary market as it is only the copy which was bought from the primary market that is being resold i.e., the copy for which reward was received by the copyright owner.[870] The practice of keeping a copy to oneself while selling a newly created copy from the purchased one can also be made impossible by using the apt technology as technology has been evolved to ensure the same. Even if he keeps it in another device it amounts to infringement. The situation thus becomes similar to the physical copy context.

Moreover, there are many beneficial aspects about the secondary markets in the digital world. The first and foremost benefit, of course, is the enhancement in access and affordability to the consumers. The secondary market or the used goods helps consumers in much better ways to obtain copyrighted works often below the market price, which is indeed is in furtherance of the objectives of copyright law.[871] It facilitates access to those who cannot afford to buy the original copy at the higher price. Secondary markets are better at price discrimination and at maximizing social welfare than copyright owners.[872]

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[869] Theodore Serra, "Rebalancing at Resale: Redigi, Royalties, and the Digital Secondary Market", Boston University Law Rev. 1753, [2013], Vol.93, p. 1777, http://www.bu.edu/bulawreview/files/2013/10/SERRA_Resale.pdf, (accessed on 7/12/2018).
Also see; Sarah Abelson, "An Emerging Secondary Market for Digital Music: The Legality of ReDigi and the Extent of the First Sale Doctrine", Ent. & Sports law. 8, [2012],Vol.29, p. 10, available athttps://heinonline.org/HOL/LandingPage?handle=hein.journals/entspl29&div=35&id=&page=, (accessed on 12/12/2018) .

[870] John A. Rothchild, "The Incredible Shrinking First-Sale Rule: Are Software Resale Limits Lawful?", Rutgers Law Review,[2004], Vol. 57 , Number 1, p.103,
available at https://digitalcommons.wayne.edu/cgi/viewcontent.cgi?article=1350&context=lawfrp, (accessed on 7/12/2018).

[871] Kristin Cobb, "The Implications of Licensing Agreements and The First Sale Doctrine on U.S. and EU Secondary Markets for Digital Goods", Duke Journal of Comparative & International Law, [2014], Vol. 24, pp.529-556, available at https://scholarship.law.duke.edu/cgi/viewcontent.cgi?article=1408&context=djcil, (accessed on 6/12/2018).

[872] Aaron Perzanowski and Jason Schultz, "Digital Exhaustion", Digital Exhaustion, UCLA L. Rev. 889, [2010], Vol.58, p.895, available at https://scholarship.law.berkeley.edu/cgi/viewcontent.cgi?article=2246&context=facpubs, (accessed on 23/12/2018).Also see; Ruth Anthony Reese, "The First Sale Doctrine in the Era of Digital Networks", B.C.L. Rev. 577, [2003],Vol.44, p.585, available at

Even in the digital context when a transfer takes place, the user must make sure that there is no copy retained by the person once it sold, making exhaustion doctrine analogous to tangible medium context. The illegal reproductions of the sold product in a flawless manner with so much ease can be taken care of by the reproduction right of the copyright owner, just as it is done in the analogue context. Therefore the argument that the economic loss to the copyright owner gets aggravated when it comes to the digital context cannot be conclusively accepted. Therefore, secondary markets are crucial in maintaining the balance between rights of copyright holders and public interest.[873]However, the question is whether the mere threat to primary market can call for closure of secondary markets? This question should be answered primarily using the philosophy of exhaustion. The exhaustion doctrine works on the principle of enabling the consumer to enjoy the benefits over a product he purchased as title has changed hands. It does not take into consideration the whole primary market which the author serves. It is concerned merely over the product the author has sold once for which the author has received adequate consideration. Therefore the argument of loss to primary market has its own limitation.

Another major impact of digital exhaustion is the competition that the secondary market creates. For example, in the online platform, the distribution channel enables the copyright holders to bring about crucial and sophisticated price discrimination among consumers, even to the extent of first degree price discrimination i.e., by resorting to individual centric setting of prices.[874] This can be done by offering the product to consumers on a one to one basis stetting different prices for the same work after assessing the consumer's willingness to pay.[875] This can lead to high prices for the copyrighted works and the focus here is not the maximum reach but the maximum profit. Therefore certain consumers are forced to pay high prices compared to others and even

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https://lawdigitalcommons.bc.edu/cgi/viewcontent.cgi?referer=https://www.google.com/&httpsredir=1&article=2233&context=bclr (accessed on 6/12/2018).Also see; Wendy Gordon, "Intellectual Property as Price Discrimination: Implications for Contract", 73 CHI.-KENT L. REV. 1367, [1998], pp.1383-90, available at https://scholarship.kentlaw.iit.edu/cgi/viewcontent.cgi?referer=https://www.google.com/&httpsredir=1&article=3152&context=cklawreview, (accessed on25/12/2018).

[874] Wolfgang Kerber, *Exhaustion of digital goods: An economic perspective*, Joint Discussion Paper Series in Economics, No. 23-2016, pp.15-16, available at http://www.uni-marburg.de/fb02/makro/forschung/magkspapers, (accessed on 7/12/2018).

[875] Wolfgang Kerber, *Exhaustion of digital goods: An economic perspective*, Joint Discussion Paper Series in Economics, No. 23-2016, pp.15-16, available at http://www.uni-marburg.de/fb02/makro/forschung/magkspapers, (accessed on 7/12/2018).

may lead to reduced access to consumers. Thus the presence of secondary markets can make it affordable for consumers who cannot afford such high prices when sold at one to one basis or are not willing to buy at such an arbitrary price and can facilitate increased access to consumers.

Another major function of secondary market is the dynamic efficiency it brings in the digital environment. The users also innovate upon the copy legally purchased by them so as to bring out a new copyrightable work. The so called challenges posed by the digital medium such as the issue of violation of reproduction rights, paved way for the development of new technologies which can resolve such issues. The clear cut example for the same is the fact that Amazon has obtained a patent for secondary market.[876] Various other technological measures are also evolving. Therefore, secondary markets are crucial in maintaining the balance between rights of copyright holders and public interest.[877]

Therefore, in the interest of the consumers, exhaustion must be recognized in the digital context also. The secondary market, as seen above, does not result in the economic loss to the copyright holder and can boost the market of the copyright holder at times. Not recognising exhaustion in the digital context would amount to granting absolute monopoly over the digital medium to the copyright holder hampering consumer welfare as well as the basic aim of intellectual property rights and may even lead to non-use of digital technology by the consumers. Thus, the secondary market can play a crucial role in the digital world in facilitating competition without affecting the fair commercial benefits of the IP holder.

5.1.4. Business strategies to overcome Copyright exhaustion in the digital context: Sale v. License –

Another major concern about digital exhaustion is in relation to the business strategy used by the owners of copyright to restrict the application of exhaustion in the digital context, by limiting the

[876] Amazon Patent for Secondary market for digital objects (United States Patent 8,364,595,), available at https://patentimages.storage.googleapis.com/09/28/25/54ba132d0de701/US8364595.pdf, (accessed on 25/12/2018).AlsoSee;Guy A. Rub**,** **"**Rebalancing Copyright Exhaustion"*,* [2015], Emory L.J., Vol. 64, pp.741-817, available at http://law.emory.edu/elj/_documents/volumes/64/3/articles/rub.pdf, (accessed on 6/12/2018).

[877] Jessica Stevens, "The secondary sale, copyright conundrum – Why we need a secondary market for digital content", Australian Intellectual Property Journal, [2016], Vol.26(4), pp. 3-4, available at http://eprints.qut.edu.au/98942/, (accessed on 7/12/2018).

property interest of the consumers purchasing the online content or the software. They do this by renaming the transfer agreement as license rather than sale.[878] The reason for this is that for exhaustion to kick in, the user must be the owner of the copy.[879]Owners of copyright, therefore, while passing on the digital content to the consumer in the digital content, try to strategically avoid the application of exhaustion doctrine by stating that the transaction is licensing, rather than sale even though there is not much difference in the nature of the transaction. The question, therefore, is what determines the nature of the transaction. Whether exhaustion could be avoided merely by attaching a notice terming the transaction license? The question becomes more significant when it comes to the U.S. concept of first sale doctrine. Here the first sale of the product is a mandatory process for determining whether exhaustion applies or not. The "sale" as a mandate, as pointed out earlier, exists even in §109[880] and §117[881] of the U.S. Copyright Act. The practice of declaring users as licensees draws its logic from the word sale in the §.109 and §.117. So when a transaction is labeled as a license by the copyright owner, it is argued that, the exhaustion will not come into place as there is no sale taking place. This creates ambiguity regarding interpretation of §.109 and §.117, as the provisions cannot be applied when the transaction is a license.

The most common method of licensing is the Shrink Wrap licenses, which automatically binds the user with all the conditions prescribed by the owner of copyright.[882] The licenses typically

[878] Victor F. Calaba, "Quibbles'n Bits: Making a Digital First Sale Doctrine Feasible", Mich. Telecomm. & Tech. L. Rev. 1 [2002], Vol.9, pp.9-11, available at https://repository.law.umich.edu/cgi/viewcontent.cgi?referer=https://www.google.com/&httpsredir=1&article=1134&context=mttlr, (accessed on 16/12/2018).

[879] Aaron Perzanowski and Jason Schultz, "Digital Exhaustion", Digital Exhaustion, UCLA L. Rev. 889, [2010], Vol.58, pp.889-946, available at https://scholarship.law.berkeley.edu/cgi/viewcontent.cgi?article=2246&context=facpubs, (accessed on 23/12/2018).

[880] 17 U.S. Code § 109 - Limitations on exclusive rights: Effect of transfer of particular copy or phonorecord (a)Notwithstanding the provisions of section 106(3), the owner of a particular copy or phonorecord lawfully made under this title, or any person authorized by such owner, is entitled, without the authority of the copyright owner, to sell or otherwise *dispose of the possession of that copy* or phonorecord

[881] 17 U.S. Code §.117, (a) Making of Additional Copy or Adaptation by Owner of Copy.

[882] Mark A. Lemley, "Beyond Preemption: The Law and Policy of Intellectual Property Licensing", Cal. L. Rev. 111, [1999], Vol.87, Issue 1, Article 4, pp.111-172, available at: http://scholarship.law.berkeley.edu/californialawreview/vol87/iss1/4, (accessed on 7/12/2018).Also see; Mark A. Lemley, "Intellectual Property and Shrinkwrap Licenses", Southern California Law Review 1239, [1995], Vol.68, pp.1241-42, available at SSRN: https://ssrn.com/abstract=2126845, (accessed on 1/1/2019).

impose restrictions on use, reproduction, transfer and modification of the software program by the consumer.[883] Shrink wrap licenses does this by limiting the right of the user to that of a mere licensee.[884] Another method that software publishers use in an effort to prevent the acquirer from becoming the "owner" of her copy is a declaration that the software publisher "retains title" to the software or to the copy.[885]Therefore, it is mandatory to look into the U.S. and European contexts, both legislative and judicial, in determining the difference between sale and license in the context of transfer of digital content and how exhaustion could be applied in such cases. An important thing to be noted here is that, the norms of exhaustion, which applies to the tangible medium needs to govern the digital medium as well since the underlying philosophy of exhaustion does not and cannot alter. The practical problems in the adaptation of the same concept to the digital context are the only questions to be enquired. Therefore, it is pertinent to understand the U.S. and European position regarding first sale doctrine and its impact on digital medium.

5.1.4. (a) First sale doctrine in digital medium under the United States Copyright Law

The basic error committed while allowing the copyright holders to restrict the resale of a copyrighted work using license agreement is the failure in distinguishing between IP, an intangible right enjoyed by the copyright owner and the rights of the purchaser of an IP product, attached to the tangible property. The copyright holder has the right to license his IP rights to anyone but the question then is can the license of IP be considered as a license for the use of the

[883] Batya Goodman, "Honey, I Shrink-Wrapped the Consumer: The Shrink Wrap Agreement as an Adhesion Contract", Cardozo L. Rev. 319, [1999], Vol. 21, p.332 , available at https://edisciplinas.usp.br/pluginfile.php/2010803/mod_resource/content/1/GOODMAN%2021_Cardozo_L%5B1%5D._Rev%20%28Honey%2C%20I%20shrink-wrapped%20the%20consumer%29.pdf, (accessed on 7/12/2018).

[884] Batya Goodman, "Honey, I Shrink-Wrapped the Consumer: The Shrink Wrap Agreement as an Adhesion Contract", Cardozo L. Rev. 319, [1999], Vol. 21, p.332 , available at https://edisciplinas.usp.br/pluginfile.php/2010803/mod_resource/content/1/GOODMAN%2021_Cardozo_L%5B1%5D._Rev%20%28Honey%2C%20I%20shrink-wrapped%20the%20consumer%29.pdf, (accessed on 7/12/2018).

[885] John A. Rothchild, "The Incredible Shrinking First-Sale Rule: Are Software Resale Limits Lawful?", Rutgers Law Review,[2004], Vol. 57 , Number 1, p.39,available at https://digitalcommons.wayne.edu/cgi/viewcontent.cgi?article=1350&context=lawfrp, (accessed on 7/12/2018). Also see; Brian W. Carver, "Why License Agreements Do Not Control Copy Ownership: First Sales and Essential Copies", Berkeley Tech. L.J. 1887, [2010], Vol. 25, pp.1899-1904, available at http://scholarship.law.berkeley.edu/btlj/vol25/iss4/7 , (accessed on 7/12/2018).

tangible property in which the IP is encompassed? Wouldn't the same amount to conditional sale if the transfer of the tangible object is termed as a license to use it in perpetuity while the transaction, in effect, has all the characteristics of a sale? In short, can the copyright holder restrict using his IP rights the use of an object containing IP by its consumers?

Therefore, before dealing with the matter of exhaustion in the digital medium, it would be worth looking into the position of exhaustion in tangible medium under §109 of the U.S. Copyright Act, 1909,[886]to answer the questions posed above in a better way. It was codified into law after the decision in *Bobbs Merrill v. Strauss*,[887] in which the court refused to entertain a notice attached to the book sold by the copyright owner, restraining the purchaser from reselling the book. The court held that the restriction was unreasonable and against public policy.[888] The legislature responded immediately, incorporating the principle underlying that decision into the law.[889] The section was redrafted as follows:

> "That the copyright is distinct from the property in the material object copyrighted, and the sale or conveyance, by gift or otherwise, of the material object shall not of itself constitute a transfer of the copyright, nor shall the assignment of the copyright constitute a transfer of the title to the material object; but *nothing in this Act shall be deemed to forbid, prevent, or restrict the transfer of any copy of a copyrighted work the possession of which has been lawfully obtained*."[890] (Emphasis added)

The word used in the section is 'possession'. This implies that a person who has lawful possession of a copyrighted work can transfer the object to any one of his choice. Another important point to be noted in the provision is that the legislature made it very clear that the copyright and the material object in which the work is embedded are different. This is the basic

[886] 17 U.S. Code § 109 - Limitations on exclusive rights: Effect of transfer of particular copy or phonorecord(a) Notwithstanding the provisions of section 106(3), the owner of a particular copy or phonorecord lawfully made under this title, or any person authorized by such owner, is entitled, without the authority of the copyright owner, to sell or otherwise *dispose of the possession of that copy* or phonorecord.

[887] 210 U.S. 339, 350 (1908).

[888] 210 U.S. 339, 350 (1908).

[889] Copyright Act of 1909, ch. 320 § 41, 35 Stat. 1075, 1084.

[890] §109 of the U.S. Copyright Act, 1909 as amended in 1908.

philosophy of exhaustion. This brings out that the logic of exhaustion as codified under the U.S. Act was to enable the full enjoyment of property possessed by a person.

In the beginning of this tug of war between owners of copyright and individual property owners, the courts favored the individual purchasers.[891] The courts held that the moment there was a transfer of material object containing copyrighted work, there took place a transfer of all the valuable things attached to the object.[892] The courts were, in fact, of the opinion that copyright was incidental to ownership of a manuscript and that it passed with the transfer of the concerned art.[893] Even the right to reproduction was conceived to have passed onto the consumer.[894]Admitting that the above said observations of the court is, in fact, a far- fetched line of thought, it is important to note that the court indeed sided with the consumers, reflecting the philosophy that the very existence of copyright law is to safeguard public interest even while granting copyright protection to the creator as an incentive. Later on, reproduction right was separated from the rights passed onto the consumer and it was held that the property acquired by the purchaser on a sale of a copyrighted material and the copyright secured to the author under the Act of Congress are altogether different and independent of each other, and have no necessary connection.[895] Copyright interests were declared to be detached from the manuscript, or any other physical existence.[896]Purchaser of the copyrighted work was held not to be infringing copyright because the sale of the copyrighted books by copyright holder carried with it the ordinary incidents of ownership in personal property and by purchasing them consumer had acquired the right to resell them.[897] This meant that clear distinction was made between the

[891] Aaron Perzanowski and Jason Schultz, "Reconciling intellectual property and personal property", Notre Dame L. Rev. 1211, [2015], Vol. 90, p.1218, available at: http://scholarship.law.nd.edu/ndlr/vol90/iss3/6 (accessed on 7/12/2018).

[892] *Parton* v. *prang* 18 F. Cas.1273 (C.C.D.Mass.1872) (No.10,784) at 1277, *Pushman*v. *New York Graphic Society* 39 N.E.2d 249 (N.Y. 1942).

[893] *Parton* v. *prang* 18 F. Cas.1273 (C.C.D.Mass.1872) (No.10,784)at 1278..

[894] *Parton* v. *prang* 18 F. Cas.1273 (C.C.D.Mass.1872) (No.10,784)at 1277, *Pushman*v. *New York Graphic Society* 39 N.E.2d 249 (N.Y. 1942).

[895] *Stephens* v. *Cady*55 U.S. (14 How.) 528, 530 (1852).

[896] *Stephens* v. *Cady* 55 U.S. (14 How.) 528, 530 (1852).

[897] *Doan* v. *Am. Book Co* 105 F. 772, 776 (7th Cir. 1901). Similar judgements were rendered in many cases such as *Kipling* v. *G.P. Putnams Sons*, 120 F 631, 65 L.R.A. 873, (2nd Circuit, 1903), holding that the defendants did not commit copyright infringement by selling a set of the plaintiff's works that they purchased from him; *Harrison* v. *Maynard, Merrill & Co.*, 61 Fed. (C.C.A.) 689, holding that the right of a copyright owner to restrain the sale of a

intellectual property right and tangible IP product, the former being under the control of IP holder and the later under the control of the consumer.[898] This means that it would be against the law and against public interest to exercise control over an object, which is under the legal possession of another. This view brings in a balance between the incentive provided by the IP holder and consumer welfare. This is the underlying philosophy of exhaustion. The basic distinction one needs to make, for understanding the concept of exhaustion, is that of the two properties that exist, viz., the intellectual property and the real property. While the copyright owner exercises his incorporeal right, the consumers exercise the corporeal right entrusted upon them by law.[899] The first sale doctrine ensures that the copyright monopoly does not encroach on the personal property rights of the individual owner by providing that owners of particular copies of a copyrighted work have the same right to sell, give away, or destroy those copies as the traditional owner of real property enjoyed.[900] This philosophy is also reflected in the §202 of the

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particular copy of a book has gone when the owner of the copyright has sold it once and that copy has parted with all his title to it, and has conferred an absolute title to the copy upon a purchaser; *Clemens v. Estes*, 22 Fed. (C.C.) 899 holding that the defendants had a right to buy, or contract to buy, books from agents who lawfully obtained them by purchase from the plaintiff or his publishers; *Stowe*v. *Thomas* 1853 U.S. App. Lexus 751-752 (1853), holding that when an author has sold his book, the only property which he reserves to himself, or which the law gives to him, is the exclusive right to multiply the copies of that particular combination of characters which exhibits to the eyes of another the ideas intended to be conveyed etc., are some examples.

[898] One must also notice that it was around the same period of that of *Stephan* v. *Cady* 55 U.S. (14 How.) 528, 530 (1852), the courts began to take similar stands in Patent cases too where in courts held that after the first sale the product comes out of the monopoly of the patent owner and is under the complete ownership of the purchaser. See *Bloomer* v.*Mcqueen*55 U.S. 14 How. 539, (1852). This was very much similar to the court decisions in *Stephan* v. *Cady* 55 U.S. (14 How.) 528, (1852), at p.530.

[899] Brian W. Carver, "Why License Agreements Do Not Control Copy Ownership: First Sales and Essential Copies", Berkeley Tech. L.J. 1887, [2010], Vol. 25, pp.1887-1954, available at http://scholarship.law.berkeley.edu/btlj/vol25/iss4/7 (accessed on 7/12/2018). Also see; Aaron Perzanowski and Jason Schultz, "Reconciling intellectual property and personal property", Notre Dame L. Rev. 1211, [2015], Vol. 90, pp.1211-1264, available at: http://scholarship.law.nd.edu/ndlr/vol90/iss3/6 (accessed on 7/12/2018); Bruce A. Lehman and Ronald H. Brown, *Intellectual Property and the National Information Infrastructure: The Report of the Working Group on Intellectual Property Rights*, United States, Information Infrastructure Task Force, (Sept. 1995), available at https://groups.csail.mit.edu/mac/classes/6.805/articles/int-prop/nii-report-sept95.txt., (accessed on 25/12/2018).

[900] Diepiriye A. Anga, "Intellectual Property Without Borders? The Effect of Copyright Exhaustion on Global Commerce", BYU Int'l L. & Mgmt. R. 53, [2014], Vol.10, p.61, available at https://digitalcommons.law.byu.edu/ilmr/vol10/iss1/4, (accessed on 7/12/2018).Also see; *Brilliance Audio, Inc.* v.*Haights Cross Commc'ns Inc*., 474 F.3d 365, 373-74 (6th Cir.2007); *Sebastian Int'l Inc.* v. *Consumer Contacts Ltd*., 847 F.2d 1093, 1096 (3d Cir. 1988).

U.S. Copyright Act. § 202 of the U.S. Copyright Act, 1976[901], clearly states that ownership of copyright and ownership of material object are different. The transfer of the material object does not transfer the copyright of the owner to the purchaser. This lays down the basis for the exhaustion provision under the U.S Copyright law as it could be read that copyright ownership does not confer on the copyright owner the right to retain his control over the material object after the ownership on itis transferred to the consumer.

In 1947, the first sale doctrine was redrafted using virtually identical language as in the Copyright Act of 1909.[902] It was the Copyright Act of 1976 that introduced the modern form of the first sale doctrine in § 109, which is being followed until now.[903] The amendment in 1976 changed the word 'possession' to 'ownership' without attributing any reason for the change.[904] This means that exhaustion can be applied only to that object that is owned by purchasers making ownership and sale a necessary ingredient of exhaustion. This made it easy for the copyright owners to control the further movements of the sold copyrighted products often by avoiding sale and resorting to licensing of the objects, especially in the digital and software contexts. The period of the amendment is also important since it was in the late 1960's that the digital technology in the form of computer and related software's boomed across the world especially in America. This amendment goes against the basic principle of exhaustion evolved from the initial case *Bobbs Merrill v. Strauss*.[905]

[901] 17 U.S. Code § 202: Ownership of a copyright, or of any of the exclusive rights under a copyright, is distinct from ownership of any material object in which the work is embodied. Transfer of ownership of any material object, including the copy or phonorecord in which the work is first fixed, does not of itself convey any rights in the copyrighted work embodied in the object; nor, in the absence of an agreement, does transfer of ownership of a copyright or of any exclusive rights under a copyright convey property rights in any material object.

[902] U.S. Copyright Act of 1947, ch. 391 § 27.

[903] 17 U.S. §109 (a) :Notwithstanding the provisions of section 106(3), the owner of a particular copy or phonorecord lawfully made under this title, or any person authorized by such owner, is entitled, without the authority of the copyright owner, to sell or otherwise dispose of the possession of that copy or phonorecord.

[904] Richard H. Stern, "Section 117 of the Copyright Act: Charter of the Software Users' Rights Or An Illusory Promise?", W. New Eng. L. Rev. 459, [1985], Vol.7, p.467, available at http://digitalcommons.law.wne.edu/lawreview/vol7/iss3/3, (accessed on 7/12/2018). Also see; Robert A. Kreiss, "Section 117 of the CopyrightAct",B.Y.U. L. REV. 1497, [1991], pp. 1508-1510, available at https://digitalcommons.law.byu.edu/lawreview/vol1991/iss4/2, (accessed on 21/12/2018)

[905] 210 U.S. 339, 350 (1908). For a detailed analysis refer to Chapter 1 of the thesis.

These facts are important for the discussion on the transfer of IP goods in the digital medium and digital exhaustion. When it comes to the software context, the software as an intangible medium is under the complete ownership of the copyright owner while the software containing C.D. comes within the ownership of the purchaser. The copyright owner, however, tries to control the movement of the C.D. containing software using license agreements, limiting the right to resale.[906] This is against the rule explained above. The copyright owner does not possess any rights beyond the copyright to control the movement of the C.D. The situation is similar to the one in online transfer.

The above said analysis sheds light in many ways for determining whether a transaction is a sale or not. There are basically two problems that the courts have confronted in the sale v. license debate. The primary concern is the attempt to control rights of the consumers upon the sold copy through contracts using the copyright. In the digital context, by failing to distinguish between copyright and personal property, and to balance the competing interests between consumers and copyright holders, it is troubling in cases that treat copyright ownership as determinative of personal property interests.[907] The above analysis also makes it clear that this practice of the software copyright owners cannot be justified as the owners of software and the tangible medium containing the software are different.

The second concern is the complexity of the agreements that the copyright holder enters with the consumer. The contracts merely term a transaction as license and thus limit the application of the exhaustion doctrine. The courts have been confronted, many a time, with the problem whether exhaustion can apply in cases where the work is licensed to the consumers throughout the term of copyright protection. Several courts, when faced with such a situation, have accepted the software publishers' argument that they do not sell, but only license their software, and that this disposition of the merchandise makes unavailable the rights granted by sections 109(a) and 117(a) of the Copyright Act.[908] As stated above, at times it is the failure to distinguish between

[906] *United States* v. *Wise* 550 F.2d 1180 (9th Cir. 1977), *Vernor*v. *Autodesk*, 2010 WL 3516435 (9th Cir. Sept. 10, 2010).

[907] Aaron Perzanowski and Jason Schultz, "Reconciling intellectual property and personal property", Notre Dame L. Rev. 1211, [2015], Vol. 90, p.1219, available at: http://scholarship.law.nd.edu/ndlr/vol90/iss3/6 (accessed on 7/12/2018).

[908] See for eg: *Microsoft Corp.* v. *Harmony Computers & Electronics, Inc*., 846 F. Supp. 208 (E.D.N.Y. 1994), *S.O.S.,*

tangible and intangible element is the reason for the same. Therefore the following section analyses these judicial decisions. The judiciary has evolved various tests as identified below for reaching at the appropriate decision.

Reservation of title test: The earliest approach taken by the judiciary in determining whether a transaction is sale or license was to determine whether the copyright holder has expressly retained the ownership of the copy transferred to the consumer through a license agreement.[909] If the agreement retains the ownership of the copy and expressly states the transaction to be a license, the courts construe that no sale has taken place and the transaction is a mere license to use the copy.[910] This test is commonly called as the 'reservation of title test'. The observation of the court that mere characterization of a transaction as license alone is sufficient to declare that it is not to a sale is a catastrophic approach adopted by the courts. The most important flaw in this approach is the failure of the court to look into the impact of such agreements on the overall consumer welfare. The handing up of the right to a conditional sale in the software context cannot in any way be justified from the public interest perspective even in software related cases. The reason is that the software is the subject of copyright while the software embedded object is the subject of tangible normal property jurisprudence.[911] Both in the tangible and intangible context, the attempt to restrict the use of the copy transferred to a consumer using copyright is

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Inc. v. *Payday, Inc*., 886 F.2d 1081, 1088 (9th Cir. 1989). Also see, John A. Rothchild, "The Incredible Shrinking First-Sale Rule: Are Software Resale Limits Lawful?", Rutgers Law Review,[2004], Vol. 57 *,* Number 1, available at https://digitalcommons.wayne.edu/cgi/viewcontent.cgi?article=1350&context=lawfrp, (accessed on 7/12/2018); Brian W. Carver, "Why License Agreements Do Not Control Copy Ownership: First Sales and Essential Copies", Berkeley Tech. L.J. 1887, [2010], Vol. 25, available at http://scholarship.law.berkeley.edu/btlj/vol25/iss4/7 , (accessed on 7/12/2018).

[909] *S.O.S. Inc.* v.*Payday, Inc*., 886 F.2d 1081, 1088 (9th Cir. 1989), *MAI Sys. Corp* v. *Peak Computer*, 991 F.2d 511, 518.

[910] For eg: In *S.O.S. Inc.* v.*Payday, Inc*., 886 F.2d 1081, 1088 (9th Cir. 1989, the S.O.S merely rented the computer on which the disputed copy of software was installed. The court held that "the literal language of the parties' contract provides that S.O.S**.** retains all rights of ownership. This language plainly encompasses not only copyright ownership, but also ownership of any copies of the software. Payday has not demonstrated that it acquired anything more than the right to possess a copy of the software for the purpose of producing the "product" for its customers." After evaluating the contract as a whole, the court saw a leasing arrangement that applied not only to the computer hardware, but also to the individual copies of the software as well.

[911] See *DSC Commc'ns Corp.* v. *Pulse Commc'ns, Inc*., 170 F.3d 1354, 1360 (Fed. Cir. 1999), case where the court criticises the MAI case for the failure to distinguish between copyright and copyright embedded tangible medium.

against the basic logic of exhaustion which differentiates the rights of the copyright owner and the rights of the consumer of the IP product.

This logic is also reflected in § 202 of U.S. Code on copyright. The court failed to understand the meaning of § 202 of U.S. Copyright Act, which differentiated between the copyright and tangible material in which copyright existed.[912] Though the copyright holder definitely enjoys the right to license IP rights, the essential question here is, if he is actually trying to license the object containing software or simply camouflaging a sale as a license. If it is the latter, it amounts to conditional sale of tangible object which is not legally recognized as valid. Merely because a license existed giving the right to use the software, does not take away the ownership of the purchaser in the tangible object. The question whether the transaction is a sale or a license has to be determined from the terms of the contract between the parties. Another important flaw in this case is that by declaring the transaction as license merely because it is stated so in the contract, the court failed to look into other aspects of the agreement to determine whether the transaction is a sale or not.[913] The literal interpretation of the agreement, merely based on the word license used in the agreement, upsets the total balance of the copyright regime as it is against the larger public interest.

Restriction of rights test: Another method of restricting the consumer from enjoying the copy sold to the consumer is through restricting the rights in copyright. The retention of ownership over the copyright by the IP holder does not give any right to restrict the rights of the purchaser in any manner.[914] The court held that once the copyright owner made it clear that she or he was granting only a license to use the copy of software and had imposed significant restrictions on

[912] See: 17 U.S.C. § 202 : "Ownership of a copyright, or of any of the exclusive rights under a copyright, is distinct from ownership of any material object in which the work is embodied."

[913] For eg: In *S.O.S.* v. *Payday*886 F.2d 1081, 1088 (9th Cir. 1989, the contract contained that the software was purchased by the Payday for $5,325. The court never looked into the interpretation of the word purchase and how it can co-exist with the words license.

[914] In *Microsoft* v. *Harmony*,846 F. Supp. 208 (E.D.N.Y. 1994) it was held that first sale would not apply even to legally purchased product as the plaintiffs have considerably retained many of the copyrights that they posses and that entering a license agreement is not a sale for purposes of the first sale doctrine. This implies that the first sale doctrine could be thwarted by a mere license agreement. This observation is very much related to the logic of implied license theory and it must be stated that implied license theory is not the base of exhaustion doctrine but restrain on alienation is.

the purchaser's ability to redistribute or transfer that copy, the purchaser could be considered a licensee and not the owner of the software.[915]

The flaw in these decisions is that the courts failed to recognize that selling a copy and entering into a license agreement is paradoxical and whether there is a sale for purposes of the first sale doctrine needs to be decided based on the question if the ownership of a particular copy has been transferred completely for all practical purposes after entering in to the agreement. The differentiation between tangible and intangible element, as analysed above, has not been reflected in these judgment. To accept a restraint on transfer one must justify it as reasonable both in respect of public interest and the intention of the parties concerned. Merely by terming a perpetual transaction a license to prevent transferring of ownership to the purchaser of IP good is an explicit attempt to avoid exhaustion and thus against public welfare. The copyright owners could not be allowed to unreasonably restrict the personal property rights of the individual consumers by simply declaring the consumers as licensees.[916] It is in effect an encroachment into the personal property interests of the consumers over a property, which they lawfully own. It is an undue extension of monopoly.[917]

At this point of time it is important to have a detailed analysis of the history of §.117 of the U.S. Copyright Act. The amendments to §.117 have to be examined in detail to have a proper understanding of their real implications. The provision was introduced into the U.S. Copyright Act by the 1980 amendment, on the basis of the discussions and the Final Report of the National

[915] *Wall data Inc.* v. *L.A. County Sheriffs Department*, 447 F.3d 769 (9th Cir. 2006) at 785. The present case pertainedthe defendants contravened the shrink-wrap license and volume control license and installed more software than permitted in more computers. They did it after developing a baseline of software applications and then copying the software installed in one computer to the other computers.

[916] Molly Shaffer Van Houweling, "Exhaustion and the Limits of Remote-Control Property", Denv. L. Rev. 951, [2016], Vol.93, p.952,available at http://static1.1.sqspcdn.com/static/f/276323/27253933/1474324079933/93.4_951+Van+Houweling.pdf?token=tBZYkcVWiiF2pBr5pocoUJoYCkk%3D, (accessed on 8/12/2018).

[917] *Bloomer* v. *McQueen*, 55 U.S. 14 How. 539 539 (1852)**.** Brian W. Carver, Why License Agreements Do Not Control Copy Ownership: First Sales and Essential Copies, Berkeley Tech. L.J. 1887, [2010], Vol.25, pp. 1907-1944, available at https://scholarship.law.berkeley.edu/cgi/viewcontent.cgi?referer=https://www.google.com/&httpsredir=1&article=1863&context=btlj (accessed on 7/12/2018).

Commission on New Technological Uses of Copyrighted Works (CONTU).[918]The CONTU report, in fact, recommended the Congress to amend the copyright law so as to enable a "rightful possessor" of a copy of a computer program to make certain copies and adaptations of the program without infrnging copyright.[919]As per the report a "person in rightful possession of copies" was meant to include any authorized licensee or lessee.[920]However, the Congress replaced the word 'rightful posesseor' with 'rightful owner', making ownership as the primary condition for defense under §.117.[921] The reason for the rejection of CONTU recommendation in the 1980 amendment was not explained by the legislature.[922] However, the ultimate result of the amendment is that ownership has to be established for the purose of attracting §.117. The statute did not clearly state the circumstances under which a user has to be treated as the owner of the copy embodying the software.[923] However, the impact of this confusion created by the law was that it gave a chance to the copyright owner, in the digital medium, to evade exhaustion by entering in to a contract of license rather than a contract of sale to avoid conferring ownership with the user. This change, one can see, is in contravention to the following four major propositions put forth in the CONTU report in the context ofdigital copyright protection: (a) Copyright should eliminate unauthorised copying of works, (b) copyright should in no way inhibit the rightful use of works, (c) copyright should not block development and dissemination of these works, (d) copyright should not grant anyone more economic power than necessary to

[918] *Final Report of the National Commission on New Technological Uses of Copyrighted Works*, United Nations National Commission On New Technological Uses of Copyrighted Works, (1978), available at https://babel.hathitrust.org/cgi/pt?id=mdp.39015026832934;view=1up;seq=3, (accessed on 8/12/2018).

[919]*Final Report of the National Commission on New Technological Uses of Copyrighted Works*, United Nations National Commission on New Technological Uses of Copyrighted Works, (1978), p. 30, available at https://babel.hathitrust.org/cgi/pt?id=mdp.39015026832934;view=1up;seq=3 (accessed on 8/12/2018).

[920] *Final Report of the National Commission on New Technological Uses of Copyrighted Works*, United Nations National Commission on New Technological Uses of Copyrighted Works, (1978), p. 30, available at https://babel.hathitrust.org/cgi/pt?id=mdp.39015026832934;view=1up;seq=3 (accessed on 8/12/2018).

[921] §117 of the 17 U.S. Copyright Act, 1976.

[922] Robert A. Kreiss, , "Section 117 of the Copyright Act", B.Y.U. L. REV. 1497, [1991], pp.1523-25, pp. 1508-1510, available at https://digitalcommons.law.byu.edu/lawreview/vol1991/iss4/2, (accessed on 14/12/2018) . Also see; Richard H. Stern, "Section 117 of the Copyright Act: Charter of the Software Users' Rights Or An Illusory Promise?", W. New Eng. L. Rev. 459, [1985], Vol.7, p.467, available at http://digitalcommons.law.wne.edu/lawreview/vol7/iss3/3, (accessed on 7/12/2018).

[923] Petra Heindl, *A Comparative Analysis of Online Distribution of Software in the United States and Europe: Piracy or Freedom of "First Use"?,* TTLF Working Papers, No. 6, Stanford – Vienna Transatlantic Technology Law Forum**,** 2010, p.10, available at http://www.law.stanford.edu/program/centers/ttlf/papers/heindl_wp6.pdf, (accessed on 25/12/2018).

achieve the incentive to create.[924] It was upon these grounds that the CONTU report suggested the inclusion of the word "possessor" instead of "owner". This shows that the CONTU report, which aimed at achieving balance between the rights of the copyright owner and the public interest through safeguarding the utilitarian function of the intellectual property, was not taken into account while making this alteration in the law. The report also suggested that the rightful possessor of a copy should be able to sell the copy which he possess to any other person provided he sells all his rights on the copy to the another person and does not keep an copy of the program.[925] This recommendation, the report says, was made specifically with the intent to recognize exhaustion under S.109 (a).[926]

The above philosophy underlying the CONTU report does not justify the Act of the congress in replacing the words "rightful possessor" with"owner". Proponents of a 'transfer of the title' interpretation argue that Congress' intent behind the change in the wording was to restrict the scope of the §. 117 exceptions to one who has complete title to the program.[927] However, this author fails to understand the logic behind the licensing mechanism in the digital context. In the tangible context, placing restrictions on the purchaser of the IP product using licensing mechanism was prohibited by the courts on the ground that it amounted to conditional sale; that it is incompatible with the competition principle; that it amounted to restraint on alienation of goods purchased; and that it is against consumer welfare.[928] However, it appears that the judiciary has not shared the same view in the digital context. The court often seems to be in a dilemma.

[924] *Final Report of The National Commission on New Technological Uses Of Copyrighted Works*, United Nations National Commission On New Technological Uses Of Copyrighted Works, (1978), p. 29, available at https://babel.hathitrust.org/cgi/pt?id=mdp.39015026832934;view=1up;seq=3 (accessed on 8/12/2018).

[925] *Final Report of The National Commission on New Technological Uses of Copyrighted Works*, United Nations National Commission on New Technological Uses of Copyrighted Works, (1978), p. 13, available at https://babel.hathitrust.org/cgi/pt?id=mdp.39015026832934;view=1up;seq=3 (accessed on 8/12/2018).

[926] *Final Report of The National Commission on New Technological Uses of Copyrighted Works*, United Nations National Commission On New Technological Uses of Copyrighted Works, (1978), p. 13, available at https://babel.hathitrust.org/cgi/pt?id=mdp.39015026832934;view=1up;seq=3 (accessed on 8/12/2018).

[927] *Applied Information Management, Inc.* v.*Icart,* 976 F.Supp. 149, 153.

[928] See for eg; *BobbsMerril* v. *Strauss*210 U.S. 339 (1908), *Keeler v. Standard Folding-Bed Co*157 U.S. 659 (1895).

The decision in *DSC Communications Corp. v. Pulse Communications, Inc*,[929] was a turning point in many ways. The court began to correct the faults in the earlier decisions and to differentiate between the intangible and tangible element involved in the software cases.It recognized the ownership of consumers over the tangible element and observed that the license of copyright and ownership of purchasers can co-exist.[930] However, the court erred in deciding the question of the nature of the transaction by identifying it as a license and not a sale, blindly relying on the terms included by the copyright holder, restricting the use of the software. The Plaintiffs DSC communications restricted by contract the use of the software by insisting that the software can be used only with the hardware provided by them. In this case the court, after examining the terms used in the contract which restricted the use of the copy embedding the software by the consumer, held that the contract which expressly restricts the use of the copy by the consumerhas to be treated as a license. Though the court accepted the view that when a payment was made through a onetime transaction and the use was intended to be perpetual, the transaction could be termed as sale,[931] it opined that these terms were not the sole indicators of ownership. If the consumers' use of the software was severely restricted by the copyright holder, the transaction will not amount to sale.[932] This observation is wrong as it confers on the copyright holder the right to restrict the use of the tangible copy using his copyright, which is against the common law rule against restraint of alienation. Though initially the court had accepted that copyright and ownership over copyrighted good are distinct and can co-exist, it failed ultimately, to understand its real implication. The court also failed to bring clarity as to what constitute sale and when it is only a license.[933] Even though it did not apply the 'reservation of title' test evolved in *MAI* and *Payday* cases, the court came to the same conclusions though in

[929] 170 F.3d 1354 (Fed. Cir. 1999)

[930] The court held that "Plainly, a party who purchases copies of software from the copyright owner can hold a license under a copyright while still being an "owner" of a copy of the copyrighted software for purposes of section 117**.** We therefore do not adopt the Ninth Circuit's characterization of all licensees as non-owners." See; *DSC Communications Corp.* v*. Pulse Communications, Inc,* 170 F.3d 1354 (Fed. Cir. 1999).

[931]*DSC Communications Corp.* v. *Pulse Communications, Inc,* 170 F.3d 1354 (Fed. Cir. 1999).

[932] See *DSC Communications Corp.* v. *Pulse Communications, Inc,* 170 F.3d 1354 (Fed. Cir. 1999), p.9,because the DSC-RBOC agreements substantially limit the rights of the RBOCs compared to the rights they would enjoy as "owners of copies" of the POTS-DI software under the Copyright Act, the contents of the agreements support the characterization of the RBOCs as non-owners of the copies of the POTS-DI software.

[933] The district court in the same case had previously observed that if a transaction takes place where reward or the payment for using the software was one time payment and if the software is transferred for use for an unlimited period of time, then the transaction would amount to sale, irrespective of the restrictions placed by the seller. See *DSC Communications Corp.* v. *Pulse Communications, Inc,* 170 F.3d 1354 (Fed. Cir. 1999).

a different way.[934] This finding is inconsistent, as stated earlier, with the rule against restraint on alienation and of the rules pertaining to conditional sales.

Economic realities test: The next test towards determining whether a transaction was sale or license was evolved in *Microsoft Corp*. v. *DAK Indus.*,[935] Microsoft and DAK entered into a license agreement granting DAK certain nonexclusive license rights to Microsoft's computer software. The DAK industries were provided with a master CD which contained the software of the word programmed developed by the Microsoft and DAK could copy the software from the CD into computers which the DAK sold. The agreement provided that DAK would pay a royalty rate per copy of computer software that it distributed. The Court described the transaction as a sale rather than license through developing a new test based on the economic realities taking place between the copyright holder and the consumer.[936] The economic realities refer to the nature of economic transaction involved in the contract between the parties. Under this approach the court still examined if the transaction is a license or not from the terms of the contract. But instead of asking whether the agreement puts significant restrictions on the customer‘s use, it asks whether the transaction as a whole more closely resembles a sale or some kind of non-sale transaction, looking at the economic implications of it.[937] In this case, the court developed the economic realities test from the stipulation in the contract between DAK and Microsoft which obliged DAK to pay royalty rate per copy of computer software that it distributed. From this pricing structure of the transaction between Microsoft and DAK the court concluded that it was a sale.[938] The court found that the agreement was best characterized as a lump sum sale of software units to DAK, rather than a grant of permission to use an intellectual property. The court noted:

[934] “The DSC-Ameritech agreement provides that Ameritech shall "not provide, disclose or make the Software or any portions or aspects thereof available to any person except its employees on a 'need to know' basis without the prior written consent of [DSC] **. . . ."** Such a restriction is plainly at odds with the section 109 right to transfer owned copies of software to third parties.” See; *DSC Communications Corp.* v. *Pulse Communications, Inc,* 170 F.3d 1354 (Fed. Cir. 1999).

[935] 66 F.3d 1091 (9th Cir.1995).

[936] *Microsoft Corp.* v. *DAK Indus* , 66 F.3d 1091 (9th Cir.1995).

[937] Jim Graves, "Who Owns a Copy?: The Ninth Circuit Misses an Opportunity to Reaffirm the Right to Use and Resell Digital Works," Cybaris, (2011), Vol. 2 , Issue. 1, Article 4, available at: http://open.mitchellhamline.edu/cybaris/vol2/iss1/4, (accessed on 8/12/2018).

[938] See *Microsoft Corp.* v. *DAK Indus* , 66 F.3d 1091 (9th Cir.1995), para 27, “Second, the pricing structure of the

> "Because we look to the economic realities of the agreement, the fact that the agreement labels itself a "license" and calls the payments "royalties", both terms that arguably imply periodic payment for the use rather than sale of technology, does not control our analysis".

Since the goods were transferred upon the initial payment itself though the payments were effected at different stages the court drew the conclusion that it was a sale and not a license.

The second ground for the court reach the above conclusion was that the rights got transferred at the first transaction itself, when the money was paid in lump sum. This, in the court's opinion was analogous to any sale of goods. The third ground relied on by the court was that Microsoft, through the agreement, has granted the right to sell rather than right to use the intellectual property.[939] The reason was that the DAK industries sold the programme along with the computers to the consumers and this was allowed by the Microsoft. This can be possible only when the first transaction is a sale. Therefore the transaction between the Microsoft and DAK was considered as a sale.Thus, Microsoft was declared not to simply hold an administrative expense in the form of a license but to have obtained title over the master CD since the whole transaction was a sale.[940]

In *Novell, Inc. v. Unicom Sales, Inc,*[941] the *Unicom Sales* received copies of the Novell's software from Frederick County Public Schools ("FCPS"),who had received the software from Novell under an "School License Agreement" ("SLA") license. Novell granted customers a non-exclusive, non-transferable license to copy and distribute the software developed by it on SLA work sheet for use by authorized users on customers work stations. Only individuals qualified as authorized users were permitted to copy and use the software. The agreement did call the transaction a license, and it contained user restrictions, requirements such as maintenance of annual license fee etc. The agreement also mandated that if Novell removed the software

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agreement indicates that it was more akin to a sale of an intellectual property than to a lease for use of that property. The amount of the minimum commitment, as well as any additional payments, was calculated based upon quantity of units DAK obtained, as in most sales arrangements, not upon the duration of the "use" of the property, as in most rental arrangements."

[939] See *Microsoft Corp.* v. *DAK Indus* , 66 F.3d 1091 (9th Cir.1995).

[940] *Microsoft Corp.* v. *DAK Indus.,* 66 F.3d 1091 (9th Cir.1995).

[941] No. 03-2785, 2004 U.S. Dist. LEXIS 16861 (N.D. Cal. Aug. 17, 2004).

licensed from the price list that it maintained, the customer shall not be allowed to make any additional copies, and that the consumer may, however, continue to use the software. On examining the nature of the initial transaction, the court felt that the agreement granted FCPS a license to copy the software only for the use by its students and employees. The license was for a specific term of one year, and required payment of an annual license fee. When the SLA expired, FCPS was required to return the software to Novell. All of these terms in the agreement are consistent with a license agreement, rather than an agreement for sale. In this judgment, the court did not recognize first sale doctrine since the transaction was characterized as license.[942] However, this decision cannot be criticized as the terms of the agreement did not grant perpetual license and mandated return of the product on the expiration of the term of license. Still, the court appreciated the facts of the case and stated that the overall nature of the transaction should take predominance over the mere words in the contract. In this case, apart from the reservation on the title, the court went onto check additional factors and examined whether (a) the license granted was perpetual, (b) an annual fees was prescribed, and (c) return of software after expiration of time period was made mandatory.[943] In other words, the court in this case refused to go by the simple words in the terms of contract and explored the real intention behind the agreement to decide whether it actually it meant to have a license or a clandestine sale under the guise of license to avoid the application of exhaustion doctrine.

In *Softman Products Co., LLC v. Adobe Systems, Inc*.,[944] the court directly criticized the practice among the software industry, of limiting first sale doctrine through contracts. Even though Adobe framed the issue as a dispute on the ownership of intellectual property, it was actually a dispute on the ownership of individual pieces of Adobe software product. Section 202 of the U.S. Copyright Act[945] dealing with ownership of copyright, as distinct from ownership of material object, recognizes the distinction between tangible property rights in copies of the work and

[942] No. 03-2785, 2004 U.S. Dist. LEXIS 16861 (N.D. Cal. Aug. 17, 2004).

[943] No. 03-2785, 2004 U.S. Dist. LEXIS 16861 (N.D. Cal. Aug. 17, 2004).

[944] 171 F. Supp. 2d 1075 (C.D. Cal. 2001).

[945] 17 *U.S.* Code § *202:* Ownership of a copyright, or of any of the exclusive rights under a copyright, is distinct from ownership of any material object in which the work is embodied. Transfer of ownership of any material object, including the copy or phonorecord in which the work is first fixed, does not of itself convey any rights in the copyrighted work embodied in the object; nor, in the absence of an agreement, does transfer of ownership of a copyright or of any exclusive rights under a copyright convey property rights in any material object.

intangible property rights in the creation itself. The court opined that "in this case, no claim is made that transfer of the copy involves transfer of the ownership of the intellectual property within. What is at stake here is the right of the purchaser to dispose of that purchaser's particular copy of the software." This brings out the fact that court was persuaded by the consumer welfare points. The court held that the well-settled principle is that in determining whether a transaction is a sale, a lease, or a license, courts have to look to the economic realities of the exchange.[946]The court further held that a transaction involving a transfer of title and risk of loss generally constitutes a sale. The court referred to the *DAK* decision and stated that the mere "license" label could not be the determinative factor in the analysis.

The court, citing §202, noted that the question before it was not one of ownership of the copyright, but of "ownership of individual pieces of Adobe software".[947] The copy of the software was sold to the purchaser for a price which amounted to the maximum possible (full) price for the copy. This transfer was for an indefinite period. The court observed that Adobe transfers large amounts of merchandise to distributorsfor indefinite period and the distributors pay full value for the merchandise contemplating even the risk that the software may be damaged or lost. The distributors also accept the risk that they may be unable to resell the product. The distributors then resell the product to other distributors in the secondary market. The secondary market and the ultimate consumer also pay full value for the product, and accept the risk that the product may be lost or damaged. This evidence from the nature and scope of the transaction suggests a transfer of title in the good. The transfer of a product for a consideration with a risk of loss generally constitutes a sale. The court stressed the fact that in order to understand whether a transaction is a sale or license one needs to look into the actual character of transaction and not the name he has chosen to call it. For these reasons, the Court found that the circumstances surrounding the transaction strongly suggested that the transaction is in fact a sale rather than a

[946] 171 F. Supp. 2d 1075 (C.D. Cal. 2001).

[947] See ;*Softman Products Co., LLC* v. *Adobe Systems, Inc* 171 F. Supp. 2d 1075 (C.D. Cal. 2001). The court held that "the purchaser commonly obtains a single copy of the software, with documentation, for a single price, which the purchaser pays at the time of the transaction, and which constitutes the entire payment for the "license." The license runs for an indefinite term without provisions for renewal. In light of these indicia, many courts and commentators conclude that a "Shrinkwrap license" transaction is a sale of goods rather than a license."

license.[948] This decision of the court, it appears, resembles the one-time reward theory of exhaustion.

In *United States v. Wise*,[949]again, the issue was whether there was any first sale when the copyright owners of a film transferred their copies to another person pursuant to an agreement. Multiple agreements were entered in to by the appellants (motion pictures) with its multiple kinds of users. The court construed the terms of each type of contracts differently. In the first type of agreement examined by the court, which was between American Broadcasting Company (ABC) and Screen Gems, a division of Columbia Pictures Industries Inc., even though the transaction was called a license in the contract, no restriction on the use or further resale of such a copy was provided in the contract. Therefore the court construed it as a sale. In the second type of agreement called as the V.I.P. agreement which the owners entered in to with certain individual owners was also held to be a sale by the court after looking into the nature of the contract as a whole. The agreement did state that it was for personal use and enjoyment and had to be retained in the possession of the user. It was also stipulated that the said print shall not be sold, leased, licensed or loaned by the purchaser to any other person and shall not be reproduced in any size or type prints. However, the court observed that when the language of the agreement is taken as a whole, it reveals a transaction strongly resembling a saleand therefore exhaustion applies.

In the third type of agreement, it was stated that the copy of the film prints were licensed to the distributors for a fixed period and after the expiration of the said license period the copy should be returned to the Motion Picture Studios, the appellants. This type of licenses also retained the rights and title to both the copyright and the copy distributed.[950]Court, while deciding on this agreement examined the principles of contract law and said that if a contract specifies itself as a license, definitely that has to be the nature of the transaction. The court examined the claims

[948] *SoftmanProducts Co., LLC* v. *Adobe Systems, Inc* 171 F. Supp. 2d 1075 (C.D. Cal. 2001).The court justified this observation by stating that "For example, the purchaser commonly obtains a single copy of the software, with documentation, for a single price, which the purchaser pays at the time of the transaction, and which constitutes the entire payment for the "license." The license runs for an indefinite term without provisions for renewal. In light of these indicia, many courts and commentators conclude that a "Shrinkwrap license" transaction is a sale of goods rather than a license."*Softman Products Co., LLC* v. *Adobe Systems, Inc* 171 F. Supp. 2d 1075 (C.D. Cal. 2001).

[949] 550 F.2d 1180 (9th Cir. 1977*).*

[950] *United States* v. *Wise*, 550 F.2d 1180 (9th Cir. 1977*).*

upon which the nature of the agreement, i.e., if it is a license or sale, has to be determined as per the contract. The factors relied upon to determine the nature of the contract are the following: Whether the agreement (a) was labeled a license, (b) whether it was provided that the copyright owner retained title to the prints, (c) if it required the return or destruction of the prints, (d) has it forbade duplication of prints, or (e) if it required the transferee to maintain possession of the prints for the agreement's duration.[951] In the present agreement, the distributors and users were restricted to use the copy only for a certain period of time after which the copy had to be returned to the copyright holders and the rights on the copy were also to be retained by the copyright owners.[952] These restrictions reveal that this particular agreement could be justified to be called a license as it clearly required the copy to be returned to the copyright holder after the expiration of the license period. Therefore the judgment of the court should be appreciated. But the observation of the court that if a transaction is named license then the nature of the transaction will definitely be sale is irrational as it opens up the avenue for copyright holders to maintain any transaction a license by merely calling it so.

Thus, under United States v. *Wise*[953], where a transferee received a particular copy of a copyrighted work pursuant to a written agreement, the Court was required to consider all the provisions of the agreement to determine whether the transferee became an owner of the copy or has received only a license. The court looked into the contract limitations between copyright owners and consumers and observed that the court must look into the overall nature and terms of contract which the court called the "arrangement at issue" and decide whether it should be considered a first sale.[954]

In *UMG Recordings* v. *Augusto*,[955] the Ninth Circuit of the U.S. Court of Appeals had to address the question whether the first sale doctrine is applicable to CDs which were sent as promotional copies to persons.[956] The court decided with the help of various judicial authorities and principles

[951] 550 F.2d 1180 (9th Cir. 1977*).*
[952] 550 F.2d 1180 (9th Cir. 1977*).*
[953] 550 F.2d 1180 (9th Cir. 1977*).*
[954] 550 F.2d 1180 (9th Cir. 1977*).*
[955] No. 08-55998 , D.C. No. 2:07-cv-03106- SJO-AJW, United States Court of Appeals, Ninth Circuit, 2011.
[956] Defendants resold in e-bay, the CD'S sent by UMG to private persons (promotional CD'S). UMG sold these to

that the transfer amounted to sale rather than license. It adduced various reasons for reaching the decision. Firstly, the promotional CDs were dispatched to the recipients without any prior stipulations as to the recipient's rights over those particular copies. The CDs were not numbered, and no attempt was made to keep track of those particular copies or to see what use was made of them. The court opined that UMG failed to establish that the transaction that occurred between them and the recipients was license even though restrictions were placed. Because the CDs were unordered merchandise, the recipients were free to dispose of them as they wished under the Unordered Merchandise Statute, 39 U.S.C. § 3009.[957] The court held that the promotional statement, "Promotional Use Only—Not for Sale," could not be considered as a stipulation intending to create a license.[958] Further the court observed that even if UMG Recordings stipulation that the copy was for personal use only, the acceptance of the CD cannot be presumed to render the person accepting it bound by the license as it was only a promotional CD and not ordered by him.[959]

It is evident from the above analysis that many tests such as reservation of title tests, economic realities test and agreements controls test have been used by the courts to resolve sale v. license debate and to find out whether exhaustion is applicable in the digital context. The initial case laws dealing with reservation of title approach erred in many ways in balancing the consumer interest and the copyright owner's rights. However, the court after adopting the economic realities test took the right direction of balancing interests.

However, in the case, *Vernor v. Autodesk*,[960] the court went back to its earlier jurisprudence of retention of title and restrictive use tests in determining whether a transaction is a sale or not.[961]

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private persons through contract restriction of no reselling. UMG argued it was mere licensing to private persons to use and not a sale while Augusto claimed the defence of first sale doctrine.

[957] Unordered Merchandise Statute, 39 U.S.C. § 3009, which provides in that,

(a) except for . . . free samples clearly and conspicuously marked as such, . . . the mailing of unordered merchandise . . . constitutes an unfair method of competition and an unfair trade practice. . . .

(b) Any merchandise mailed in violation of subsection (a) of this section . . . may be treated as a gift by the recipient, *who shall have the right to retain, use, discard, or dispose of it in any manner he sees fit without any obligation whatsoever to the sender* . . . .(Emphasis Added).

[958] 558 F. Supp. 2d 1055.

[959] No. 08-55998 , D.C. No. 2:07-cv-03106- SJO-AJW , United States Court of Appeals, Ninth Circuit, 2011.

[960] 2010 WL 3516435 (9th Cir. Sept. 10, 2010).

[961] Timothy Vernor purchased used copies of Autodesk's AutoCAD software from Cardwell/Thomas & Associates,

In this case Autodesk placed user and transfer restrictions on the users of the software.[962] The court discussed many cases to examine whether transfer of ownership is taking place under the contract to answer the question if first sale doctrine is applicable in this case. The court relied heavily on the *United States* v. *Wise decision*[963] and the *MAI Sys. Corp.* v. *Peak Computer, Inc.*[964] Enunciating the principles underlying these cases, the court held that the user of software is a licensee rather than owner if the agreement between the parties (1) specifies that the user is granted a license; (2) significantly restricts the user's ability to transfer the software; and (3) imposes notable use restrictions. Thus the court held that if the license agreement expressly mentions that the software is not sold but only licensed exhaustion cannot occur. The case is a catastrophe as far as exhaustion as a mechanism to foster access is concerned. The court never looked into the fact whether the software was licensed for perpetuity to the user or there was no obligation to return the copy after use. The destruction of copies was mandated only upon up-gradation to a latest version. Even though the court did rely on *United States v. Wise,*[965] it overlooked the observations of the court in *Wise* making it mandatory to look into whether the use of the copy transferred to the user was for an indefinite or a limited period of time. If it was not for a limited period, then as per *Wise* judgment, it cannot qualify as a license. The Court has also failed to properly appreciate the logic underlying §202 in this decision.

It should be primarily understood that the sale v. license debate can even occur in the tangible medium also, as it was the case in *Bobbs Merill v. Strauss*[966] wherein courts categorically rejected the contractual limitations. If an express statement of licensing is made in the tangible

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Inc. (CTA), which itself had purchased the software new. Before installing the Autodesk software, the user is required to agree to the terms of Autodesk's software license agreement (SLA), which contains certain transfer and use restrictions. The SLA also requires that, if the software is an upgrade of a previous version, the user must destroy all copies of the previous version. CTA had been using the Release 14 version of AutoCAD but later upgraded to the next version. After installing the latest version, however, instead of destroying its Release 14 CDs as required by the SLA, CTA made them available for purchase at an office sale. Vernor purchased these Release 14 CDs from CTA, at a substantial discount from the original price, and subsequently listed them for sale on eBay.

[962]The SLA license contained restrictions such as retention of title to all copies, granted customer a non- exclusive and nontransferable license to use the software. Third, it imposes transfer restrictions, prohibiting customers from renting, leasing, or transferring the software without Autodesk's prior consent and from electronically or physically transferring the software out of the Western Hemisphere.

[963] 550 F.2d 1180 (9th Cir. 1977).

[964] 991 F.2d 511, 518.

[965] 550 F.2d 1180 (9th Cir. 1977*).*

[966] 210 U.S. 339 (1908).

medium after it was sold, the courts used to term it as license. But in the digital medium, as already discussed, it is not that simple. It should also be noted that the decisions on the sale v. license debate have not taken a straightforward journey. The courts have adopted many tests, as explained above, but still are not consistent in their decisions

Confusions, especially in the context of software, were often the result of misunderstandings, as already discussed in the previous section, regarding the difference between the software and the material in which it is embodied. By allowing the license argument to persist, the courts have actually granted rights to the copyright owners, much beyond the scope of what the legislature has actually conferred on them.[967] Rejection of exhaustion rule in digital context also results in the same. In many cases the courts have tried to use different tests to distinguish between license and sale in the digital medium without understanding these impacts. This resulted in many courts ending up with pro-license decisions. The courts by issuing pro-license judgments were actually extending protection to copyright owners of software both under copyright and contract.[968] By doing so, the court has enabled to further monopolise the protection granted under Copyright unmindful of the fact that such control amounts to anti-competitive practice as it is abuse of dominance.[969]

In the normal property jurisprudence, there are basically two kinds of transfers, which are either transfers involving change of title such as gift or sale and other kinds of transfers such as lending, rental etc wherein there is transfer of only possession of property with the expectation of the return of the product after the desired purpose is achieved. However, in the software context,

[967] Brian W. Carver, "Why License Agreements Do Not Control Copy Ownership: First Sales and Essential Copies", Berkeley Tech. L.J. 1887, [2010], Vol. 25, p.1892, available at http://scholarship.law.berkeley.edu/btlj/vol25/iss4/7, (accessed on 7/12/2018).

[968] Christian Nadan, "Software Licensing in the 21st Century: Are Software "Licenses" Really Sales, and How Will the Software Industry Respond?", AIPLA Q.J. 555, [2004], Vol. 32, p.653, available at http://heinonline.org/hol-cgi-bin/get_pdf.cgi?handle=hein.journals/aiplaqj32&section=21, (accessed on 22/12/2018) . Also see; Brian W. Carver, "Why License Agreements Do Not Control Copy Ownership: First Sales and Essential Copies", Berkeley Tech. L.J. 1887, [2010], Vol. 25, pp.1888-1954, available at http://scholarship.law.berkeley.edu/btlj/vol25/iss4/7,(accessed on7/12/2018).

[969] See *Bobbs- Merril*v. *Strauss*, 210 U.S. 339 (1908), *Adams* v. *Burke84 U.S. 455 (1873). Keeler* v. *Standard Folding Bed Co* 157 U.S. 659 (1895),*AnsulCo.*v. *Uniroyal* 306 F. Supp. 541, which are the earlier cases of exhaustion wherein courts have categorically held that such extension of rights would amount to overdoing of rights under the intellectual property system.

the transfer which is perpetual in nature is being termed as license and this has very negative connotations on free trade. If a transaction allows the owner to enjoy perpetual use of the copy, without any condition to return it to the copyright holder after use, and for a reward it, definitely, is not a license but sale. From the contractual perspective also the transaction will have to be treated as sale since any contract wherein restrictions are placed on resale or use of the copy through a contract by the copyright owner, will be treated as a conditional sale and render the conditions void. When a copyright owner has received the reward over the copy and has allowed for perpetual use of the copy, then he loses the right to restrict the use of the copy.[970]

5.2. Online distribution and Copyright exhaustion: The U.S. legal perspective

The position of exhaustion doctrine in the online medium was specifically addressed by the court in *Capitol Records, LLC, vs. ReDigi Inc.*[971] The facts of the case were related to online sale of "used "music.[972] 'Used' here presupposes legally acquired ones. ReDigi provides an online marketplace for buying and selling of used digital music. The process is done via a Media Manager which the user installs in his computer which, after scanning the user's system and enlisting the eligible files and then making sure no particular file exist more than in one copy, migrates the file from the user's computer to the Cloud Locker. The file moves 'packet by packet' so that the data does not exist in two places at the same time. What they try to accomplish is, no claim as to copying a file must be alleged. '. Meanwhile, Capitol Records, which owns a number of recordings, comes up with the issue of copyright infringement against Re Digi. Here, the Court had to find whether exhaustion is limited to material copy. Right to distribution[973] is the exclusive right of the copyright owner. However, as already mentioned, First Sale Doctrine[974] is a limitation upon this right. ReDigi permits only lawfully acquired copy.

[970] See *Bobbs- Merril*v. *Strauss*, 210 U.S. 339 (1908), *Adams* v. *Burke84 U.S. 455 (1873). Keeler* v. *Standard Folding Bed Co.* 157 U.S. 659 (1895), *AnsulCo.*v. *Uniroyal* 306 F. Supp. 541

[971] *Capitol Records, LLC* v.*ReDigi Inc.*, 934 F. Supp. 2d 640, 655-56 (S.D.N.Y. 2013).

[972] *Capitol Records, LLC* v. *ReDigi Inc.*, 934 F. Supp. 2d 640, 655-56 (S.D.N.Y. 2013)

[973] 17 U.S.C §106 (3) Subject to sections 107 through 122, the owner of copyright under this title has the exclusive rights to distribute copies or phonorecords of the copyrighted work to the public by sale or other transfer of ownership, or by rental, lease, or lending.

[974] 17 U.S.C § 109 (a) a) Notwithstanding the provisions of section 106(3), the owner of a particular copy or phonorecord lawfully made under this title, or any person authorized by such owner, is entitled, without the authority of the copyright owner, to sell or otherwise dispose of the possession of that copy or phonorecord.

Such a copy can be resold by its owner without the prior permission of the copyright owner; which is exactly what a user did here or what ReDigi provided for. Nevertheless, the Court opined that the copy was unlawfully reproduced and hence, decided that first sale of such a copy in the digital medium does not exhaust the right of the copyright owner.[975] The technology adopted by the Re digi enabled the copy to be transferred packet by packet in such a way that every packet so transferred got removed from the seller's system. However, the court found that the first sale doctrine could not apply to digital media because the method of transferring digital media necessarily implicated the reproduction right, as a new copy is unavoidably created.[976]The court failed to recognize the fact in this case that measures were taken to ensure that only one copy is in circulation and the first owner is not retaining any copy with him while making the second sale. This decision limited the application of exhaustion principle to tangible items alone, as reproduction is an incidental part of any digital transfer. The logic adopted by the court that creation of a different copy was taking place in the process of transfer in the case of Redigi really resounds the language in MAI judgment wherein the court observed that the running of computer programs even for maintenance of the computer resulted in the creation of a copy which violated the reproduction right of the copyright owner. The logic of §117 of 17 US Code regarding incidental creation of copies in using a computer program enables an owner to utilize the computer program without the fear of infringement. This logic could have been extended to the file transfer in the online context. Rather than looking at whether an additional copy is created during transfer, the court ought to have looked into whether two copies were in circulation even after transfer. If the technology enables the deletion of a parallel/second copy, the transfer must be subjected to first sale doctrine. If the copy created upon transfer is not considered as an incidental copy that would end up in chaos in the context of online transfers and resale of copyrighted works. The court was of the view that any decision to expand the scope of law was the concern of the Congress.[977] The court, however, could have at least given some guidance to

[975] *Capitol Records, LLC* v.*ReDigi Inc.*, 934 F. Supp. 2d 640, 655-56 (S.D.N.Y. 2013).

[976] *Capitol Records, LLC* v.*ReDigi Inc.*, 934 F. Supp. 2d 640, 649-50 (S.D.N.Y. 2013).

[977] *Capitol Records, LLC* v.*ReDigi Inc.*, 934 F. Supp. 2d 640, 655-56 (S.D.N.Y. 2013). Further in *Twentieth Century Music Corp.* v. *Aiken* 422 *U.S.* 151. Court states"…while the fact that the radio was not developed at the time the Copyright Act…was enacted may raise some question as to whether it properly comes within the purview of the statute, it is not, by that fact alone, excluded from the statute. In other words, the statute may be applied to new situations not anticipated by Congress, if, fairly construed, such situations come within its intent and meaning… While statutes should not be stretched to apply to new situations not fairly within their scope, they should not be

the legislature regarding the direction in which the expansion of law must take place to ensure that the digital medium does not obstruct the right of the purchasers to resell the digital works they purchase. The legislature has unequivocally stated under §109 of 17 US Code that the intent of the law is to permit the legally owned copies to be resold and the judicial precedents also have made it clear that consumer welfare is the ultimate objective of exhaustion doctrine under §109. The court, however, failed to capture these points.

Further, in the earlier section of this chapter discussing §117 of U.S. Copyright Code, we could find that the incidental copy exception was allowed to bring copyright law in line with digital media, as reproduction was incidental to digital world. The reluctance of the court to extend this logic to the Redigi's transfer of files is quite baffling. The *ReDigi*court's strict perception that it is for the Congress to change the copyright law is unwarranted, as the court has the duty to interpret the law as it currently exists and apply it to contemporary issues.[978] The court also failed to recognize that exhaustion was a judicially created doctrine, which was later codified by the Congress.[979] Further, the court stated that exhaustion can be applicable to digital media only if the material embodying the copy of the work is sold along with it.[980] This approach would hamper consumer interest producing consumer lock-in.

5.2.(a) Attempts at law reforms

A Bill was submitted before the American congress, which was named The Benefit Authors without Limiting Advancement or Net Consumer Expectations (BALANCE).[981] The objective of the Act was to safeguard the rights and expectations of consumers who lawfully obtain digital entertainment.[982]The purpose of the proposed BALANCE Act was to restore the traditional

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so narrowly construed as to permit their evasion because of changing habits due to new inventions and discoveries."

[978] Monica L. Dobson, "ReDigi and the Resale of Digital Media: The Courts Reject a Digital First Sale Doctrine and Sustain the Imbalance between Copyright Owners and Consumers," Akron Intellectual Property Journal, [2014], Vol. 7, Iss. 2, Article 3, p.202,
available at: http://ideaexchange.uakron.edu/akronintellectualproperty/vol7/iss2/3, (accessed on 6/12/2018).

[979] *Bobbs- Merril*v. *Strauss*, 210 U.S. 339 (1908).

[980] *Capitol Records, LLC* v.*ReDigi Inc*., 934 F. Supp. 2d 640, 656 (S.D.N.Y. 2013).

[981] The bill was introduced in the 1st Session of 109th Congress, on December 14, 2005 by Ms. Zoe Lofgren of California (for herself, Mr. Boucher, and Mr. Doolittle).

[982] Preamble to the Bill of ''Benefit Authors without Limiting Advancement or Net Consumer Expectations

balance between copyright owners and individual consumers in society.[983] S.4 of the proposed bill of the BALANCE Act dealt with first sale doctrine.[984] The only condition prescribed under the section for the application of the first sale doctrine was that the user should not maintain a copy on transfer. The language of the section placed burden on the user not to maintain the copy after digital transfer. This implied that the keeping additional copies amounted to infringement and could be sued. The section aimed at amending S.109 of the U.S. Copyright Act. The amendment would have expressly extended the exhaustion doctrine to digital format too provided there is no original copy retained by the consumer. However, the Act never came into effect as the Congress took a wait and see approach.[985] In the light of ReDigi case it is expected that the Congress will reconsider enacting this law.

5.3.European law on exhaustion and digital transfers

The situation of European law is different from that of the U.S. The European Union has indeed taken necessary steps to bring about free movement of goods within their territory.[986]As a result Instead of favouring adoption of international exhaustion,[987] it developed the concept of regional

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(BALANCE) Act of 2005'', available at
https://www.congress.gov/bill/109th-congress/house-bill/4536/text?q=H.R.+4536+%28109%29,
(accessed on 9/12/2018).

[983] Eric Matthew Hinkes, "Access Controls in the Digital Era and the Fair Use/First Sale Doctrines", Santa Clara Computer &High Tech. L.J. 685, [2007], Vol.23, p.721, available at
http://digitalcommons.law.scu.edu/chtlj/vol23/iss4/4, (accessed on 9/12/2018).

[984] 17 U.S.C. § 109, is amended by adding at the end the following: ''(f) The privileges prescribed by subsections (a) and (c) apply in a case in which the owner of a particular copy or phonorecord of a work in a digital or other non analog format, or any person authorized by such owner, sells or otherwise disposes of the work by means of a transmission to a single recipient, if the owner does not retain the copy or phonorecord in a retrievable form and the work is so sold or otherwise disposed of in its original format.''.

[985] Monica L. Dobson, "ReDigi and the Resale of Digital Media: The Courts Reject a Digital First Sale Doctrine and Sustain the Imbalance between Copyright Owners and Consumers," Akron Intellectual Property Journal, [2014], Vol. 7, Iss. 2, Article 3, p.184,
available at: http://ideaexchange.uakron.edu/akronintellectualproperty/vol7/iss2/3, (accessed on 6/12/2018).

[986] Petra Heindl, *A Comparative Analysis of Online Distribution of Software in the United States and Europe: Piracy or Freedom of "First Use"?,* TTLF Working Papers, No. 6, Stanford – Vienna Transatlantic Technology Law Forum**,** 2010, p.10, available at http://www.law.stanford.edu/program/centers/ttlf/papers/heindl_wp6.pdf, (accessed on 25/12/2018).

[987] Maja case, 22 January 1964, GRUR Int. 202, Cinzano v. Java [1974] 2 CMLR 21 and Bundesgerichtshof [Bgh] Gewerblicher Rechtsschutz Und Urheberrecht [GRUR] 1983.

exhaustion.[988] Therefore, it is imperative to look at the exhaustion doctrine through the lens of free movement of goods when it comes to the European jurisdiction. The European law also has differentiated between exploitation of software contained in tangible medium[989] and intangible medium containing software content. [990] It enables the copyright owner of software to exploit the market. However, the software owner also has the responsibility to provide the software at a reasonable price to the consumers of different markets.[991] This warrants recognition of exhaustion rule at least within the European jurisdiction.

The European Union had issued a Directive 2009/24/EC of the European Parliament and of the Council for the legal protection of computer programs in 2009. Article 4 (c) of the Directive confers on the owner of software the right to authorize "any form of public distribution" of the software.[992] This definition is based on the WCT provision under Article 6(1), which defines

[988] The reason provided for the same is the creation of free area within the EU, See discussion in Chapter 3 of the thesis.

[989] Art. 30 of the EC Treaty states: "The provisions of Articles 28 and 29 shall not preclude prohibitions or restrictions on imports, exports or goods in transit justified on grounds of public morality, public policy or public security; the protection of health and life of humans, animals or plants; the protection of national treasures possessing artistic, historic or archaeological value; or the protection of industrial and commercial property. Such prohibitions or restrictions shall not, however, constitute a means of arbitrary discrimination or a disguised restriction on trade between Member States." Also see Petra Heindl, *A Comparative Analysis of Online Distribution of Software in the United States and Europe: Piracy or Freedom of "First Use"?,* TTLF Working Papers, No. 6, 2010, pp.58-59, available at http://www.law.stanford.edu/program/centers/ttlf/papers/heindl_wp6.pdf, (accessed on 25/12/2018).

[990] Art. 49 respectively of the EC Treaty states: "Within the framework of the provisions set out below, restrictions on freedom to provide services within the Community shall be prohibited in respect of nationals of Member States who are established in a State of the Community other than that of the person for whom the services are intended. The Council may, acting by a qualified majority on a proposal from the Commission, extend the provisions of the Chapter to nationals of a third country who provide services and who are established within the Community." Also see Petra Heindl, "A Comparative Analysis of Online Distribution of Software in the United States and Europe: Piracy or Freedom of "First Use"?", TTLF Working Papers, Stanford – Vienna Transatlantic Technology Law Forum**,** No. 6, 2010, pp.58-59, available at http://www.law.stanford.edu/program/centers/ttlf/papers/heindl_wp6.pdf, (accessed on 25/12/2018).

[991] Bundesgerichtshof [BGH] [Federal Court of Justice] July 6, 2000, I ZR 244/97 (F.R.G.), CR 2000, 651, available at http://www.jurpc.de/rechtspr/20000220.

[992] Art. 4 of the Directive 2009/24/E C of the European Parliament and of the Council of 23 April 2009 on the legal protection of computer programs – Restricted Acts: - 1. "Subject to the provisions of Article 5, the exclusive rights referred to in Article 1 shall include the right to do or to authorize: (c) the distribution of a computer program by means of sale, licensing, lease, rental and the importation for these purposes. The right to control the distribution of a program shall be exhausted in respect of its sale and its importation following the first marketing of the

distribution to include making available to the public of the original and copies of their works through sale or other transfer of ownership.[993]

Article 4 (2)[994] of the Directive states that the first sale of the computer software by holder of right exhausts, within the Community, his right of distribution of the software, other than the right to rental. The word used in the Article 4 is right holder and not owner. Moreover, Article 5 of the Directive further restricts this exception.[995] Article 5 implies that prior consent need not be taken from the copyright holder by the lawful acquirer to use any computer program in accordance with Article 4, i.e.,"where they are necessary for the use of the computer program by the lawful acquirer in accordance with its intended purpose", unless expressly restricted. This means that it is possible to restrict the exhaustion doctrine through contract. Further, in the database directive,[996] recitals 33[997] and 43[998] directly dealt with exhaustion in the event of online

program by the right holder or with his consent", available at https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32009L0024&from=EN, (accessed on 9/12/2018).

[993] Art.6 (1) of WCT,1996, states: - Authors of literary and artistic works [including computer programs] shall enjoy the exclusive right of authorizing the making available to the public of the original and copies of their works through sale or other transfer of ownership.

[994] Art. 4 (2) of the Directive 2009/24/EC Of The European Parliament And Of The Council of 23 April 2009 on the legal protection of computer programs: - The first sale in the Community of a copy of a program by the right holder or with his consent shall exhaust the distribution right within the Community of that copy, with the exception of the right to control further rental of the program or a copy thereof.

[995] Art. 5 of the Directive 2009/24/EC Of The European Parliament And Of The Council of 23 April 2009 on the legal protection of computer programs reads: - In the absence of specific contractual provisions, the acts referred to in points (a) and (b) of Article 4(1) shall not require authorisation by the right holder where they are necessary for the use of the computer program by the lawful acquirer in accordance with its intended purpose, including for error correction.

[996] Directive 96/9/EC of the European Parliament and of the Council of 11 March 1996 on the Legal Protection of Databases, 1996, available at https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:31996L0009&from=EN, (accessed on 9/12/2018)

[997] Directive 96/9/EC of the European Parliament and of the Council of 11 March 1996 on the Legal Protection of Databases, 1996, available at https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:31996L0009&from=EN, (accessed on 9/12/2018) : Whereas the question of exhaustion of the right of distribution does not arise in the case of on-line databases, which come within the field of provision of services; whereas this also applies with regard to a material copy of such a database made by the user of such a service with the consent of the right holder; whereas, unlike CD-ROM or CD-I, where the intellectual property is incorporated in a material medium, namely an item of goods, every on-line service is in fact an act which will have to be subject to authorization where the copyright so provides;"

[998] Directive 96/9/EC of the European Parliament and of the Council of 11 March 1996 on the Legal Protection of Databases, 1996, available at

transmissions. The database directive excludes the application of exhaustion principle to online transmissions as well as the online-transmitted materials. This implies that, within the field of service, exhaustion of the right of distribution shall not apply in the case of online databases. Online transmissions do not exhaust the right to prohibit re-utilization of either the database or a material copy of the database or a part thereof made with the consent of the right holder by the recipient of the transmission.[999] Similar line of thought has been incorporated into the InfoSoc Directive.[1000] Recital 29 states that there is no question of exhaustion arising in the case of online services.[1001] However, it must be understood that the online transmissions of works do not fall under the category of services but goods. Therefore, exhaustion does apply to online download of copyrighted works. .

Even though the situation seems to move from bad to worse in legislative sense, judiciary has responded quite sensibly to the consumer welfare angle of exhaustion. An important case law by the European Court of Justice in this context is *UsedSoft v. Oracle International Inc*.[1002]Oracle International Corp., the plaintiff in the case, develops and markets computer programs. Oracle

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https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:31996L0009&from=EN,(accessed on 9/12/2018): Whereas, in the case of on-line transmission, the right to prohibit re-utilization is not exhausted either as regards the database or as regards a material copy of the database or of part thereof made by the addressee of the transmission with the consent of the right holder."

[999] Petra Heindl, *A Comparative Analysis of Online Distribution of Software in the United States and Europe: Piracy or Freedom of "First Use"?,* TTLF Working Papers, No. 6, Stanford – Vienna Transatlantic Technology Law Forum**,** 2010, p.64, available at http://www.law.stanford.edu/program/centers/ttlf/papers/heindl_wp6.pdf, (accessed on 25/12/2018).

[1000] Directive 2001/29/EC of the European Parliament and of the Council of 22 May 2001 on the harmonisation of certain aspects of copyright and related rights in the information society, available at https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32001L0029&from=EN., (accessed on 9/12/2018).

[1001] Recital 29 of the Directive 2001/29/EC of the European Parliament and of the Council of 22 May 2001 on the harmonisation of certain aspects of copyright and related rights in the information society, available at https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32001L0029&from=EN., (accessed on 9/12/2018).states that "the question of exhaustion does not arise in the case of services and on-line services in particular. This also applies with regard to a material copy of a work or other subject-matter made by a user of such a service with the consent of the right holder. Therefore, the same applies to rental and lending of the original and copies of works or other subject-matter which are services by nature. Unlike CD-ROM or CD-I, where the intellectual property is incorporated in a material medium, namely an item of goods, every on-line service is in fact an act which should be subject to authorisation where the copyright or related right so provides. Also see; Ruth L. Okediji, Creative Markets and Copyright in the Fourth Industrial Era: Reconfiguring the Public Benefit for a Digital Trade Economy, ICTSD, [2018], Issue Paper No. 43, p.27, available at https://www.ictsd.org/sites/default/files/research/creative_markets_and_copyright_in_the_fourth_industrial_era-okediji-ictsd_final_0.pdf, (accessed on 21/12/2018).

[1002] [2012] E.C.D.R. 19.

basically distributes its software (mainly client-server software) via Internet downloading; in fact, direct downloads from the Internet represent 85% of the company's distribution activity. Clients do not receive a CD or DVD with the computer program unless they specifically ask for one. When commercializing its client-server software, Oracle uses a mixed second- and third-degree price-discrimination strategy: 69 companies are offered the client-server software with fewer restrictions on group licenses for a minimum of 25 users per group, so that if a customer requires that 30 of its employees have to be able to use the software issued, it will have to acquire two licenses. However, it offers more restrictive licenses and products to other sorts of clients. The right to use the program governed by the license agreement included the right to store a copy of the program permanently on a server that could be accessed by a certain number of users who would make temporary copies on their own computers. Updates and patches for correcting errors could be downloaded from Oracle's website.In the case in question, Oracle's license agreement contained the following term under the heading, 'grant of rights' which reads: 'With the payment for services you receive exclusively for your internal business purposes for an unlimited period, a non-exclusive non-transferable user right, free of charge for everything that Oracle develops and makes available to you on the basis of this agreement".

The defendant, UsedSoft GmbH, was a German company that offered licenses for 'second-hand' or 'already used' computer programs, on the market. In October 2005 UsedSoft promoted an 'Oracle Special Offer' in which it offered 'already used' licenses for the Oracle programs and informed prospective customers that the licenses were valid and updated and that the lawfulness of the original sale was confirmed by a notarial certificate. UsedSoft had acquired the licenses from Oracle clients who had requested group licenses for a larger number of users than they actually needed as a consequence of the licensing policies. After acquiring a license, UsedSoft's clients either downloaded a copy of the Oracle software directly from Oracle's website or, if they were already in possession of the computer program in question, were induced to copy the program onto the additional user's work station. Oracle filed a lawsuit against UsedSoft for copyright infringement, trademark infringement and unfair competition practices. In relation to the copyright infringement claims, Oracle argued that the actions of UsedSoft and its customers infringed the company's exclusive rights of reproduction and distribution. Three main issues were dealt with in this case. The first one pertained to the question who was a lawful acquirer

under Article 5 (1) of Directive of 2009/24; i.e., whether subsequent acquirer is a lawful acquirer. The court addressed the third issue along with the first issue; i.e., whether a consumer who is a lawful acquirer, who has downloaded and used software from, authorized persons, can rely on exhaustion if he no longer uses the software after resale. Regarding the first and third issue the court opined:

> "Articles 4(2) and 5(1) must be interpreted as meaning that, in the event of the resale of a user license entailing the resale of a copy of a computer program downloaded from the copyright holder's website, that license having originally been granted by that right holder to the first acquirer for an unlimited period in return for payment of a fee intended to enable the right holder to obtain a remuneration corresponding to the economic value of that copy of his work, the second acquirer of the license, as well as any subsequent acquirer of it, will be able to rely on the exhaustion of the distribution right under Article 4(2) and hence be regarded as lawful acquirers of a copy of a computer program within the meaning of Article 5(1) and benefit from the right of reproduction provided for in that provision." [1003]

As regards the second question, i.e. whether the right to distribute a copy of a computer program exhausted when the acquirer has made the copy with the right holder's consent by downloading the program from the internet onto a data carrier the court ruled as below:

> Article 4(2) must be interpreted as meaning that the right of distribution of a copy of a computer program is exhausted if the copyright holder who has authorised, even free of charge, the downloading of that copy from the internet onto a data carrier has also conferred, in return for payment of a fee intended to enable him to obtain a remuneration corresponding to the economic value of the copy of the work of which he is the proprietor, a right to use that copy for an unlimited period.[1004]

Thus, the *UsedSoft* case has now ensured the software users that exhaustion takes place if the license agreement is perpetual and if they have paid the copyright owner remuneration as a

[1003] *UsedSoft* v. *Oracle International Inc,* [2012] E.C.D.R. 19.
[1004] *UsedSoft* v. *Oracle International Inc,* [2012] E.C.D.R. 19.

onetime payment. However, it should be noted that the judgment is strictly applicable to software context alone.

5.4. Exhaustion as a tool to counter Tethered Technologies and Technological Protection Measures

In the past quarter of the Century, the "digital shift" and the emergence and rapid proliferation of network technologies have dramatically changed the nature of accessing and sharing creative works, thereby altering the value of information in the networked world.[1005] Information and the control over it is the most valuable thing in this digital era.[1006] Since the copying and dissemination of information has become much easier in the digital world, the copyright owners have developed different technologies to control the movement of information and to create absolute monopoly. The technology has grown so much that they enable the copyright owners to even delete the documents from your personal computers whenever they wish. They are often called tethered technologies.[1007]The tethering technologies function by tethering, or by means of establishing a permanent link between a platform and a computer.[1008] This enables the operators of the platform to reprogram the technology whenever they choose to do so.[1009] The main reason provided for using such technology is to administer control over their licensed products and to prevent such products from being used otherwise than under the licensing agreement.[1010] The tethered technology can be even applied to the cloud strategies. The consumers are at the

[1005] Niva Elkin-Horen, "Tailoring Copyright to Social Production", Theoretical Inquiries L. 309, [2011], Vol.12 p.321, available at SSRN : https://ssn.com/abstract=1663982, (accessed on 20/12/2018).

[1006] Carys J. Craig, "Technological Neutrality: Recalibrating Copyright in the Information Age", Theoretical Inquiries L. 601, [2016], Vol.17, available at SSRN: https://ssrn.com/abstract=2852385, (accessed on 14/12/2018).

[1007] Christoph B. Graber, "Tethered Technologies, Cloud Strategies and the Future of the First Sale/Exhaustion Defence in Copyright Law" , Queen Mary Journal of Intellectual Property, [2015], Vol. 5, No. 4, pp. 389–408, available at SSRN: https://ssrn.com/abstract=2866835 (accessed on 9/12/2018).

[1008] Christoph B. Graber, "Tethered Technologies, Cloud Strategies and the Future of the First Sale/Exhaustion Defence in Copyright Law" , Queen Mary Journal of Intellectual Property, [2015], Vol. 5 No. 4, pp. 389–408, available at SSRN: https://ssrn.com/abstract=2866835 (accessed on 9/12/2018).

[1009] Jonathan Zittrain, ''Perfect Enforcement on Tomorrow's Internet'', in Roger Browns word and Karen Yeung (eds), *Regulating Technologies: Legal Futures, Regulatory Frames and Technological Fixes*, Hart Publishers, Oxford, 1st Edition, 2008, at pp. 131–132.

[1010] Christoph B. Graber, "Tethered Technologies, Cloud Strategies and the Future of the First Sale/Exhaustion Defence in Copyright Law" , Queen Mary Journal of Intellectual Property, [2015], Vol. 5, No. 4, pp. 389–408, available at SSRN: https://ssrn.com/abstract=2866835 (accessed on 9/12/2018).

receiving end in the context of these emerging technologies. Tethered technologies squeeze consumers into an access-based type of contract.[1011] It also restricts the uses of the consumers in many ways such as by prohibiting them from making changes to the licensed object, by restricting further transfer etc. Further, the copyright holders use different kind of TPM measures in the guise of protecting their genuine rights under copyright, which brings economic loss to the consumers. They often resort to measures such as CSS[1012] or regional coding[1013] of DVD's which result in reduced purpose of use for the consumers.[1014] Along with the anti-circumvention law, these technologies undermine the resale market of a used digital copy.

Therefore, exhaustion is the answer to all these technologies. The technological protection measure and the protection awarded to the same under a country's copyright law are significant factors while examining whether exhaustion can successfully curb this malice. For eg., under the U.S. Copyright law, the anti-circumvention law is so strong that the consumers cannot circumvent this technology for enabling exhaustion. It should be further noted that the U.S. patent office has granted patent to Amazon for running a secondary market place in the digital world. The technology used is similar to that of Redigi where no copy exists at the same time.

Media Neutrality may be another solution to the problem of non-application of exhaustion in the digital context. Media neutrality, in general terms, means that the copyright owner's rights should be the same regardless of the form, whether analog or digital, in which the work may be embodied or fixed.[1015] As it is commonly understood, the principle of technological neutrality

[1011] Justin Graham, "Preserving the Aftermarket in Copyrighted Works: Adapting the First Sale Doctrine to the Emerging Technological Landscape", Stan. Tech. L. Rev. 1, [2002], available at https://heinonline.org/HOL/Page?handle=hein.journals/stantlr2002&div=2&g_sent=1&casa_token=&collection=journals, (accessed on 20/12/2018).

[1012] CSS is the technological protection measure adopted by the motion picture industry and consumerelectronics manufacturers to provide security to copyrighted content of DVDs and to prevent unauthorized copying of that content. See; Technological Protection Systems for Digitized Copyrighted Works: A Report to Congress, available at, https://www.uspto.gov/sites/default/files/web/offices/dcom/olia/teachreport.pdf (accessed on 9/12/2018).

[1013] Region coding is a technological means of preventing DVDs manufactured for sale in one region of the world from playing on a DVD player that is manufactured for sale in a different region of the world.

[1014] *DMCA Section 104 Report*, A Report of the Register of Copyrights Pursuant to §104 of the Digital Millennium Copyright Act, U.S. Copyright Office, 2001, pp.35-36, available at https://www.copyright.gov/reports/studies/dmca/sec-104-report-vol-1.pdf , (accessed on 6/12/2018).

[1015] Deborah Tussey, "Technology Matters: The Courts, Media Neutrality, and New Technologies", J. Intell. Prop. L. 427, [2005], Vol. 12, p.428,

prescribes that laws can and should be developed in such a way that they are independent.[1016] Under this concept, it logically follows that a consumer should also enjoy the same rights despite the form in which the media exists. Media neutrality affords courts the flexibility to expand copyright law in order to facilitate its application to new technological advancements.[1017] It was this concept of media neutrality that the court forgot to apply in the *Capitol Records, LLC v. ReDigi Inc.*,[1018] where the court reasoned that exhaustion is limited to tangible medium and does not apply to digital world. The U.S. congress House Report itself suggests that copyright law is indifferent to the medium in which the work is fixed.[1019] Then the inevitable question is why differential rights are provided based on the medium on which the fixation of work is done? The courts, on earlier occasions, have balanced the rights of the consumers to the emerging technologies.[1020] Therefore, it is necessary that the courts must construe every technological development in a manner which does not affect the rights of the consumers in mind.

5.5.Advantages of exhaustion in the digital context

The exhaustion rule in the intellectual property law maintains the balance between providing incentive to the owner and furthering the consumer interest, the two major objectives that the IP system aims to achieve. Once a consumer pays money for the IP product by way of incentive for the creation and brings it into the market, the second objective of the IP system is dissemination of the work to the public. This could be ensured only through guaranteeing the unrestricted use and enjoyment of the copy of the work by the consumer who purchased it. This is the objective of principle of exhaustion. Exhaustion doctrine ensures many benefits to the purchaser of the IP product/software such as increased affordability, continued availability of works, access to works

available at: http://digitalcommons.law.uga.edu/jipl/vol12/iss2/3, (accessed on 9/12/2018).

[1016] Carys J. Craig, "Technological Neutrality: Recalibrating Copyright in the Information Age", Theoretical Inquiries L. 601, [2016], Vol.17, p.603, available at http://din-online.info/pdf/th17-2-8.pdf, (accessed on 9/12/2018).

[1017] Deborah Tussey, "Technology Matters: The Courts, Media Neutrality, and New Technologies", J. Intell. Prop. L. 427, [2005], Vol.12, p.428,
available at: http://digitalcommons.law.uga.edu/jipl/vol12/iss2/3, (accessed on 9/12/2018)

[1018] *Capitol Records, LLC* v.*ReDigi Inc.*, 934 F. Supp. 2d 640, 655-56 (S.D.N.Y. 2013).

[1019] H.R. REP. 94-1476, at 5665 (1976).

[1020] *Sony Coop. of America* v. *Universal City Studios,* 464 U.S. 417, 220 U.S.P.Q. (BNA) 665 (1984).

withholding their identity from copyright owners, promoting user innovation, providing platform for competition etc., so as to further social welfare.[1021]

Affordable access to products is the most important function of exhaustion. The utilitarian justification of intellectual property is to bring about access to the consumers at affordable price.[1022] The ability to resell a product, for which there is demand, creates space for secondary market.[1023] Secondary market helps the consumers to receive the product at a low price compared to the market price.[1024] For example, once the distribution right is exhausted upon the first legal sale of a product, it could be rented or lent to others, reducing the consumer costs.[1025] Further, the secondary market regulates the market price and prevents arbitrary pricing.[1026] It

[1021] See generally, Aaron Perzanowski and Jason Schultz, "Digital Exhaustion", Digital Exhaustion, UCLA L. Rev. 889, [2010], Vol.58, available at https://scholarship.law.berkeley.edu/cgi/viewcontent.cgi?article=2246&context=facpubs, (accessed on 23/12/2018). Also see Ruth Anthony Reese, "The First Sale Doctrine in the Era of Digital Networks", B.C.L. Rev. 577, [2003], Vol.44, available at https://lawdigitalcommons.bc.edu/cgi/viewcontent.cgi?referer=https://www.google.com/&httpsredir=1&article=2233&context=bclr (accessed on 6/12/2018).Also see; Joseph P. Liu, "Owning Digital Copies: Copyright Law and the Incidents of Copy Ownership", WM. & Mary L. Rev. 1245, [2001], Vol.42, pp.1289-1294, available at https://core.ac.uk/download/pdf/73966362.pdf, (accessed on 14/12/218).

[1022] *Stewart* v. *Abend*, 495 U.S. 207, 228 (1990).

[1023] P. Sean Morris , "Beyond Trade: Global Digital Exhaustion in International Economic Regulation", Campbell L. Rev. 107, [2014], Vol.36, pp. 134-137, available at https://scholarship.law.campbell.edu/cgi/viewcontent.cgi?article=1575&context=clr, (accessed on 12/12/2018). Also see; Aaron Perzanowski and Jason Schultz, "Digital Exhaustion", UCLA L. Rev. 889, [2010], Vol.58, available at https://scholarship.law.berkeley.edu/cgi/viewcontent.cgi?article=2246&context=facpubs, (accessed on 23/12/2018).

[1024] Ruth Anthony Reese, "The First Sale Doctrine in the Era of Digital Networks", B.C.L. Rev. 577, [2003], Vol.44, p.586, available at https://lawdigitalcommons.bc.edu/cgi/viewcontent.cgi?referer=https://www.google.com/&httpsredir=1&article=2233&context=bclr, (accessed on 6/12/2018).

[1025] Aaron Perzanowski and Jason Schultz, "Digital Exhaustion", UCLA L. Rev. 889, [2010], Vol.58, p.894, available at https://scholarship.law.berkeley.edu/cgi/viewcontent.cgi?article=2246&context=facpubs, (accessed on 23/12/2018). Ruth Anthony Reese, "The First Sale Doctrine in the Era of Digital Networks", B.C.L. Rev. 577, [2003], Vol.44, p.587, available at https://lawdigitalcommons.bc.edu/cgi/viewcontent.cgi?referer=https://www.google.com/&httpsredir=1&article=2233&context=bclr (accessed on 6/12/2018).

[1026] Wendy Gordon, "Intellectual Property as Price Discrimination: Implications for Contract", Chi-Kent l. Rev. 1367, [1998], Vol.73, pp.1383-1390. Also see; *The Impact of Parallel Imports of Books, Films / Music and Software on the Indian Economy with Special Reference to Students"*, NCAER, 2014, p.32, available at http://copyright.gov.in/documents/parallel_imports_report.pdf (accessed on 11/12/2018).

also effectively addresses the problem of lack of availability of works due to reasons such as the book becoming out of print or the disinterest of the copyright owner in making them available for the lack of commercial viability, or withdrawal or suppression of works by copyright owners for cultural or political reasons, or the problem of "orphan works" where copyright owners are either unreachable or no longer exist.[1027] Such situations could be averted through secondary markets.

Further, exhaustion creates a platform for consumer innovation and also avoids consumer lock-ins. Innovation is at the heart of intellectual property. Many a time innovation is made by users themselves from products they purchase.[1028] For e.g., consumers innovate upon the purchased software by improving the compatibility or making new software studying the new software. The presence of exhaustion promoted this activity as this entitled them to make a profit by selling the modified product. When exhaustion is denied, the consumers have lesser incentive to innovate, as the innovated product cannot be sold. Therefore the consumers will not innovate. Secondly, the secondary market, from which the innovator can get the products for experimenting at a cheap rate will be absent if exhaustion rule is excluded in the digital scenario. These factors make consumer innovation and diffusion costlier once the exhaustion doctrine is not recognised.[1029] Consumer lock in is another problem created by the absence of exhaustion. The consumers always look for new competing upgraded products. However, the amount of money that needs to be spent on the new technology makes the switching over a questionable task.[1030] If

[1027] Aaron Perzanowski and Jason Schultz, "Digital Exhaustion", UCLA L. Rev. 889, [2010], Vol.58, p.895, available at https://scholarship.law.berkeley.edu/cgi/viewcontent.cgi?article=2246&context=facpubs, (accessed on 23/12/2018).

[1028] Aaron Perzanowski and Jason Schultz, "Digital Exhaustion", UCLA L. Rev. 889, [2010], Vol.58, pp.897-900, available at https://scholarship.law.berkeley.edu/cgi/viewcontent.cgi?article=2246&context=facpubs, (accessed on 23/12/2018).Monica L. Dobson, "ReDigi and the Resale of Digital Media: The Courts Reject a Digital First Sale Doctrine and Sustain the Imbalance between Copyright Owners and Consumers," Akron Intellectual Property Journal, [2014], Vol. 7, Iss. 2, Article 3, available at: http://ideaexchange.uakron.edu/akronintellectualproperty/vol7/iss2/3, (accessed on 6/12/2018).

[1029] Aaron Perzanowski and Jason Schultz, "Digital Exhaustion", UCLA L. Rev. 889, [2010], Vol.58, pp.897-900, available at https://scholarship.law.berkeley.edu/cgi/viewcontent.cgi?article=2246&context=facpubs, (accessed on 23/12/2018).

[1030] Aaron Perzanowski and Jason Schultz, "Digital Exhaustion", UCLA L. Rev. 889, [2010], Vol.58, p.900, available at https://scholarship.law.berkeley.edu/cgi/viewcontent.cgi?article=2246&context=facpubs, (accessed on 23/12/2018). Also see; *DMCA Section 104 Report*, A Report of the Register of Copyrights Pursuant to §104 of the Digital Millennium Copyright Act, U.S. Copyright Office, 2001, p.xix, available at

the old product could be sold and some amount could be recouped, it is considerably easy to buy new products. This would increase access and chances of incremental innovation to a higher level.[1031] Further, the absence of exhaustion forces consumers to deal with the owners even after owning the product, increasing the consumer cost further. It was precisely to avoid these problems that the common law principle of rule against restraint on alienation was developed.[1032]

5.6.Conclusion

From the above analysis, it is clear that, the application international exhaustion should also be extended to the digital transfers. The application of exhaustion doctrine must be independent of the medium in which the copyright exists since the doctrine draws its logic from the concept of ownership, which confers absolute enjoyment of rights over a product to its purchaser. Exhaustion focuses on the scope of the property interest transferred rather than the nature or mode through which the object is transferred.[1033] The examination of evolution of the concept of exhaustion in Chapter One reveals that, the rights inherently attached to a property and incapable of being severed from it also gets transferred along with the property.[1034] Applying this logic to the digital environment, there seems no reason to exclude the benefits brought about by the

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https://www.copyright.gov/reports/studies/dmca/sec-104-report-vol-1.pdf , (accessed on 6/12/2018); Capitol Records, LLC v. ReDigi Inc., 934 F. Supp. 2d 640, 655-56 (S.D.N.Y. 2013).

[1031] Aaron Perzanowski and Jason Schultz, "Digital Exhaustion", UCLA L. Rev. 889, [2010], Vol.58, pp.897-900, available at https://scholarship.law.berkeley.edu/cgi/viewcontent.cgi?article=2246&context=facpubs, (accessed on 23/12/2018).

[1032] *Morse* v. *Blood*, 68 Minn. 422, 443, 7I N. W. 682 (1897),*Trust Co.* v. *Brown*, IO0 Conn. 26I, 295, I35 Atl. 555, 567 (I926), *Chappell* v. *Frick Co*., i66 Ky. 3II, 315, I79 S. W. 203, 204 (19I). Also see ;Sir Henry Sumner Maine*, Ancient Law: Its Connection with the Early History of Society and Its Relation to Modern Ideas,* John Murray, London, (1st edn, 1908).

[1033] *Reply Comments of the Library Associations Before the Library of Congress*, The United States Copyright Office and The Department of Commerce, National Telecommunications and Information Administration, Washington, D.C., 2000, available athttp://www.arl.org/info/frn/copy/letter06050O.html, (accessed on 21/12/2018). Also see, Victor F. Calaba, "Quibbles 'n Bits: Making a Digital First Sale Doctrine Feasible", Mich. Telecomm. Tech. l. rev. 1 [2002],Vol.9, available athttp://www.mttlr.org/volnine/calaba.pdf ; PetarCimentarov, "The Exhaustion of Copyright in the Digital Environment: Are the Rules Suitable to Deal with Digitally Transmitted Goods? A Comparative Approach between the USA and the EU", available at https://lib.ugent.be/fulltxt/RUG01/001/786/979/RUG01-001786979_2012_0001_AC.pdf, (accessed on 11/12/2018). *Kirtsaeng*v. *John Wiley & Sons, Inc. 568 U.S. 519 (2013)*and *Impression Products, Inc. v. Lexmark Int'l, Inc*., 581 U. S. 1523 (2017).

[1034] *Kirtsaeng*v. *John Wiley & Sons, inc. 568 U.S. 519 (2013)*and *Impression Products, Inc. v. Lexmark Int'l, Inc*., 581 U. S. 1523 (2017).

exhaustion principle to the transfers occurring in the digital environment. The law must evolve or change so as to accommodate the new technological changes and at the same time protect the welfare of the consumers. It is the duty of the legislature to achieve balance by adapting law to the changing scenarios. It is an indisputable fact that consumers support exhaustion principle even in the digital context, as they consider themselves to be entitled to dispose of their property as they wish, and think that digital media is no exception to this.[1035]A contrary position would end up in conferring on the copyright holders, absolute and perpetual control over the digital copies. If this is permitted by law, it would upset the balance between rights of the copyright holder and the consumers. A formalistic application of the exclusive reproduction right would end up in preventing consumers from utilizing new technologies, and preventing traditional user rights such as international exhaustion doctrine from being applicable in new technological environments.[1036] The problem of keeping additional copies even after the sale of a copy in the digital transfers should be resolved using technologies such as the one which provides for automatic deletion of the copy after the transfer. Exhaustion doctrine is also justified in the digital context for the reason that a total ban on exhaustion in the digital context will completely kill the secondary markets in the digital world creating undue monopoly and anti-competitive effects, especially when the world is changing more towards digital life. The economic significance of the secondary market is evident from the patent granted in U.S. for Amazon for secondary market for music and books, which was discussed above. In cases where he transfers the purchased product keeping a copy to him, it will be an infringement because then what he is transferring is a reproduced copy and not the copy he purchased.

The method of licensing used by the copyright holders to circumvent exhaustion cannot be justified. Even in the digital context, if the transaction has all the characteristics of a sale, it would be only legal to allow the resale and other proprietary rights that are attached to the sold

[1035] Henry Sprott Long III, "Reconsidering the "Balance" of the "Digital First Sale" Debate: Re-examining the Case for a Statutory Digital First Sale Doctrine to Facilitate Second-Hand Digital Media Markets", ALA. L. Rev. 1183, [2008], Vol.59, p.1192 available at https://heinonline.org/HOL/LandingPage?handle=hein.journals/bamalr59&div=38&id=&page= (accessed on 11/12/ 2018).

[1036] *Reply Comments Before the Library of Congress*, American Library Association, The United States Copyright Office and The Department of Commerce, National Telecommunications and Information Administration, Washington, D.C., 2000, available at https://www.copyright.gov/reports/studies/dmca/reply/Reply008.pdf, (accessed on 12/12/2018).

article. As recommended by the CONTU Report, it should be the words 'legal possessor' and not the words 'owner of the copy' who should be recognised in the legal provisions of exhaustion. The non-recognition of exhaustion in digital context amounts to violation of common law principles, and has to be characterized as anti-competitive as it harms both fair competition and consumer welfare. If one agrees that exhaustion contributes to the creation of the right balance in intra-brand competition and prohibits certain restrictions on trade in the physical world, it is perfectly logical to argue that the same positive impact should be extended to the digital world as well.[1037] Even if one says that exhaustion applies only in the tangible medium, it is only the medium which changes, the incentive and other IP factors do not change. It thus becomes evident that the argument against exhaustion advocated by many[1038] is due to the incomplete understanding of the principles and philosophy underlying exhaustion. Rather than an irrational carve out or an exception, exhaustion is an inherent part of copyright law's balance between the rights of creators and the rights of the public.[1039] It is, thus, part of the concept of property in IP. The free movement of goods is also applicable to digital world. The concept of international exhaustion is all the more necessary in the digital world since the online goods could be transferred to any part of the world through the digital medium. The U.S. practice of thwarting exhaustion in the digital format, both by the legislature and the judiciary is disheartening. The judgement in the Capitol Records v. Re Digi[1040] has practically killed the exhaustion doctrine in the digital platform in U.S. However, the European law and their judicial practice are favouring digital exhaustion. Though the mode of exhaustion followed in EU is regional, they have encompassed the concept of exhaustion in the digital format except to online services. Therefore, for a healthy competitive online market, international exhaustion is very much necessary.

[1037] *DMCA Section 104 Report*, A Report of the Register of Copyrights Pursuant to §104 of the Digital Millennium Copyright Act, U.S. Copyright Office, 2001, available at https://www.copyright.gov/reports/studies/dmca/sec-104-report-vol-1.pdf , (accessed on 6/12/2018).

[1038] *DMCA Section 104 Report*, A Report of the Register of Copyrights Pursuant to §104 of the Digital Millennium Copyright Act, U.S. Copyright Office, 2001, p.xix, available at https://www.copyright.gov/reports/studies/dmca/sec-104-report-vol-1.pdf , (accessed on 6/12/2018).Also See; Capitol Records, LLC v. ReDigi Inc., 934 F. Supp. 2d 640, pp.655-56 (S.D.N.Y. 2013).

[1039] Aaron Perzanowski and Jason Schultz, "Reconciling intellectual property and personal property", Notre Dame L. Rev. 1211, [2015], Vol. 90, available at: http://scholarship.law.nd.edu/ndlr/vol90/iss3/6 (accessed on 7/12/2018).

[1040] Capitol Records, LLC v. ReDigi Inc., 934 F. Supp. 2d 640, pp.655-56 (S.D.N.Y. 2013).

Chapter VI

Analysis of Parallel Imports through the Indian Copyright Patent, Trademark, Semiconductors and Plant Varieties Laws and regimes

6. Introduction

The most important among the various criticisms raised against the TRIPs agreement is that it has been drafted to serve the purpose of the developed countries. However, the developing nations, even in the midst of pressure from the developed nations, have tried to incorporate the flexibilities available inside the TRIPs. India is one of the front-runners who advocated for international exhaustion to facilitate parallel imports for access and affordability of cheap products.[1041] The economic conditions and the general public interest of this country compels for such an effort. The area where parallel imports create a heavy impact is the Patent and Copyright regimes. It is therefore stressed that it is imperative that the developing and least developed countries utilise these flexibilities to the maximum. One of the most important flexibility in TRIPs is the exhaustion principle, wherein it is the understanding to disagree upon the mode of exhaustion to be followed. However, the fact that some of the Indian statutes do not expressly provide for the exhaustion principle as are available in various statutes of the foreign nations is attention grabbing. Still the legislature has indirectly recognized the international exhaustion as the Indian policy. This stand of the legislature is not surprising as India, even in the TRIPs and other international forums have argued for international exhaustion. The Indian law has categorically tried to recognize international exhaustion especially in the Patent arena, immediately upon the onset of TRIPs era. This probably would be because India understands how public welfare can be enhanced by parallel imports. However as stated early, the reluctance to express the same in clear terms would be because of the lobbying efforts of the interested

[1041] MTN.GNG/NG11/W/37, Submission of India in the Second phase of TRIPs negotiation, (1988-1989).

groups.[1042] The most saddening part in the Indian Scenario is that judiciary has made a mess of this already baffling situation. When it comes to the copyright scenario, judiciary has categorically delivered judgments without any consideration of the public interest, defeating the efforts of the legislature completely and in the trademark arena, at least one judgment exists which has supported the government policy of international exhaustion.

The Government policy on exhaustion had been to advocate international exhaustion on all platforms of international negotiations. As we had seen in Chapter 3, India was one of the strongest party who pushed for international exhaustion in the TRIPs negotiation. India had pushed for international exhaustion in all forms of the IP regimes. It is in the light of this international position that one must view the Indian law on exhaustion.

6.1 Legislative framework and judicial approach under the Indian copyright law

6.1.1. Copyright Law

Under the Indian Copyright Act there is no express provision providing for exhaustion or parallel imports. Indian copyright Act does not recognise right to import to the copyright owner.[1043] There is no provision in copyright Act by which owner of copyright is granted the exclusive right to import a copyrighted work into India. The Act only prohibits importation of infringing copies.[1044] And infringing copies are, in simple words, copies which are published without the permission of the author.[1045] But this is not the case with the parallel imports. They are copies which are lawfully produced by the owner or his licensee and lawfully acquired by the person importing them without the permission of the author. But the question to be answered at this point is, whether the permission of the author is required to import a legally acquired lawful copy of a work? The answer would be negative from the reading of the copyright statute. The judiciary however felt otherwise. The failure of the courts to understand the concept and the need of international exhaustion are evident from the judicial pronouncements delivered which will be

[1042] This is evident from the rejection of the proposed amendment to Sec. 2 (m) of the Indian Copyright Act which would have expressly made parallel imports legal doing away with all the confusions in the language of the law.

[1043] Sec. 14 of the Act guarantees the rights available to a copyright owner and it does not recognise importation right.

[1044] Sec. 51(b) (iv) of the Indian Copyright Act, 1957.

[1045] Sec. 2 (m) of the Indian Copyright Act, 1957, defines an infringing copy of a work.

dealt with in the coming sections of the chapter. For a country like India, where goods are not so affordable and accessible, keeping in view the consumer welfare of the country, international exhaustion would be the most desirable one. Even though local publication and distribution of books have increased in India, 75% of books are still imported into India, the bulk of which includes educational books.[1046] India's imports of books exceed its exports.[1047] The price of the books available in India is more when compared to the price of the books in other countries.[1048]

In its November 2010 Report, the Parliamentary Standing Committee which was supervised by India's Ministry of Human Resource Development made several observations on the need to amend the copyrights provisions for textbooks in the Indian Copyright Act, 1957. The Committee urged the government to ensure that the purpose for which the copyright amendment was proposed, i.e., to protect the interests of students in India, should be kept in mind while moving forward.[1049] Therefore the committee requested for adoption of international exhaustion.

6.1.2. Judicial interpretations and Legislative responses towards parallel imports under Copyright.

The first reported case regarding parallel imports in the copyright arena was the *Penguin Books Ltd. v. India Books Distributors and Ors*[1050]. In this case the court was called upon to decide whether import by a third party without the express authority of the copyright owner

[1046] "Appendix - I, Indian Copyright Law Amendments 2012 Publishers' Presentation to NCAER", in *The Impact of Parallel Imports of Books, Films / Music and Software on the Indian Economy with Special Reference to Students*, NCAER, 2014, p.6, executive summary, available at http://copyright.gov.in/documents/parallel_imports_report.pdf (accessed on 26/11/2018).

[1047] *The Impact of Parallel Imports of Books, Films / Music and Software on the Indian Economy with Special Reference to Students*, NCAER, 2014, p. 32 , available at http://copyright.gov.in/documents/parallel_imports_report.pdf (accessed on 26/11/2018).

[1048] *The Impact of Parallel Imports of Books, Films / Music and Software on the Indian Economy with Special Reference to Students*, NCAER, 2014, p. 43 , available at http://copyright.gov.in/documents/parallel_imports_report.pdf (accessed on 26/11/2018).

[1049] *227th Report on The Copyright Amendment 2010*, The Standing Committee on Human Resource Development, Department - Related Parliamentary Standing Committee On Human Resource Development, 2010, available at http://164.100.47.5/newcommittee/reports/EnglishCommittees/Committee%20on%20HRD/227.pdf, (accessed on 14/12/2018).

[1050] AIR 1985 Delhi 29.

constitutes infringement. Court ruled that it constituted infringement because it amounted to infringement of the right of the owner to publish. Court opined:

> "While publishing generally refers to issue to public, importation for the specified purpose maybe a necessary step in the process of issuing to public and therefore of publishing. *Exclusive right of the copyright owner to print, publish, and sell these titles in India would extend to the exclusive right to import copies into India for purpose of selling or by way of trade offering or exposing for sale the books in question*. It is also an infringement of copyright knowingly to import into India for sale or hire infringing copies of a work without the consent of the owner of the copyright, though they may have been made by or with the consent of owner of copyright in place they are made."[1051](Emphasis added.)

Thus the court held that it was illegal to import a lawfully produced work in one country to another country merely for the reason that the right to publish that work in that country vested with the some other person.[1052] And as a result the court went to the extent of expanding the rights of the author to create a separate right to import which the Act had never envisaged.[1053] The court seems to follow the dictum followed in the Australian case and unconvincingly gave a farfetched interpretation to the right to publish under the Indian Act.[1054] The court, thus, was absolutely unmindful of the interest of the Indian consumers. It also propounded an 'acid test' for finding out whether a copy imported is an infringing copy or not using section 2 (m) and section 51 and section 53.[1055] It was held that the essence of these sections was to prevent unauthorized use or appropriation of someone else's property. The court further highlighted

[1051] *Penguin Books Ltd.* v. *India Book Distributors and Ors* AIR, 1985 Delhi 29.

[1052] Arathi Ashok, "Economic Rights of the authors under Copyright Law: Some Emerging Judicial Trends", JIPR [2010], Vol.15, p.50, available at http://docs.manupatra.in/newsline/articles/Upload/1EC850DF-EAA0-4E86-BD9B-99E2B16F12BB.pdf, (accessed on 20/12/2018).

[1053] Arathi Ashok, "Economic Rights of the authors under Copyright Law: Some Emerging Judicial Trends", JIPR [2010], Vol.15, p.50, available at http://docs.manupatra.in/newsline/articles/Upload/1EC850DF-EAA0-4E86-BD9B-99E2B16F12BB.pdf, (accessed on 20/12/2018).

[1054] K. Ponnuswami, "Performing Right if the Intellectual Worker: Judicial Annihilation" J.I.L.I., [1986] Vol. 28, Issue 4, p.354.

[1055] *Penguin Books Ltd.* v. *India Book Distributors and Ors,* AIR 1985 Delhi 29.

the importance of territorial division and geographical area. It took the position that outside a defined territory the sale of a copyrighted work constituted a sale of an "infringing copy".[1056] Thus the court facilitated for the exploitation of the Indian consumers.

Under the Copyright Act, 1957, as it then existed, infringing copies were those which were made or imported in contravention of the provisions of the Act.[1057] The question the court should have addressed was whether the copies made in America were infringing or contravening the provisions of the Indian copyright Act, when imported to India.[1058] An American copy can never be made in contravention of the Indian Copyright Act. The next question should have been whether they are imported in contravention of the provisions of the Act. There is no law in India which bars importation of a lawfully made copy to India.[1059] By extending scope of the 'right to publish in India' granted to the copyright owner or his licensee in India so as to cover importation of copies in to India, the judiciary has made a mess of the Indian copyright law creating undue monopoly ultra-vires the Act.

In order to overcome this chaos made by the High Court the legislature removed the words "publishing" through the amendment of Copyright Act in 1994, and introduced a right to "to issue copies of the work to the public not being copies already in circulation".[1060] Moreover, the explanation to the section clarifies that a copy which has been sold once shall be deemed to be a copy already in circulation. Therefore the copyright Act confers on the copyright owner only the right to issue copies of the work which are not sold. This was the first step to recognize the doctrine of exhaustion in the Indian copyright Act in India. When the words of the section "copies already in circulation" is construed in a sense that it is first sold anywhere in the world, and the word 'public' as international public, it could be said that it provides for international exhaustion. Thus the 1994 amendment makes it clear that once the copies are in circulation the

[1056] *Penguin Books Ltd.* v. *India Book Distributors and Ors*, AIR 1985 Delhi 29.
[1057] Sec. 2(1)(m)(i) of the Indian Copyright Act, 1957
[1058] K. Ponnuswami, "Performing Right if the Intellectual Worker: Judicial Annihilation" J.I.L.I., [1986] Vol. 28, Issue 4, p.353.
[1059] K. Ponnuswami, "Performing Right if the Intellectual Worker: Judicial Annihilation" J.I.L.I., [1986] Vol. 28, Issue 4, p.354.
[1060] Ss. 14 (a) (ii), 14 (b)(i) , 14 (c) (iii) of the Indian copyright Act, 1957.

owner of copyright has no control over it and the copies can move freely to any territory following the principles of international exhaustion. It also permits person to import legal copies of the same book from any other territories and sell it in India.

It is interesting to note that the 1994 Amendment also introduced rental rights including resale right for computer programme, cinematograph film and sound recording. The phrase used in the legal provision is "to sell or give on hire or offer for sale or hire regardless of whether such copy has been sold or given on hire on earlier occasions".[1061] This gave an impression that after the amendment exhaustion of right, both national and international, is not available for computer programme, sound recording and cinematograph film, because it prevented resale of the copies once sold without the permission of the owner anywhere in India. The background seems to be that the parliament wanted to introduce rental rights for these works but mistakenly added resale rights also with it.[1062] Exhaustion of rights at least within the territory of a country is a well accepted international norm of copyright law followed globally.[1063] The provision was amended in 1999 amendment and the right in the case of computer programme as it stands in the current provision is "to sell or give on commercial rental or offer for sale or for commercial rental any copy of computer programme".[1064] Thus international exhaustion was recognized for computer programme too. But the situation remained the same for cinematograph film and sound recording.

In another important case *Eurokids International Pvt. Ltd. v. India Book Distributors Egmont*[1065], the Bombay High Court also refused to recognize international exhaustion.[1066] The court never

[1061] See Ss. 14 (1) (b) (ii), 14 (d) (ii) and 14 (e) (ii) Indian Copyright Act, 1957.

[1062] Prof. N.S. Gopalakrishnan, "Note on section 2 (m) of the Copyright (Amendment) Bill 2010", in Appendix III to *The Impact of Parallel Imports of Books, Films / Music and Software on the Indian Economy with Special Reference to Student*s, NCAER, (2014), p. 3 , available at http://copyright.gov.in/documents/parallel_imports_report.pdf (accessed on 26/11/2018).

[1063] Prof. N.S. Gopalakrishnan, "Note on section 2 (m) of the Copyright (Amendment) Bill 2010", in Appendix III to *The Impact of Parallel Imports of Books, Films / Music and Software on the Indian Economy with Special Reference to Student*s, NCAER, (2014), p. 3 , available at http://copyright.gov.in/documents/parallel_imports_report.pdf (accessed on 26/11/2018).

[1064] Sec. 14(b) (ii) of the Indian Copyright Act, 1957 reads: "to sell or give on hire or offer for sale or hire, any copy of the computer programme, regardless of whether such copy has been sold or given on hire on earlier occasions."

[1065] 2005 (6) Bom.CR 198.

looked into the concept of exhaustion and decided against the defendant merely by interpreting sections 14, 16 and 51 and concluding that it is the exclusive licensee's right to import as per the law and importation by anyone other than him violated the Indian copyright Act.Even the amendment made in to the Section 14 of the Copyright Act in 1999 was not taken note of by the court. It concluded by saying that it is in the public interest that one should protect the interest of the copyright owner as any violation of copyright hampered public interest.[1067]

In *Warner Bros. v. Santhosh V.G*[1068], the Bombay High Court had to decide on the issue of exhaustion in cinematograph films. The decision lays down an interpretation of section 2(m) , section 14 (d), and section 51 of the copyright Act in the light of the principle of International exhaustion. Plaintiffs carry on the business of film production and are the owners and licensees of the copyrights in the films produced by them. The defendants distribute through rental DVD'S of films in which plaintiffs have copyright. The plaintiffs claim infringement under section 14 (d) (ii)[1069] and section 51[1070]. The court had to address the issue of whether the sale of DVD'S in India which is authorized to be distributed outside India is violation the right of the plaintiffs. The court in this case differentiated the rights guaranteed for the literary, dramatic and musical work with that of the rights for the cinematograph films and sound recording. The words " copies in circulation" and the explanation attached thereto is applicable only for literary , musical and dramatic works and not to cinematograph films, which makes it clear that the legislature never intended to provide international exhaustion for the cinematograph

[1066] The defendants bought books which were published in U.S. from authorized licensees and imported the same to India. Plaintiffs were the exclusive licensee in India. Plaintiffs alleged that the books sold in U.S. were under territorial restrictions and cannot be sold in India.

[1067] *Eurokids International Pvt. Ltd. v. India Book Distributors Egmont* 2005 (6) Bom.CR 198.

[1068] CS (OS) No. 1682/2006, available at https://indiankanoon.org/doc/67850614/, (accessed on 27/12/2018).

[1069] Sec.14 (d) (ii) of the Indian Copyright Act: "In the case of cinematograph film ... to sell or give on hire, or offer for sale or hire, any copy of the film, regardless of whether such copy has been sold or given on hire on earlier occasions."

[1070] Sec. 51 of the Indian Copyright Act deals with circumstances in which copyright is infringed.

films.[1071]The court cannot be blamed for such an interpretation because court merely applied the wordings of the section 14 (d)(ii). The section mandates that the owner of copyright over the cinematograph film has the right to sell or give on hire or offer for sale, any copy of the film "regardless of whether such copy has been sold or given on hire on earlier occasions". Thus it expressly states that the owner has the right over the copy of a film which is once sold or given on hire which is a clear negation of first sale doctrine. However the court could have pointed out that such a differentiation made regarding cinematograph film was absurd. The court had the leeway of questioning the differentiation. The casual way in which the court applied the literal rule of interpretation could be due to the lack of understanding the importance of international exhaustion and its implication on the social life. The court could have criticized the legislature for making such an absurd distinction between rights in different works. The court also failed to address or highlight the problem of access or affordability that can result from the negation of exhaustion. This may due to the incomplete understanding of the impact of international exhaustion. The courts should have highlighted the fact that the implication of the words "regardless of whether the copies are in circulation or not" which meant that not even national exhaustion is permissible in India, completely negating the application of exhaustion concept in cinematograph films. The fact that the decision was rendered years after TRIPs negotiation was concluded, where India strongly propounded for international exhaustion, adds to the injury caused by the judiciary as it brings out the fallacies in comprehending the international scenario by the Indian judiciary. Subsequently the 2012 amendment to the copyright Act deleted the words 'regardless of whether such copy has been sold or given for hire'.[1072]This implies that international exhaustion applies to cinematographic films too and has come in tune with the provisions of exhaustion in other works.

[1071] Karishma D Dodeja, "The Sheer 'Film' of Protection- An Exercise in Exhaustion", JIPR, [2013], Vol.18, pp. 7-14, available at http://nopr.niscair.res.in/bitstream/123456789/15741/1/JIPR%2018%281%29%207-14.pdf, (accessed on 21/12/2018)

[1072] The Current Sec. 14 (d) (ii) reads as: "to sell or give on commercial rental or offer for sale or for such rental, any copy of the film."

In another case, *John Wiley & Sons v. Prabhat Chander Kumar Jain*,[1073] court addressed the issue whether the export of legal copyrighted works is legal in India. Plaintiffs were in the business of selling low priced editions of advanced educational books in the Indian sub-continent. There were difference in the books made available in India and in U.S.A in terms of quality of paper, printing and also in prices. Defendants set up a website to sell the low priced Indian editions to customers to U.S.A by exporting the books to U.S.A. The court interestingly applied an absurd principle regarding international exhaustion. Delhi High Court held that the first sale doctrine was applicable only against the exclusive licensees and not against the owners who will continue to have a cause of action against defendants. The court differentiated the right of the owners and that of licensees through an analysis of the provisions of the copyright Act. It held:

> "The purchaser after purchasing from the exclusive licensee cannot, by claiming the principle of exhaustion or extinguishment of rights, defeat the rights of the owner. This is the only harmonious interpretation possible by invocation of doctrine of first sales in the present case."[1074]

The court opined that when the first sale of the work takes place, the rights of the licensee only will get extinguished but not the rights of the owner.[1075]This interpretation is inconsistent with the provisions of the copyright Act. Court relied on the principle that the rights conferred through section 14 of the Copyright Act cannot be limited by territorial limitations and can be made available to the copies of it in any part of the world, and when this right is licensed to another person and when he sells the goods the rights of the licensee gets exhausted but not that of the copyright owner.

[1073] CS (OS) No. 1960/2008, May 17, 2010, available at https://indiankanoon.org/doc/777762/, (accessed on 18/12/2018).

[1074] *John Wiley & Sons* v.*PrabhatChander Kumar Jain*, CS (OS) No. 1960/2008, May 17, 2010

[1075] PraneshPrakash, "Exhaustion: Imports, Exports, and the doctrine of first sale in Indian Copyright Law", NUJS L. rev. [2012], Volume 5, Issue 4,
p.651, available at http://nujslawreview.org/wp-content/uploads/2016/12/06_pranesh.pdf., (accessed on 14/12/2018).

During the draft proposal for the 2012 amendments, a proposal was tabled to amend the section 2(m) of the Copyright Act which dealt with infringing copies. The amendment aimed at adding a proviso to the section which was as follows: "provided that a copy of a work published in any country outside India with the permission of the author of the work and imported from that country into India shall not be deemed to be an infringing copy".[1076] This provision would have directly allowed third parties to sell and import copyrighted works that had been purchased from anywhere in the world and thus would have directly recognised the principle of international exhaustion.[1077] However this amendment never came into effect as it was opposed to the greatest extent by the lobby of the publishers supported by the current ministry.[1078] A further amendment was also made to section 52 (z) (c) so as to allow importation of literary or artistic works such as labels or logos which are incidental to the copies which are imported lawfully.[1079] The clause supports Section 30 (3) of the Indian Trademark Act, which provides for parallel imports of trademark goods.[1080]However with current provisions in the section 14 which in fact deal with the international exhaustion, there is little effect which would have made by the amendment proposed. The only advantage would have been that the judiciary would have been made clear of the intention of the legislature to recognize international exhaustion.

[1076] PraneshPrakash, "Exhaustion: Imports, Exports, and the doctrine of first sale in Indian Copyright Law", NUJS L. rev. [2012], Volume 5, Issue 4,
pp.652-653, available at http://nujslawreview.org/wp-content/uploads/2016/12/06_pranesh.pdf., (accessed on 14/12/2018).

[1077] ShamnadBasheer, et.al, "Exhausting Copyrights and promoting access to Education: An Emperical Stake", JIPR, [2012], Vol17, p.336, available at
http://nopr.niscair.res.in/bitstream/123456789/14461/1/JIPR%2017%284%29%20335-347.pdf, (accessed on 21/12/2018)

[1078] PraneshPrakash, "Exhaustion: Imports, Exports, and the doctrine of first sale in Indian Copyright Law", NUJS L. rev. [2012], Volume 5, Issue 4,
p.635, available at http://nujslawreview.org/wp-content/uploads/2016/12/06_pranesh.pdf., (accessed on 14/12/2018).

[1079] Sec.52 (z) (c) of the Indian Copyright Act, 1957.

[1080] Zakir Thomas, "Overview of the Changes to the Changes to the Indian Copyright Act", JIPR, [2012], Vol.17, pp.324-334, available at http://nopr.niscair.res.in/bitstream/123456789/14460/1/JIPR%2017%284%29%20324-334.pdf, (accessed on 4/12/2018).

The above analysis brings to light the fact that the Indian courts were finding it hard to understand and appreciate the concept of exhaustion in the copyright context. This is evident from the fact that the courts believed that exhaustion of licensees will take place but not that of the owner after the sale has taken place.[1081] The court also negated exhaustion so as to give excessive consideration to copyright protection believing it to bring about public interest.[1082] The court even extended the right to publish which was present once under the Indian Copyright Act to right to import. The excessive dependence of courts on foreign judgments should also be pointed out as a reason for the same.

There are no direct cases in India which deals with digital context. However, the court did make observations relating to software containing C.D.'s in cases where it dealt mainly with taxation matters. The court tried to differentiate the copyright inside the C.D. and the copyright containing C.D. for the purpose of determining whether the tax law applies to the supplier of such C.D.'s. The court held that the ownership of C.D. and the ownership of software are different.[1083] Based on such an observation the court held that the transfer of the C.D. containing software for use will automatically amount to a sale as the ownership in the C.D. is completely transferred. The court for the purpose of taxing has held the C.D. containing software is a tangible medium as soon as the software is copied to the C.D.[1084] The court also observed that the C.D. containing software becomes a good once it exhibits qualities such as (a) its utility; (b) capable of being bought and sold; and (c) capable of transmitted, transferred, delivered, stored and possessed.[1085] It becomes an article of value.[1086] The moment the article becomes a marketable object, it becomes a good.[1087] This can imply that the court was trying to restrict the rights of the intellectual property holder. However the court erred in finding that the sale of a copy of the film endorses along with it a part of the copyright of the owner and it

[1081] *John Wiley & Sons* v.*Prabhat Chander Kumar Jain*, CS (OS) No. 1960/2008, May 17, 2010.
[1082] *Eurokids International Pvt. Ltd.* v. *India Book Distributors Egmont* , 2005 (6) Bom. CR 198.
[1083] *Tata Consultancy Services* v. *State of Andhra Pradesh* AIR 2005 SC 371
[1084] *Tata Consultancy Services* v. *State of Andhra Pradesh* AIR 2005 SC 371.
[1085] *Tata Consultancy Services* v. *State of Andhra Pradesh* AIR 2005 SC 371.
[1086] *Tata Consultancy Services* v. *State of Andhra Pradesh* AIR 2005 SC 371.
[1087] *Tata Consultancy Services* v. *State of Andhra Pradesh* AIR 2005 SC 371.

can therefore be limited by the copyright owner.[1088]The court differentiated between computer software and other copyright works such as literary works of books or music C.D.'s.[1089]

6.2. Exhaustion under Indian Patent law

The Indian Patent Act of 1970 was the first Act, which was made by the Indian legislature in the field of Patents. However, it had two important predecessors during the British rule viz., the British- Patent Act of 1856 and the Indian Patent and Designs Act of 1911. Both the laws did not contain any express provisions on exhaustion. They were indeed based on England's Patent Act of 1852. However, they also did not conferon the patentee any rightto import. This indicates that importation from outside India by persons other than the patent holder himself, who has acquired a legal title to those goods was not intended to be prohibited by the Patent Act of 1856 and Indian Patent and Designs Act of 1911.

After independence, it was felt that a major restructuring was needed in Patent law to suit national interests and economic policies.[1090] Therefore, a committee was formed with Justice N. Rajagopala Ayyangar Chairman. The committee report raised many specificquestions about the existing patent system and one of the major worries of it was the misuse of the patent right to import.[1091] The report suggested:

> "(T)he existence of patent prevents the importation of the product manufactured by the same or similar process from a country which might offer the article at a lower price. In this connection, it might be pointed out that where the same patentee manufactures the same article in different countries, the price of the product might not be the same in each country. …"

[1088] *Samsung Electronics Company* v.*Assesee*, ITA No.299/Bang/2011 decided on March 2012, available at https://indiankanoon.org/doc/147187654/, (accessed on 4/1/2018).

[1089] *Samsung Electronics Company* v. *Assesee*, ITA No.299/Bang/2011, decided on March 2012, available at https://indiankanoon.org/doc/147187654/, (accessed on 4/1/2018).

[1090] Shri Justice N. Rajagopala Ayyangar, *Report on the revision of the patents law*, The Minister for Commerce and Industry, Government of India, 1959, p. 3, available at https://spicyip.com/wp-content/uploads/2013/10/ayyangar_committee_report.pdf., (accessed on 4/1/2018).

[1091] Shri Justice N. Rajagopala Ayyangar, *Report on the revision of the patents law*, The Minister for Commerce and Industry, Government of India, 1959, p. 17, available at https://spicyip.com/wp-content/uploads/2013/10/ayyangar_committee_report.pdf., (accessed on 4/1/2018).

This explains that the committee was very much aware of the existence of differential pricing mechanisms and the misuse that can occur due to importation right. The committee also justified differential pricing terming it as a market mechanism, but failed to visualize how it can be utilized for the benefit of the Indian consumers. The report further stated that process patent should be the mode of protection under the Indian Patent law in the context of medicine and food because a patent for a process conferred merely an exclusive right to use the patented process, and not any exclusive right to sell the product made by the process.[1092] The Committee might have contemplated that the importation of the product made abroad by the patented process and its sale would not constitute an infringement of the process patent. The result would be that any one was free to import any article made abroad and sell it in India. This would lead to increase in competition between products leading to reduction in price. The competition in the market between low priced imported product and product produced in India would lead to a reduction in price, and this would be particularly so in cases where the article was produced in countries where the invention patented in India does not enjoy patent protection.[1093] Therefore the committee desired for competition between low priced products made outside India and the products made within India. It is also interesting to note that in the recommendations, right to import was not included as a right of the patent holder.[1094] This could have been avoided so as to curb the misuse of the importation right. Since no right to import was recognised, any person was in a position to import a patented product placed in the market once by the patentee or his agents in any part of the world. The logic for this reasoningis that since no right to import was granted

[1092] See Shri Justice N. Rajagopala Ayyangar, *Report on the revision of the patents law*, The Minister for Commerce and Industry, Government of India, 1959, p.161, available at https://spicyip.com/wp-content/uploads/2013/10/ayyangar_committee_report.pdf., (accessed on 4/1/2018). "It would be seen that under that rule, since a patent for a process confers merely an exclusive right to use the patented process, and not any exclusive right to sell the product made by the process, the importation of the product made abroad by the patented process and its sale would not constitute an infringement of the process patent. The result would be that as any one was free to import the article and sell it, the competition would lead to a reduction in price, and this would be particularly so in cases where the article is produced in countries where the invention patented in India does not enjoy patent protection."

[1093] Shri Justice N. Rajagopala Ayyangar, *Report on the revision of the patents law*, The Minister for Commerce and Industry, Government of India, 1959, p.161, available at https://spicyip.com/wp-content/uploads/2013/10/ayyangar_committee_report.pdf., (accessed on 4/1/2018).

[1094]Shri Justice N. Rajagopala Ayyangar, *Report on the revision of the patents law*, The Minister for Commerce and Industry, Government of India, 1959, p.164, available at https://spicyip.com/wp-content/uploads/2013/10/ayyangar_committee_report.pdf., (accessed on 4/1/2018)..

to the patent holder there was no need for any express mentioning of international exhaustion. This means that Committee might have thought that the patent holder could not have prohibited importation of patented products in to Indiafrom elsewhere, unless they were infringing products. However, the committee recommended for distribution right to the patent holder. This could be without understanding the impact of such a provision on imports of goods made outside India. However, the observations made by the committee regarding the availability of cheap products outside India and the intention of not granting product patents to pharmaceutical and food products to further competition from cheap products made outside India is a clear intention of the committee to have had favour towards international exhaustion even though they were not quite fully aware of the same when they granted the right to distribute to the Patent holder. Further, the right to be granted under the Ayyangar Committee Report was right to sell the patented product and not the right to resale.

The Indian Patent Act, 1970 was enacted on the basis of the recommendations of the Ayyangar Committee Report. The Act was born with several layers of public interest provisions ensuring access to patented products.[1095] It did not contain any provisions regarding exhaustion, probably because Shri.Ayyangar never mentioned the same, as there was no importation right under the Act. Later, during the TRIPs negotiations in the Uruguay Round of GATT, the right to import and exhaustion were subjects of heated debates. The negotiation ended up in with the so called 'flexibility' under TRIPs of providing parties the freedom to adopt any mode of exhaustion.[1096] The developing and the least developed countries demanded the recognition of international exhaustion in the TRIPs negotiation. Even though the TRIPS Agreement conferred on the patent holder a right to import, the said right is subject to Article 6.[1097] This was highly necessary since when an exclusive license to import was granted, it would have otherwise meant that any act of

[1095] YogeshPai, "The Hermeneutics of Patent Exhaustion Doctrine In India", in Irene Calboli and Edward Lee,*Research Handbook on Intellectual Property Exhaustion and Parallel Imports*,Edward Elgar Publishing, Cheltenham, (2016),p.324.

[1096] Art. 6 of the TRIPs, 1994, provides that "For the purposes of dispute settlement under this Agreement, subject to the provisions of Articles 3 and 4 nothing in this Agreement shall be used to address the issue of the exhaustion of intellectual property rights".

[1097] Footnote 6 to Art. 28 of TRIPs, 1994, says "This right, like all other rights conferred under this Agreement in respect of the use, sale, importation or other distribution of goods, is subject to the provisions of Article 6."

distribution without the permission of patent holder amounted to infringement.[1098] The implication of the footnote 6 to Article 28 becomes important in this context. As per the footnote 6, exhaustion extends not just to imports but also to use, sale or distribution of IP goods. This means that the right to use a patented product also gets narrowed down in the absence of the exhaustion of the same right. This coupled with the access and market problems that India could face due to granting of importation right, could be the reason why India demanded for the recognition of international exhaustion.[1099] Further in the Doha declaration on the TRIPS Agreement and Public Health[1100] it was clarified that the effect of the provisions in the TRIPS Agreement that are relevant to the exhaustion of intellectual property rights is to leave each Member free to establish its own regime for such exhaustion without challenge, subject to the MFN and national treatment provisions of Articles 3 and 4.[1101]

With the onset of the TRIPs regime, India was on the path of revising the IP laws so as to make it in compliance with the TRIPs standards. The flexibility provided under the TRIPs regime, which was further clarified by the Doha declaration,granted India the right to recognize international exhaustion in its Patent law. The first attempt to introduce the right to import and to include a provision permitting international exhaustion was made in the Patents (Second Amendment) Bill 1999. The Indian Patent law had two major revisions in the years 2002 and 2005. It was in the 2002 amendment that both the right to import[1102] and the provision regarding exhaustion were incorporated in to the Indian Patents Act. Section 107 A was inserted by Patents (Amendments Act) 2002which contained a clause (b) recognizing international exhaustion. In the Second amendment Bill introduced in the Parliament in 1999, the Statement of Objects and Reasons had stated that the salient feature of the Bill was to provide for provisions relating to parallel import

[1098] YogeshPai, "The Hermeneutics of Patent Exhaustion Doctrine In India", in Irene Calboli and Edward Lee,*Research Handbook on Intellectual Property Exhaustion and Parallel Imports*,Edward Elgar Publishing, Cheltenham (2016),p.324.

[1099] MTN.GNG/NG11/W/37.

[1100] Doha Ministerial –Declaration on the TRIPS Agreement and Public Health adopted on 14 November 2001, WT/MIN(01)/DEC/2.

[1101] Para 5 (d) of the Doha Ministerial –Declaration on the TRIPS Agreement and Public Health adopted on 14 November 2001, WT/MIN(01)/DEC/2.

[1102] Sec. 48 Indian Patents Act, 1970.

of patented products.[1103] Clause 51[1104] of the Bill recommended the inclusion of the provision of parallel imports. Thus it is clear that market accessibility and public interest was a major aim for bringing parallel import provision. Also it made clear that the amendment aims at international exhaustion rather than national exhaustion. Section 107 A (b) read as "*importation of patented products by any person from a person who is* **duly authorized by the patentee** *to sell or distribute the product, shall not be considered as an infringement of patent rights."*[1105]

Thus, the amendment clearly enabled any third person to import a "patented" product provided that he purchases the product from a person who is authorised by the 'patentee to sell or distribute the product'. The section however was said to have certain problems. The main and obvious problem was the condition attached for the provision to kick in i.e. that the importer should have purchased the product from the patentee himself or any person who is authorised by the patentee to sell or distribute the product. This could restrict the scope of the provision and really could hamper the real public interest aimed by the provision. Another problem raised was about the word Patented and patentee. Section 2(1)(m) defines "patent" as a patent for any invention granted under this Act. Thus, the patentee and patented product refers to any patent granted under Indian law, reiterating the territorial nature of patent whereby exhaustion is also restricted.[1106]

[1103] ShamnadBasheer and MrinaliniKochupillai, "Trips, Patents And Parallel Imports In India: A Proposal For Amendment", Indian J. Intell. Prop. L., [2009], Vol. 2, p.73, available at SSRN: https://ssrn.com/abstract=1286823, (accessed on 5/1/2018). Also see; Dr. N.S. Gopalakrishnan, The Patents (Second Amendment) Bill, 1999 – An Analysis, 1 SCC (Jour), [2001], Vol. 14, available at http://www.supremecourtcases.com/index2.php?option=com_content&itemid=54&do_pdf=1&id=1038, (accessed on 18/12/2018).

[1104] Clause 51 of the Patents (Second Amendment) Bill, 1999, states: "This clause seeks to insert a new section 107A in the Act, relating to certain acts which are not to be considered infringement. It is also proposed that the importation of patented products from the person who is duly authorized by the patent holder shall not constitute an infringement. This provision is proposed to ensure availability of the patented product in the Indian market at minimum international market price." Also see; ShamnadBasheer and MrinaliniKochupillai, "Trips, Patents And Parallel Imports in India: A Proposal For Amendment", Indian J. Intell. Prop. L., [2009], Vol. 2, p.73, available at SSRN: https://ssrn.com/abstract=1286823, (accessed on 5/1/2018).

[1105] Sec.107 A (b) of the Indian Patent Act.

[1106] J. Sai Deepak, "Section 107 A (B) Of The Patents Act: Why It May Not Refer To Or Endorse Doctrine Of International Exhaustion?", Indian J. Intell. Prop. L., [2011], Vol.4, 121, at p.125, available at http://www.commonlii.org/in/journals/INJlIPLaw/2011/8.html, (accessed on 24/12/2018).

However, in the 2005 amendment to the Patent Act, the issue of authorization from the patentee was removed. The new section reads as "*importation of patented products by any person from a person who is duly authorized* **under the law** *to produce and sell or distribute the product"*[1107]. Therefore the new amendment replaced patent holders consent with the consent of the law. Any person who buys the patented product from a person who is authorised under the law to produce and sell or distribute can legally import the product to India. Amendment was also made regarding the activities for which authorization was to be granted. Earlier it was authorised to 'sell or distribute', which was amended to be authorised under the law to 'produce and sell or distribute'.

Even the current provisions are not without ambiguities. What does "under the law" in Section 107 A (b) refers to? Is it the Patent law or does it simply imply that the product should be a legal good? Does the law refer to Indian law? What does "authorised under the law to distribute" refers to? Should the authorization be to produce and sell or produce and distribute? There are different methods to do away with these confusions. First obvious way would be to find out the legislative intent behind introducing these provisions. During the debates in the RajyaSabha, the Minister of State for Commerce and Industry, stated, *"... the relevant sections are Section 47, Sections 82-84 and Section107 (a) and (b) which deals with parallel imports. .... The short point that I want to make is that, on the issue of prices, on the issue of availability of patented medicine, on the issue of the ability of the Government to retain the right of ensuring that the patent is translated into a product, there are enough safeguards in the existing legislation both in the 1970 legislation, but more importantly in the revised Patents Act of 1970 reflecting the new provisions for compulsory licensing, reflecting the new provisions for parallel import particularly; and also reflecting the new provisions for enabling the Government to import; and use and distribute for its own use either through itself or through the third party."*[1108]The statement gets all the more importance because it explains (a) Section 107 A (b) aims at facilitating parallel imports (b) it also differentiates the reservation of right of the government to import and use and distribute from parallel imports.[1109]Therefore, the section talks about

[1107] Sec.107 A (b) of the Indian Patent Act ,1970.

[1108] See RajyaSabha Debates, available at http://rajyasabha.nic.in/rsdebate/deb_ndx/204/ (accessed on 7/6/2016).

[1109] J. Sai Deepak, "Section 107 A (B) Of The Patents Act: Why It May Not Refer To Or Endorse Doctrine Of International Exhaustion?", Indian J. Intell. Prop. L., [2011], Vol.4, 121, at p.134, available at

importing goods from outside the territory of India.[1110] Therefore, necessarily it must refer to any good, which has been legally produced under the foreign law and not the Indian law. Now as to the matter of whether the word law in section 107 A (b) means patent law, the words used in the section are 'authorised under the law', and does not specify to patent law. This must only imply legal goods since there could be nations where no patent law exists or where even if patent law exists no patent exists. So if a product is manufactured in a country where no patent exists and is imported into India, does S.107 A (b) makes it illegal? Does that mean the production of goods there with the permission of the government makes the product illegal? It is the law, which has authorised the production of the goods. It can also include patent law.

Turning to the next question, how can one read the last portion of the section? Should the authorization under the law be to produce and sell or produce and distribute? Alternatively, can it be read as authorised to produce and sell or authorised to distribute? The logical interpretation and the aim of the provision suggest that the authorization to distribute can be seen separately. The words produce and sell has been used together while distribution has been used separately. Further, reading otherwise would only narrow the scope of the provision since purchasing and importing from a person authorised to distribute would otherwise become illegal.

Having said all these, it could be safely said that Section 107 A (b) enables a third party to import patented products including those which are covered price control measures or compulsory license provisions and also products from places where no patent law exists.[1111]

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http://www.commonlii.org/in/journals/INJlIPLaw/2011/8.html, (accessed on 24/12/2018). arguing for the recognition of national exhaustion in section 107 A(b) has relied on a statement made by Shri Kamal Nath in the combined discussion held in the Lok Sabha, in which he stated "*On import of patented commodity from anywhere in the world, the Government reserves the right."* This could be a mistake made by the minister since he was not aware of the separate provisions on parallel imports as well as the government right to import, both for protecting public interest and facilitating cheaper access of goods.

[1110] J. Sai Deepak, *"*Section 107 A (B) Of The Patents Act: Why It May Not Refer To Or Endorse Doctrine Of International Exhaustion?", Indian J. Intell. Prop. L., [2011], Vol.4, 121, pp.121-138, available at http://www.commonlii.org/in/journals/INJlIPLaw/2011/8.html, (accessed on 24/12/2018).

[1111] See YogeshPai, "The Hermeneutics of Patent Exhaustion Doctrine In India", in Irene Calboli and Edward Lee,*Research Handbook on Intellectual Property Exhaustion and Parallel Imports*,Edward Elgar Publishing, Cheltenham, (2016), p.324.

6.2.1. Section 107 A(b): A TRIPS Plus Provision?

A strong argument has been raised saying that Section 107 A (b) goes beyond TRIPs because it allows to import products even from a nation that does not contain Patent but the law allows the production of the product which is patented in other countries and it falls under the category of legal goods.[1112] Such a situation, it is argued, goes beyond what is envisioned in Article 6 as no first sale takes place with the consent of the patent holder.[1113] Here when the first sale takes place in a place where there is no patent, it is not the patent owner who gets the incentive and thus Article 6 does not come in.

To answer this challenging question one can take many approaches. However, the very first task is to understand the true ambit of Section 107 A (b). The section has never mentioned any word such as exhaustion. Nor does the legislative history of the provision mention Article 6 as the flexibility in TRIPs which has been used to result in the section.[1114] It merely has been enacted to encourage parallel imports i.e. import of genuine, cheap, foreign goods to promote consumer welfare.[1115] Article 7 of the TRIPs[1116] provision provides the countries to adopt measures conducive to their economic conditions considering the public interest and consumer welfare of the nation. Therefore one can safely argue Section 107 A (b) relies on Article 7 promoting consumer welfare and provides basically for parallel imports of cheaper goods rather than clinging on to Article 6.

Another way of looking into it is to analyse the section from a property jurisprudence angle along with WTO jurisprudence. The philosophy underlying exhaustion is that every subsequent purchaser of a genuine patented product must be able to enjoy fruits of ownership that he

[1112] ShamnadBasheer and MrinaliniKochupillai, "Trips, Patents And Parallel Imports in India: A Proposal For Amendment", Indian J. Intell. Prop. L., [2009], Vol. 2, pp.491-492, available at SSRN: https://ssrn.com/abstract=1286823, (accessed on 5/1/2018).

[1113] See ShamnadBasheer and MrinaliniKochupillai, "Trips, Patents And Parallel Imports in India: A Proposal For Amendment", Indian J. Intell. Prop. L., [2009], Vol. 2, pp.491-492, available at SSRN: https://ssrn.com/abstract=1286823, (accessed on 5/1/2018).

[1114] RajyaSabhaDebates , available at http://rajyasabha.nic.in/rsdebate/deb_ndx/204/ (accessed on 7/6/2016).

[1115] RajyaSabhaDebates , available at http://rajyasabha.nic.in/rsdebate/deb_ndx/204/ (accessed on 7/6/2016).

[1116] Art. 7 of the TRIPs agreement, 1994, states : "*The protection and enforcement of intellectual property rights should contribute to the promotion of technological innovation and to the transfer and dissemination of technology, to the mutual advantage of producers and users of technological knowledge and in a manner conducive to social and economic welfare, and to a balance of rights and obligations.*"

possesses over the product.[1117] The right to alienate or sell a product is an inherent right of the owner of the product. This implies that when a genuine product is owned by a person, he has the right to sell that product anywhere in the world. The WTO jurisprudence on free movement of goods also is aimed at the same.[1118] The Overall philosophy of Article 6 must be viewed from this perspective. Whether Patent law exists or not in the country from where the goods were purchased is immaterial. Therefore the argument that importation of goods from a nation, which does not contain any patent law, overdoes the Article 6 cannot sustain since the underlying principle of exhaustion is to enable the purchaser of a real property to enjoy the full rights attached to it. Irrespective of whether the patent law in India or its rights under Article 48 providing for importation right, it cannot prohibit a legal purchaser from enjoying his right over the property. This would be aggrandizement of the rights envisioned under the Indian Patent law. It would directly contravene with the WTO jurisprudence on free movement of goods. Under the WTO philosophy, goods across borders cannot be restricted unless justified through express exceptions provided therein.[1119] The banning of parallel imports thus contravenes WTO jurisprudence.

Thus, S.107 A (b)must be viewed from the angle of the purchaser and of course with public interest in mind. Thus when a product is imported from a country where the good has been legally produced it cannot be prohibited since protecting the interest of the purchaser is the aim of Article 6. Section 107 A(b) will not only facilitate imports from countries having patent law but also from countries with no patent law compelling the Patent owner to take patents in most countries including under developed countries facilitating technology transfer to these nations while ensuring products at cheap prices to the Indian consumers.[1120]

6.2.1 (a) Right of import, Section 107 A (b) and Article 6 of the TRIPs: Express right of import has been granted under the Indian Patent Act to the Patent holder. Does Section 107 A(b) makes

[1117] Vishnu Shankar P., "Hegelian and Kantian Analysis of the Concept of Exhaustion", CULR, [2014],Vol.xxxviii, January-June, , Number 1 & 2, pp.96-109.

[1118] Preamble of the WTO agreement, 1994.

[1119] Art. XI of WTO agreement, 1994.

[1120] N.S. Gopalakrishnan and T.G.Agitha, "The Indian Patent System: The Road Ahead,", in Ryo Shimanami, *The Future Of Patent System*, Edward Elagar, [2012], p.229.

this right useless?[1121] The answer is negative. Importation right is granted so as to enable the Patent holder to stop importing infringing goods. Neither TRIPs nor Indian Patent Act prohibits importation of lawfully made products. TRIPs allow seizure of counterfeit or pirated products at the borders and do not obligate any member country to seize legal products.[1122] It should be in the light of this aspect that one should view the right to import under Indian Patent law. Thus, parallel imports do not hamper the right to import of patent holder.

The only reported case[1123] in the area of patent regime concerning parallel imports in the Indian Jurisdiction is Strix Limited vs. Maharaja Appliances Limited.[1124]The Plaintiff holds a product patent in respect of Liquid Heating Vessels. The Defendant is an Indian company engaged in the business of manufacturing and selling of electrical appliances including electric kettles. According to the Defendant, electric kettles were earlier being supplied by the Plaintiff to the Defendant in the years 2005-2006. The Defendant states that the products of the Plaintiff were of inferior quality and, therefore, the Defendant commenced importing electric kettles containing the impugned heating element, from China. The Defendant states that it did not at any point in time manufacture the said heating element installed in the kettles. The Defendant states that they are traders and have not undertaken any manufacturing activity. The Defendant claims to have imported the product bona fide from China and states that the supplier in China from whom the Defendant imported the product in question held a patent inclusive of the heating element installed in the kettle.

[1121] ShamnadBasheer and MrinaliniKochupillai, "Trips, Patents and Parallel Imports in India: A Proposal For Amendment", Indian J. Intell. Prop. L., [2009], Vol. 2, pp. 74-77, available at SSRN: https://ssrn.com/abstract=1286823, (accessed on 5/1/2018).

[1122] Art. 51 of the TRIPs agreement, 1994.

[1123] An Public interest litigation was filed before the Hon. Supreme Court of India by a person named J.Sai Deepak claiming the underlying philosophy of Sec. 107 A (b) is national exhaustion. However the Supreme Court dismissed the case on finding lack of locus standi. The arguments raised by the petitioner relied on various erroneous interpretations of the patent Act relying compulsory provisions under the Patent Act such as Section 84 (7) and 90. The author finds no merit in the arguments of the petitioner, hence not discussing it in detail. For detailed reference of the arguments read ;J. Sai Deepak, "Section 107 A (B) Of The Patents Act: Why It May Not Refer To Or Endorse Doctrine Of International Exhaustion?", Indian J. Intell. Prop. L., [2011], Vol.4, 121, at pp.121-138, available at http://www.commonlii.org/in/journals/INJlIPLaw/2011/8.html, (accessed on 24/12/2018).

[1124] I.A. No.7441 of 2008 in C.S. (OS) No.1206 of 2008

Defendant in the instant case has argued that they have purchased the product from the patent holder in china and hence they are protected under Section 107 A (b) making the imported goods legal goods. The court demanded evidence from the defendants regarding the existence of patent in the China. However, the court refused to discuss more about the issue since the defendants could not bring about any document proving that the person from whom the defendant purchased had valid patents. The court opined that unless any proof of the same could be produced, court would assume that there exist no patent in China making the imported goods illegal. The implication of the same would be that, if there had been a valid patent in china from whom the defendants purchased the goods, then Section 107 A(b) would kick in which supports the international exhaustion notion of the Section 107 A (b). However, the error which the court construed seems to be that the court failed to understand the meaning of the words 'under the law' in section 107 A (b). The demand of the court to produce evidence about the existence patent in China shows that the court has wrongly construed the law to mean patent law rather than simply meaning "legal goods". The court failed to understand the amendment made to the section and to correctly understand the word law.

Thus, the Indian stand on exhaustion regime has been clearly to recognise international exhaustion from the very beginning after getting Independence. This is clear from the Ayyangar committee reports demining the right to import and the fact that India introduced exhaustion provisions as soon as right to import was granted under its law through Indian Patent Amendments made in 2002.

6.3. Legislative Framework and Judicial Interpretations Regarding Parallel Imports in Trademark Law:

The Indian trademark law too did not contain any express provisions regarding exhaustion. There first enactment in the field of trademark law was the Indian Merchandise Marks Act 1889, which later on gave way to the Trademarks Act 1940 the Trade and Merchandise Marks Act 1958 and finally the Trademarks Act 1999. But prior to the final legislation in 1999, no express provisions regarding exhaustion were present in the Indian trademark law. However certain other laws supplemented the trademark law which had an impact on exhaustion rules regarding trademark goods. The first among them was the Customs Act 1962 under which the prohibition on

importation was confined only to those goods which were having false trademarks or which showed wrong place of origin of goods.[1125] In other words, there was no prohibition on legitimate goods, which meant that international exhaustion was the norm. Further, a notification by the department of Revenue dated 18th January 1964,[1126] empowered the Government of India to permit importation of goods having similar trademarks as that of the trademark owner, put as a condition only that the name of the country of origin of the goods is printed in large visible letters.

The Notes on Clauses under the Trademarks Bill, 1999, (Bill No. XXXIII of 1999) has explained Clause 30 as under:

> "Sub clause (3) and (4) recognize the principle of "exhaustion of rights" by preventing the trade mark owner from prohibiting on ground of trade mark rights, the marketing of goods *in any geographical area*, once the goods under the registered trade mark are lawfully acquired by a person. However, when the conditions of goods are changed or impaired after they have been put on the market, the provision will not apply".[1127] (Emphasis added)

Department - Related Parliamentary Standing Committee on Human Resource Development has also stated in its 227threport on Copyright Amendment Bill, 2010[1128] that international exhaustion is followed in the Indian Trademarks law[1129] which means that the general rule was

[1125] Sec. 11 of The Customs Act, 1962.

[1126] For further information see,https://www.seair.co.in/custom-notifications/notifications-issued-before-the-year-2000-notification-no-011964-dated-18th-jan-1964-145.aspx

[1127]Notes on clause 30under the Trademarks Bill, 1999, (Bill No.XXXIII of 1999). Also see ;ShamnadBasheer and MrinaliniKochupillai, "Trips, Patents and Parallel Imports in India: A Proposal For Amendment", Indian J. Intell. Prop. L., [2009],Vol. 2, p. 69, available at
SSRN: https://ssrn.com/abstract=1286823, (accessed on 5/1/2018).

[1128] *227th Report on The Copyright Amendment 2010*, The Standing Committee on Human Resource Development, Department - Related Parliamentary Standing Committee On Human Resource Development, 2010, available at http://164.100.47.5/newcommittee/reports/EnglishCommittees/Committee%20on%20HRD/227.pdf, (accessed on 14/12/2018).

[1129] *227th Report on The Copyright Amendment 2010*, The Standing Committee on Human Resource Development, Department - Related Parliamentary Standing Committee On Human Resource Development, , 2010, p. 20, available at
http://164.100.47.5/newcommittee/reports/EnglishCommittees/Committee%20on%20HRD/227.pdf, (accessed on 14/12/2018).

that once trademarked goods were released anywhere in the market by or with the consent of trade mark proprietor, the proprietor cannot assert its trademarks rights to prevent imports of such goods into India, provided that such goods are not materially altered. This statement reflects the position of the legislature regarding exhaustion. Moreover, under the current system, the Intellectual Property Rights (Imported Goods) Enforcement Rules, 2007, the definition of "goods infringing intellectual property rights" covers only "any goods which are made, reproduced, put into circulation or otherwise used in breach of the intellectual property laws in India or outside India and without the consent of the right holder or a person duly authorized to do so by the right holder".[1130] Further section 52 (z) (c) of the Indian Copyright Act, 2012, allows the importation of copies of literary or artistic works containing logos or labels which are incidental to other goods or a lawfully imported copy. This reaffirms the stand that the trademarks law recognizes international exhaustion, since the provision included in the Indian copyright Act is to ensure that there should not be any conflict with the international exhaustion provision under the trademarks Act.

However, Section 29 of the Indian Trademark Act, 1999 dealing with trademarks infringement says that the use of a registered trademark by any person other than the owner can amount to infringement[1131] and explains the word 'use' by stating imports and exports amounts to use.[1132] Therefore, parallel imports may prima facie appear to be blocked by the above sections. However, Section 30 (3) of the Act clarifies the position by stating that when a person lawfully acquired a product, the sale of that product in a market or any other dealing in those goods by that person or person claiming under him will not constitute infringement.[1133]This point towards

[1130] Rule 2 (a) of Intellectual Property Rights (Imported Goods) Enforcement Rules, 2007, available at http://www.cbic.gov.in/htdocs-cbec/customs/cs-act/formatted-htmls/ipr-enforcementrules, (accessed on 22/12/218)

[1131] Sec. 29 (1) of the Trademarks Act, 1999, reads: "A registered trade mark is infringed by a person who, not being a registered proprietor or a person using by way of permitted use, uses in the course of trade, a mark which is identical with, or deceptively similar to the trade mark in relation to goods or services in respect of which the trade mark is registered and in such manner as to render the use of the mark likely to be taken as being used as a trade mark."

[1132] Sec. 29(6) of the Trademarks Act, 1999.

[1133] Sec. 30(3) of the Trademarks Act, 1999 reads as : "Where the goods bearing a registered trade mark are lawfully acquired by a person, the sale of the goods in the market or otherwise dealing in those goods by that person or by a person claiming under or through him is not infringement of a trade by reason only of----(a) the registered trade mark having been assigned by the registered proprietor to some other person, after the

international exhaustion. The only limitation provided for opposing the release of these goods is the change or impairment of the condition of the goods after they have been placed in the market.[1134]A careful reading of the Clauses 30(3) and section 30 (4) makes it evident that goods which are lawfully placedin market once cannot be considered as use of a trademark and thus cannot be banned from importing.

The judicial decisions pertaining to parallel imports of trademark goods has a better standing than that of the copyright decisions. Even though early judicial decisions failed to recognize the importance of international exhaustion, there are at least few decisions which came out well in support of parallel imports. However, the initial case laws were not in support of international exhaustion. For example, in *Hindustan Lever Ltd. v. Briju Chhabra*[1135] when genuine parallel imported produts were banned from entering into commerce merely because the plaintiffs had gegraphical restriction agreements which restrained defendants from selling in India[1136] the Court accepted the argument of the plaintiffs that statutory rights of the plaintiffs were violated by the defendants through selling these products. It appears that the court was either unaware of or unmindful of the concept of international exhaution as no discussion of the exhaustion concept appeared in the judgement. The reason for the same may also be the fact that the law at that point of time never contained any express provision on exhaustion of trademark rights.

In *CISACO Technologies v. Shrikanth*[1137] the plaintiff CISCO was selling its products used in computer hardware since the year 1984 under the trademark 'CISCO'. Defendants imported goods sold outside India into India. Court held the importation illegal since the trademark law provided the right to import to the owner of trademark.[1138]The Court stated:

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acquisition of those goods: or (b) the goods having been put on the market under the registered trade mark -by the proprietor or with his consent".

[1134] Sec. 30 (4) of the Indian Trademarks Act, 1958.

[1135] Suit No. 2345 of 2000, High Court of Delhi, available at https://indiancaselaws.wordpress.com/2013/10/19/hindustan-lever-ltd-v-briju-chhabra/ (accessed on 6/1/2018).

[1136] The plaintiff HLL was the registered proprietor of the trade mark LUX and LUX label in respect of toilet soaps within India. The defendant imported into India LUX soaps manufactured in Indonesia without any license, permission or authorization from HLL. The product so imported had on them the express indication that they were meant for sale only in Indonesia.

[1137] 2005 (31) PTC 538 (Del).

[1138] The court devised such a right from interpreting the Sec. 29 (6) (c) of the Indian Trademarks Act, 1958.

> "For persons who hold benefit of registered trademarks, Section 140 of the Trade Mark Act, 1999 makes statutory provisions where under the Collector of Customs could prohibit the importation of goods if the import thereof would infringe Section 29(6)(c) of the Trade Marks Act. The statutory authorities could prohibit import of such products, import whereof would result or abet in the violation of the proprietary interest of a person in a trademark/trade name".[1139]

Here the courts have equated the imported goods to counterfeit goods/infringing goods without bothering to understand the meaning of the word "infringe" or the nature of the goods. The court failed to address the issue of exhaustion at all and never cared to look into S.30 of the Trademark Act, 1999. Therefore this judgment may be considered as *per in curiam*. In *Wipro CyprusPvt.Ltd. v. Zeetel Electronics*,[1140]the Madras High Court stated that the plain reading of section 28 relating to the rights of the trademark holder reveals that the assignee of the trademark has the exclusive right to use it in India. Any other reading of it would make the section nugatory. The Court went on to explain that a harmonious reading of section 28, 29 and Section 30 would render Section 30 a proviso to Section 29 and interpreting Sec. 30 in such a way to allow imports by defendant would render trademark registration as meaningless since it will amount to use under Section 29 (6) (c). Allowing the import by defendants was held to be also violative of section 29 (6) (c). In addition to giving such an erroneous interpretation, court went on to state that Competition was not the aim of trademark law when monopoly certainly was. This brings out the inexperience and the incompetence of the Indian courts when it comes to IP cases. The real balance between IP and consumer welfare can achieved only by bringing competition principles into the IP framework. In fact the provision for international exhaustion has been built into IP laws so as to promote competition through the law and to limit the undue monopoly of the IP holder.[1141] It is one of the main aims of the IP law to prohibit anti-competitive practices of the IP holder. The lack of social sensitiveness of the courts is a serious issue that India faces when it comes to interpretation of IP laws.

[1139] *CISACO Technologies v. Shrikanth* 2005 (31) PTC 538 (Del) para 8.

[1140] 2005 (31) PTC 538 (Del).

[1141] The FTC report of 2003 by U.S. is an illuminating document which brings out the importance of competition in the intellectual property frame work. Even under the TRIPs provision there is express provision on competition and cautions intellectual property holder from anti-competitive practices.

However, certain positive signs began to come out in the later cases which came up before courts. In *Samsung Electronics Company Ltd. v. Mr. G. Choudhary*[1142] the plaintiff wanted to stop parallel importation of products manufactured by them in china into India. They contended that although the products were genuine, they were not meant for the Indian market. The court looked into the sections 29 (1) sec. 29(6) (c), sec. 30 (3) and also Article 50 of TRIPs. On a detailed analysis of these provisions the court came to the conclusion that Section 30 of the Indian Trademark Act, 1999 expressly addressed the question of exhaustion. Section 30 (3) clearly states that when the goods bearing a registered trade mark are lawfully acquired, further sale or other dealings in such goods by the purchaser or by a person claiming to represent him is not considered an infringement if the goods have been put on the market under such mark by the proprietor or with his consent.[1143] However the court held that the onus was upon the defendants to prove that the goods were sold initially in a market by the owner of trademark. Therefore the goods were suspended from releasing. The court granted injunction in favor of the plaintiff stating that any other decision would cause irreparable damage to the plaintiff and appointed a commissioner to verify the parties' claims.[1144] The only solace in this case is that the court has at least referred to the implication of the Section 30 (3). In the same year in *Xerox Corporation v. PuneetSuri*, [1145] the court held that the importation in to and selling of Xerox machines, which are lawfully acquired in another country, in India is not a violation of the Trademark rights and that section 30 (3) of the Act provided for international exhaustion. This is the first case in which court specifically mentioned and recognized international exhaustion.

Another important case that came up before the Commissioner of customs, in which the court allowed resale of parallel imported Dell laptops in the Indian market is commonly known as the Dell case[1146].[1147] The Customs Commissioner in that case passed an order on the basis of Section 30(3) (b) of Trade Marks Act, 1999, stating that when the trademark goods are 'lawfully

[1142] 2006 (33) PTC 425 Del.

[1143] 2006 (33) PTC 425 Del.

[1144] 2006 (33) PTC 425 Del.

[1145] CS (OS) No. 2285/2006.

[1146] F.NO.SIIB/IPR-3, 4 &5/ 2012 ACC(1) available at https://indiancaselaws.files.wordpress.com/2013/09/dell-case.pdf, (accessed on 22/12/2018).

[1147] Dell laptops where imported into India from china by defendants and they were captured by customs and it was subsequently referred for confirmation to Dell company on whether they are genuine goods. The plaintiffs complained infringement. Defendants sought the defence under Sec. 30(3).

acquired', there sale of it by the purchaser is not considered an infringement since the goods are put on the market under the registered trademark by the proprietor or with his consent. However, such goods should not have been materially altered or impaired after they were put in the market. Section 11 of Customs Act 1962, read along with the Intellectual Property Rights (Imported Goods) Enforcement Rules, 2007[1148], also only prohibits those goods with false or infringing trademarks.[1149]

And in another landmark judgment *KapilWadhwa v. Samsung Electronics*,[1150] the division bench of Delhi High Court, overruling the single bench decision held that the section recognised international exhaustion. The respondents in this case were companies which manufacture and trade in electronic goods. Respondents alleged that the appellants were purchasing their printers from foreign markets and selling them in India under the Trade Mark of the respondents at a price lower than that of the respondents and this amounted to infringement. The single bench had earlier held that section 29(1)[1151] read with section 29(6)[1152] prohibited importation of genuine products without permission of the owner. The court came to the interesting conclusion that section 30(3) embodied national exhaustion. However, the division bench overruled this decision and held that section 30(3) recognizes the principle of international exhaustion. Nevertheless, it upheld the interpretation of use of the mark under section 29(1) and section 29(6) and referred to import of goods under the trademark. The single bench had erroneously held that the market referred to in the section referred to domestic market and that the good with the mark should be lawfully acquired for the domestic market itself. However the division bench came to the conclusion that the market referred in the section was international market and a person can lawfully acquire a genuine good with the mark from international market also. The

[1148] Rule 6 of the Intellectual Property Rights (Imported Goods) Enforcement Rules, 2007: Prohibition for import of goods infringing intellectual property rights.- After the grant of the registration of the notice by the Commissioner on due examination, the import of allegedly infringing goods into India shall be deemed as prohibited within the meaning of Section 11 of the Customs Act, 1962.

[1149] F.NO.SIIB/IPR-3, 4 &5/ 2012 ACC(1), p.9, available at https://indiancaselaws.files.wordpress.com/2013/09/dell-case.pdf, (accessed on 22/12/2018)

[1150] 2013 (53) PTC 112 (Del.).

[1151] A registered trade mark is infringed by a person who, not being a registered proprietor or a person using by way of permitted use, uses in the course of trade, a mark which is identical with, or deceptively similar to the trade mark in relation to goods or services in respect of which the trade mark is registered and in such manner as to render the use of the mark likely to be taken as being used as a trade mark

[1152] Section says importation or exportation of the trademarked goods comes under the purview of use of mark.

court rejected the finding of the Single Bench that interpreting section 30 in the context of international exhaustion would make the section redundant. The court went on to hold that section 30 talks about goods with registered marks being put on market which is lawfully acquired by any person rather than goods put on market under any specific trademark law and that the aim of the section was to enable the further sale of goods which were lawfully acquired and preventing the TM owner from controlling the same would not create any " havoc" as feared by the learned single judge and that international or national market was an irrelevant consideration for interpreting section 30 (3).

Court also held that section 30 is an exception to section 29 and this was overlooked by the single bench. Thus it rejected the conclusion of the single bench that the intention of the legislature was to put barriers on importation as premature. Court observed that the adoption of the principle of national exhaustion would not encourage industry to be set up in India, and as in the instant case, a manufacturer abroad may simply get its trademark registered here and import goods manufactured by it in a foreign country. It felt that in such situations dual pricing may cause injury to the consumer. Here one could witness the court's endeavour to address the issue of parallel imports not only from a public interest perspective. The industrial and social advantages that international exhaustion can facilitate were pondered upon by the learned judge. In a way the judiciary has cast off all the feeble arguments by the industrial and interested sectors who oppose international exhaustion.

6.4 Exhaustion provisions relating to Indian Plant Varieties Act, 2001

It is worth examining the International law of protection on plant varieties on its position on exhaustion before looking into the law in India. International protection on plant verities is provided under International Union for the Protection of New Varieties of Plants (UPOV), Article 14 of which confers on the breeders, the rights over any acts such as offering for sale, selling or other modes of marketing, exporting, importing, and the authorisation of the breeder is required for such acts.[1153]However, this provision is subject to Article 16 of the Convention which provides for exhaustion. Article 16 of the Convention states that the breeder's right shall not extend to materials of protected variety or any material derived from the said material, which

[1153] Art. 14 (1) of UPOV, 1991.

has been sold once or otherwise marketed by the breeder or with his consent, in the territory of the member of the Union concerned.[1154] However, such exclusion of the rights of the breeder does not extend to acts involving further propagation of the variety in question[1155]or exportation of material of the variety, which enables the propagation of the variety, into a country, which does not protect varieties of the plant genus, or species to which the variety belongs, except where the exported material is for final consumption purposes[1156]. In other words, UPOV recognises only national exhaustion. Exhaustion rules under the Indian Plant Varieties Act are quite ambiguous. There are no express provisions of exhaustion under the Plant Varieties Act. Under Section 39 (iv) of the Act, a farmer is provided with certain set of rights including the right to resow and sell the farm produce including the seed of a protected variety provided that he is not selling the branded seed of a protected variety.[1157]One kind of interpretation could be that the section allows the farmer to sell seed which he has produced, with the restriction that this seed cannot be branded with the breeder's registered name.[1158] The section thus enables the farmer not only to sell or resell or resow the farm produce but also to sell or resow a seed of a protected variety provided they are not branded and sold. The provision does not clarify whether the prohibition is against the resale of resowed protected seeds that were originally branded or merely against the misuse of the brand name when second generation produce.[1159]This could lead to misuse by breeders since any extant variety or new variety can be easily converted into branded seeds.

[1154] Art. 16, UPOV, 1991: Exhaustion of the Breeder's Right - The breeder's right does not extend to acts concerning material of the protected variety, or of a variety covered of its protection which *has been sold or otherwise marketed by the breeder or with his consent in the territory of the member of the Union concerned*, or any material derived from the said material….

[1155] Art. 16 (i) of UPOV 1991.

[1156] Art. 16 (ii) of UPOV 1991.

[1157] Sec. 39 (1) (iv):- a farmer shall be deemed to be entitled to save, use, sow, *resow*, exchange, share or sell his farm produce including seed of a variety protected under this Act in the same manner as he was entitled before the coming into force of this Act: Provided that the farmer shall not be entitled to sell branded seedof a variety protected under this Act.

[1158] An explanation has been attached to the section defines a branded seed which reads "For the purpose of clause (iv) branded seed means any seed put in a package or any other container and labelled in a manner indicating that such seed is of a variety protected under this Act." See explanation to Sec. 39 (1) (iv).

[1159] SrividyaRaghavan, *Patent and Trade Disparities in Developing Countries*, Oxford University Press, New Delhi, (2012), pp.299-300. .

However in order to understand what is the mode of exhaustion, if any, that is followed by Indian Plant varieties Act, one needs to examine the rights of the breeder.[1160] A breeder is granted the right to import, which implies that no other person can import the protected variety into the country without the authorisation of the breeder. This could imply national exhaustion is the norm under the Act especially in the scenario when no express provision on exhaustion is made in the Act. But the breeder does not have any right guaranteed under the Act to prohibit the resale of seeds which are sold by him to any purchaser unless the purchaser sells it as his own new variety of seed. Therefore, the right to import grated to the breeder coupled with freedom to resell the seeds purchased by the consumer gives the impression that Indian Plant Varieties Act recognises only national exhaustion. One must not forget the fact that unlike other IP regimes, Plant variety protection is an area where the development of the protected variety is very much dependant on many external factors like climate and topography of the specific area. Therefore international exhaustion or parallel imports may nothavemuch implication on the consumers.

6.5. Indian Designs Act, 2001

In India, international exhaustion applies by way of implied license to designs registered under the Indian Designs Act, 2000.[1161] Section 22 (1) of the India Designs Act enumerates the rights available to a registered design owner.[1162] It provides for importation right to registered owner. However, Section 42 talks about unlawful restrictive agreements.[1163] Under Section 42 (1) (b) it

[1160] Sec.28 (1) of the Indian Plant Varieties Act, 2001, reads: "Registration to confer right: Subject to the other provisions of this Act, a certificate of registration for a variety issued under this Act shall confer an exclusive right on the breeder or his successor, his agent or licensee, to produce, sell, market, distribute, import or export the variety."

[1161] Sonia Baldia, "Exhaustion and Parallel imports in India", in C. Heath, (ed.), *Parallel imports in Asia*, Max Plank Series on Asian Intellectual Property Law, Vol. 9, Kluwer Law International, Netherlands, (2004), pp.163-175.

[1162] Sec. 22(1) of the Indian Plant Varieties Act, 2001, reads : "During the existence of copyright in any design it shall not be lawful for any person...

(b) to import for the purposes of sale, without the consent of the registered proprietor, any article belonging to the class in which the design has been registered, and having applied to it the design or any fraudulent or obvious imitation thereof."

[1163] Indian Designs Act 2000, Sec. 42 (1) reads : It shall not be lawful to insert- (i) in any contract for or in relation to the sale or lease of an article in respect of which a design is registered; or

(iii) (a) to require the purchaser, lessee, or licensee to acquire from the vendor, lessor, or licensor or his nominees, or to prohibit him from acquiring or to restrict in any manner or to any extent his right to acquire from any person or to prohibit him from acquiring except from the vendor, lessor, or licensor or his nominees any article other than the article in respect of which a design is registered

is unlawful to prohibit the purchaser from *using* or *to restrict in any manner or to any extent the right of the purchaser to use an article other than the article*which is not sold by the vendor, lessor or licensor or his nominee.[1164] This points towards international exhaustion though Indian law has not fully captured the concept of international exhaustion.

6.6 The Semiconductor Integrated Circuits Layout-Design Act, 2000

As in the Patent and design laws, we do not find much case laws on exhaustion even on Semiconductor laws. Section 18 of the Act deals with infringement of layout designs. The owner of designs of semiconductor chips has the right to import under S. 18.[1165] However it is provided under S. 18(7) that the rights under S. 18 (1) (b) shall not be considered to have been infringed if any of the acts mentioned under S.18 (1) (b) is performed using an article which has been put on the market once with the consent of the proprietor.[1166] The word used is market in the section. The market could be deemed as world market since no qualification or definition is attached to word market. The reasoning gets more concrete support from the international stand that India has adopted in the case of exhaustion especially in TRIPs negotiations. Further the Parliamentary debate on exhaustion in the Patent law has elaborated in the earlier part of this article solidifies the intention of the legislature regarding the mode of exhaustion that India desires is international exhaustion. Thus the word market in the Semiconductor Integrated

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b) to prohibit the purchaser, lessee or licensee from *using* or *to restrict in any manner or to any extent the right of the purchaser, lessee or licensee, to use an article other than the article* in respect of which a design is registered which is not supplied by the vendor, lessor or licensor or his nominee and any such condition shall be void.

[1164] Sec. 42 (1) of Indian Designs Act 2000.

[1165] Sec.18 (1) (b) of The Semiconductor Integrated Circuits Layout-Design Act, 2000,reads: Infringement of layout-design.—(*1*) A registered layout-design is infringed by a person who, not being the registered proprietor of the layout-design or a registered user thereof

(b) **"**does any act of importing or selling or otherwise distributing for commercial purposes a registered layout-design or a semiconductor integrated circuit incorporating such registered layout-design or an article incorporating such a semiconductor integrated circuit containing such registered layout-design for the use of which such person is not entitled under this Act."

[1166] Sec. 18 (*7)* of The Semiconductor Integrated Circuits Layout-Design Act, 2000 *reads : "*Nothing contained in clause (b) of sub-section (1) shall be construed as constituting an act of infringement where any person performs any of the acts specified in that clause with *the written consent of the registered proprietor* of a registered layout-design or within the control of the person obtaining such consent, or in respect of a registered layout-design or a semiconductor integrated circuit incorporating a registered layout-design or any article incorporating such a semiconductor integrated circuit*, that has been put on the market by or with the consent of the registered proprietor of such registered layout-design."*

Circuits Layout-Design Act, 2000, must necessarily imply international market. Moreover, if the intention of the legislature was to recognise national exhaustion, then the word country could have been used by the law. Thus, international exhaustion is clearly recognised by the semiconductor law of India.

6.7. Conclusion

The position of India in the international negotiation was one supporting the adoption of international exhaustion as the global norm. Still India has not made use of the freedom allowed under the TRIPS Agreement. Article 6 of the TRIPs agreement does not interfere with the freedom of each country to choose the mode of exhaustion best suited to their economic structure. India, being a developing country with second largest population in the world and growing demands for affordable goods in all sectors of life, should have necessarily followed international exhaustion. However, this freedom has not been effectively utilized either by legislature or by the judiciary, in most of the intellectual property laws in India. India was the major proponent of international exhaustion during the TRIPs negotiation. Therefore, it is unfortunate that the IP laws in India lack clarity on the nature of exhaustion that India follows. The impression one could gather from the legislative debates is that the legislature was supporting international exhaustion as the norm to be followed in all fields of IP. However, the analysis of the IP Laws points to the contrary. There is no clarity in almost all IP laws on the mode of exhaustion. Further, the provisions providing for exhaustion are loosely drafted in almost all the IP laws leading to confusion as to the nature of exhaustion that is followed by the Indian laws. Typical example is the case of copyright and trademarks, wherein the words 'copies already in circulation' and the word 'market', respectively, are left without being defined, giving scope for interpreting the same as providing for national exhaustion. This may give rise to serious apprehensions regarding the real interest of the legislature. The approach of the judiciary also appears to be disappointing on many occasions. It is disheartening that the courts had even failed, as we had seen in certain decisions, to look into the relevant precedents and law while deciding cases. The courts seem to have insufficient information regarding the concept of exhaustion. The judiciary, in the majority of cases, seems to be labouring under the impression that intellectual property protection is the best solution for bringing in consumer welfare without realising that the over protection of intellectual property can harm a developing country like

India. The courts have not given serious consideration to even the legislative changes that were taking place, especially in the field of copyright, to recognise international exhaustion. It should be kept in mind that even the U.S. Supreme Court has recognized the social importance of the international exhaustion and has categorically agreed that parallel imports can in fact increase consumer welfare of America.[1167]However, in India, where the educational books are even more expensive than in America, there is much hesitancy in thinking in those lines. It is high time Indian legislature and judiciary opens up to this reality. The issue of exhaustion must be understood both by the legislature and the judiciary as a mechanism to promote consumer welfare. The volume of amendments that went into the Indian Copyright Act is precisely due to the loose words that were inserted into Section 14 of the Indian Copyright Act, providing for exhaustion of rights. However, after the amendments that have taken place including that of the 2012 amendment, it is safe to say Indian Copyright Act recognises international exhaustion except in the case of C.D.'s where, as discussed above, the question of whether even exhaustion exists still remains. The attempt to recognise parallel imports under the Indian Copyright Act through the amendment suggested to section 2 (m) recognising international exhaustion was thwarted. The amendment was omitted from the final text without any reason. The lobbying of the copyright owners and the industrial groups including publishing industry would have been behind such exclusion. The study report by the National Council for Applied Economic Research, Sponsored by the National Human Resource Development, in 2014, has concluded that the presence of parallel imports benefits Indian consumers and does not affect the incentives to the Printing industry or the copyright owners.[1168]This clarifies that the Indian economic conditions favour international exhaustion in the copyright regime. In the patent law, international exhaustion has been clearly recognised. Regarding the Patent Act, one must appreciate the legislature for the inclusion of the provision resembling international exhaustion as soon as right to import was recognised. In fact, the provision encompasses not only the goods are sold with the permission or consent of the patent holder and extends to even goods produced under compulsory licensing. It also covers goods manufactured in countries where the patent protection to pharmaceutical goods was not mandated. This is because the Patent Act is a law

[1167] *Kirtsaeng*v. *John Wiley & Sons, Inc.* 568 U.S. 519 (2013).

[1168] *"The Impact of Parallel Imports of Books, Films / Music and Software on the Indian Economy with Special Reference to Students"*, NCAER, 2014, p.98, available at http://copyright.gov.in/documents/parallel_imports_report.pdf (accessed on 26/11/2018).

having substantial impact on crucial areas like food and health. For ensuring affordable access to pharmaceutical products in India international exhaustion is very much necessary. International exhaustion is impliedly recognised in the Indian trademark Act. However, section 30(3) providing for exhaustion is loosely worded and does not clarify whether the first sale must take place within the Indian market or the international market. Fortunately, the judiciary has clarified that the market implies international market and interpreted section 30(3) as to cover international exhaustion. In the Semiconductors and Plant Varieties Acts international exhaustion has not been clearly articulated. Even though India has reiterated that its support to the policy of international exhaustion in the international platforms,[1169] the legislative framework of Indian law remains ambiguous .Therefore it could be concluded that the judiciary should be cognizant to the Indian position in the international forums and interpret all the intellectual property laws, namely Copyright, Patent and Trademark laws, as accepting international exhaustion.

[1169] MTN.GNG/NG11/W/37.

Chapter 7

Conclusion

Free movement of goods, as we have seen, is the ultimate objective of the free trade framework mandated by the WTO regime and goods covers intellectual property goods as well. In the free trade regime no restriction of such free movement of genuine goods is permitted other than those specifically excluded under GATT and the same principle is equally applicable to intellectual property goods. The free movement of intellectual property goods is determined by the nature of the mode of exhaustion accepted in the jurisdictions concerned, since no international standard is fixed for that under the TRIPS Agreement. The enquiry in to the best mode of exhaustion suited to be adopted as an international norm in the free trade scenario point towards international exhaustion. This is because the elements of free trade match only with international exhaustion. Therefore, it becomes clear that in the free trade regime it is mandatory to make international exhaustion the international norm.

Another important question in this respect which is addressed in this thesis is if international exhaustion an economically viable choice. Ensuring consumer and social welfare, without compromising economic efficiency is the priority of any legal system, and therefore, it is important to see if in the case of intellectual property law, the recognition of international exhaustion ensures both. The philosophical and historical analysis of exhaustion in chapter 1 reveals that post sale restrictions on goods are against the very concept of ownership as it clashes with the exclusive rights of the purchaser of the goods. This is the logic behind the rule against restraint on alienation and this rule is in tune with the free trade principles. The basic philosophy reflected in the doctrine of exhaustion is the rule against restraint on alienation. In the context of globalization of trade, therefore international exhaustion alone is justified and in line with the principles of free trade. The inconsistency that the courts and the legislatures felt regarding the undue monopoly enjoyed by the feudalistic lords over the lands and chattels and the changing concept of ownership with the progress of trade led to the evolution of the rule against restraint

on alienation. Similarly, the abuse of rights by the intellectual property holder by trying to retain control over the sold intellectual property goods gave rise to concept of exhaustion of intellectual property rights. This reveals that both these legal concepts evolved with a view to restrict the monopolistic behaviour of the sellers or the right holders by retaining control over goods once sold by them. The theory of repugnancy discussed in Chapter 1 in the section dealing with rule against restraint on alienation establishes that the restriction placed by the seller on further alienation of sold goods by the buyer contradicts with the concept of ownership. This philosophy reflected in the judicial decisions, gets developed in to the theory of exhaustion, wherein the courts clarify that right of alienation of property once sold is incidental to the sale and cannot be restricted by the intellectual property holder. This puts a restriction on the exclusive rights granted by the legislature to the intellectual property owner. The philosophy underlying the concept of exhaustion is found justified by both Hegelian and Kantian jurisprudence. Their philosophies justify the reasoning of the courts that the product comes out of the intellectual property protection once a legal sale takes place. The bottom line of these theories was that the rights of the intellectual property holder, in any form of exploitation guaranteed by the law, should not be so unlimited as to deprive the user of the property of his complete enjoyment of ownership. The right to alienate a property is part and parcel of ownership and cannot be restricted by the intellectual property holder. International exhaustion alone ensures its application globally.

The decisions which led to the evolution of the doctrine addressed the conflict existing between the rights of a purchaser and the intellectual property holder, bringing out the fact that the rationale behind the doctrine was not simply to limit the rights of the intellectual property holder but to address the welfare of the consumers as well. The enjoyment of the property by the consumers who paid the necessary money's worth for the product they bought was given primacy by courts. The courts addressed the consumers' concerns by facilitating free movement of intellectual goods through trade and commerce. The free trade concept concentrates primarily on facilitating free movement of goods across the borders, thereby making them available to the consumers at cheap rate. The concept of parallel imports is, thus, in consonance with this philosophy underlying free trade supports international exhaustion. The same philosophy finds reflected in the fundamental principles underlying the WTO framework which facilitate free

trade. Thus, both free trade and exhaustion aim to achieve free movement of goods. The concept of free trade enables unrestricted movement of goods across the globe without any border restrictions, whereas the concept of international exhaustion facilitates free movement of intellectual property goods across the borders in a similar way. Therefore, only international exhaustion is befitting the free trade regime, as the other two types of exhaustion viz., national or regional exhaustion, restrict movement of intellectual property goods beyond a definite territory. The recognition of national or regional exhaustion, in fact, reminds one of the old feudal arrangements, wherein the movement of land and chattels were restricted beyond a fixed family or status. If the rule that the post sale restraints on land or chattels by the seller are void as they are contrary to the concept of ownership, it cannot be different when it comes to the intellectual property goods.

Moreover, since the WTO framework does not entertain any restraints on the movement of goods on the basis of territoriality or origin of goods a different treatment for IP goods is absolutely unjustified. Once an authorised sale takes place, ownership of the specific good gets transferred to the buyer and post sale restrictions are repugnant to the concept of ownership. The philosophy of exhaustion as explained in the first chapter substantiates this conclusion, since the concept of exhaustion is founded on the fact that the moment an IP product enters into commerce, the product comes out of the monopolistic control of the intellectual property holder, and attains all the relevant characteristics of a traditional good.

Though the TRIPs framework has attempted to bring in some level of uniformity among the member countries regarding the basic standards of protection required under various forms of intellectual property, certain areas give ample freedom for interpretations and make them flexible for the contracting parties. These flexibilities, it is claimed, can be utilised by the member countries to make their laws in conformity with the TRIPS Agreement in such a way as to suit their national economic and social conditions. Article 6 is counted as one among them. However, as explained in Chapter 3, it does not allow a perfect flexibility and is a mere compromise providing a limited flexibility or in fact a trap for the developing or least developed countries. Article 6 has practically disabled the contracting parties from challenging any country which intercept the freedom of other countries in exercising their free trade policy when it comes to the intellectual property goods. For example, it leaves a country, the goods of which is forfeited in

transit by another country while being exported to a third country, without any remedy as Article 6 denies DSB jurisdiction to WTO Members in matters relating to exhaustion of Intellectual Property rights. In other words, Article 6 has indirectly recognised the freedom of WTO Member countries, if they desire, to adopt protectionist measures in the case of intellectual property goods. This means that what is provided under Article 6 of the TRIPS Agreement is not a freedom to choose any mode of exhaustion, but a denial of jurisdiction. The recognition of the Customs Union under the WTO framework, the lack of WTO DSB jurisdiction on the interception of the "freedom" to choose any form of exhaustion, the lack of a definite clause not to interfere with goods in transit etc., could be read as part of a silent move towards recognition of national or regional exhaustion. This is clear from the fact that it ended up in the virtual denial of international exhaustion to those members who wanted to opt for that under the TRIPs framework.

The real crux of the problem is that the issue of international exhaustion and parallel imports have a global effect. The recognition of national or regional exhaustion by any member countries has an effect on the affordability and accessibility of products both in that home country and in other countries. It also affects the freedom of trade as parallel importing can increase the quantum of international trade. If free trade is promoted for the benefit of consumers at a global level and as a mechanism to ensure availability of more goods at a cheaper rate, banning parallel imports certainly will have a negative global impact. In the context that the developed countries themselves have pushed the free trade regime under the WTO framework, their opposition to parallel imports appears to be questionable. Further, the recognition of national or regional exhaustion, along with the recognition of customs union can create impediments to trade and can affect even goods in transit.

To understand the best mode of exhaustion suitable for promoting global welfare the economics behind international exhaustion and parallel imports is examined. The conclusion drawn on such an analysis is that parallel imports are economically efficient and promote global welfare. An analysis of the economics of differential pricing reveals that the intellectual property holder, like any other producer, creates market differentiation through the mechanism of differential pricing so as to reap maximum profit. He fixes the prices in different markets on the basis of the elasticity of each market. Therefore, differential pricing is just a market mechanism to reap

maximum profit and consumer welfare is just a by-product of the same. As seen in Chapter 4, the welfare effects of differential pricing is quite uncertain and therefore, the argument that parallel import, which is a consequence of international exhaustion would put an end to the practice of differential pricing is unconvincing. Moreover, banning parallel imports would bring in harm to the consumers, the world over, and the developed country consumers are no exceptions. The prohibition of parallel imports may ensure the producers maximum profit, but it fails to ensure affordable access to the consumers. Parallel imports cushion, to some extent, the impact of monopolistic pricing mechanism adopted by the producer. As proposed in the theory of complementarity in the chapter dealing with competition aspects of parallel imports, allocative efficiency brought about by the parallel imports as well as dynamic efficiency of the intellectual property system must work together so as to achieve global welfare in the free trade regime. This does not result in loss to the producer as it is the producer's own product that is parallel imported after the first sale. Therefore, parallel imports balance the incentive mechanism with consumer welfare, which is the aim of the intellectual property system. Prohibition of parallel imports or the system of international exhaustion also acts as an abuse of monopoly rights granted to the intellectual property holder as it would be overdoing of those rights. The prohibition of parallel imports using resale or other restrictions also amounts to abuse of dominant position by the intellectual property holder as intra-band competition is curtailed through the ban, as seen from the judicial decisions of European and American Jurisdictions. The presence of the parallel imports can, as explained in the fourth chapter, pressurise the intellectual property holder to reduce the price of the product in the market.

The recognition of international exhaustion is all the more important in the modern world. With the advent of technology, the mode of exploitation of the market by the intellectual property has changed. Major sales of the intellectual products, especially copyright products, take place through the online platform. However, this does not call for prohibition of exhaustion in the online platform. In fact, the prominence of exhaustion gets all the more important in the digital platform. This is because when the mode of exploitation of the market gets widened, then the exceptions and limitations to the rights must be given due importance rather than shrinking the same. Further, the property jurisprudence of exhaustion does not allow differentiation between different media in which the intellectual property goods are transferred. The ownership over a

good, whether digital or tangible, has the same characteristics. Therefore, limiting the exhaustion to the tangible medium alone can be a dim-witted argument from the proponents of no exhaustion rule in the digital medium. The fact that the digital technology has made unauthorised copying and distribution easier is not a convincing reason for denying exhaustion in the digital platform. The digital market and its new ways of market exploitation have an answer to those issues. Moreover, the digital technology also has some positive features. It has considerably reduced the cost of reproducing and distributing the work for the copyright holder.

However, the inherent nature of digital technology is that with every normal digital transfer, an additional copy would be made. Therefore, it is argued that, traditional exhaustion doctrine is not applicable in the digital context as the reproduction right of the author is violated on every digital transfer. §. 117 of 17 U.S.C. treats reproduced copies created during the use of computer software as incidental copies and thus exempts from copyright infringement. However, similar logic was not extended to the copies created during digital transfers and there seems to be no logic for this. It is submitted that if the copy created during digital transfers is treated as an incidental copy that could negate the allegation of infringing the reproduction right. Further, the technological advancements enable automatic deletion of the copy from the transferor's digital device, as soon as a transfer occurs. This feature could be effectively used to answer the issue of keeping of additional copies by the transferee.

Another problem addressed in this research work is how to address the use of licensing mechanism to avoid exhaustion in the digital medium. As explained in the fifth chapter, when a transaction takes place with all the characteristics of a sale, merely terming it a license will not qualify the transaction as a license. Just as in the tangible medium, it is not acceptable that merely by attaching a notice to the sold product that it has been transferred to the user by a license and it cannot be made non-transferrable by inserting such a term even in the digital context.

Another argument put forward by the copyright holders is that in the digital platform the secondary market disincentivises the copyright holder as he incurs high economic loss as unlike in the analogue context the quality of the copies does not degrade. However, the author has established in chapter five that the secondary markets have in fact positive effects on the primary

market and that the loss incurred by the copyright holder cannot be accepted conclusively without adequate evidence. Further, the economic benefits that the digital platform offers to the copyright holder by enabling him to produce and distribute copies with very low investment compared to the analogue medium also should be taken into consideration when analysing the argument of economic loss of the copyright holder. When one argues for ban on exhaustion and secondary market in the digital platform, one must not forget the beneficial aspects of the secondary market in the digital context as it advances consumer access to cheap digital goods. It also increases competition in the digital market.

It should also be noted that the law has already enabled the copyright holder to use technological protection measures to protect their rights in the digital medium. Likewise the law must be able to protect the consumer interest as well, without unduly affecting the rights of the copyright holder. Instead of rejecting the exhaustion principle, it needs to be adapted to the digital medium. As discussed in the fifth chapter, the forward and delete method is one such mode of adaptation which could be applied to retain exhaustion principle in the digital medium. The rules prescribed in the *Used-Soft Case*[1170] can be very good guideline for recognising international exhaustion in the digital medium. International exhaustion in the digital context is also important in maintaining the secondary market in the digital world.

Regarding the application of the exhaustion principle in the domestic law, it is submitted that the Indian IP laws need to be carefully interpreted when addressing the issue of exhaustion. India has been demanding adoption of international exhaustion as the international norm in all international forums, including the Uruguay round of GATT. Even the legislative debates in India clearly indicate that the intention of the legislature was to recognise international exhaustion as the domestic norm so as to encourage parallel imports. However, there is lack of clarity in the Indian judiciary on the issue of the right form of exhaustion to be adopted by India in various IP laws. Therefore, it is high time for the Indian legislature to expressly recognise international exhaustion in the IP laws. To sum up, international exhaustion should be made the international norm, as other modes of exhaustion have to be equated with non-tariff barrier to free trade. It is, therefore, high time that Article 6 of the TRIPs is amended making international exhaustion the international norm.

[1170] [2012] E.C.D.R. 19.

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Appendix

Research Publications

1. Hegalian and Kantian Analysis of the Concept of Exhaustion, CULR, Vol 38, No. 1 & 2, 2014
2. Concept of Exhaustion under Intellectual Property Rights, CULR, Vol 40, No. 1-4, 2016
3. Analysis of Concept of Exhaustion under Indian Patent, Semiconductors and Plant Varieties Laws, Elenchus Law Review, Vol:2, Issue:2, 2016

Hegalian and Kantian Analysis of the Concept of Exhaustion

Vishnu Shankar P.*

It is sometimes quoted that 'property' refers to both the bundle of rights and to the objects over which the bundle is exercised.[1] Ownership, which itself is a right, is the phenomenon through which rights and duties are established over these objects relating oneself to others. From this juncture of view, property has branched out to various levels and one of the most controversial of all was the emergence of the intellectual property regime which had and still does find a hard time in fitting into the framework of the normal property concept due to its nature. For example the intangible self and also the peculiar nature of rights that need to get attached to the same such as the reproduction right. Not many jurists of the traditional schools of jurisprudence have analyzed this special branch of property law. Unlike the tangible property the ownership over the intellectual products are rendered not to exclude others from the fruits of the outcome of the property but to facilitate access to the same. Ownership in a sense being monopoly need to be checked so that welfare of the large population should not be compromised and one of the mechanisms ensuring this public responsibility is the exhaustion doctrine.

Intellectual property is the reward of intellectual creations i.e. intangible inputs creating tangible results which are capable of economic exploitation for the creator. The same is done through the grant of 'limited' monopoly rights to the creator. The rights are limited in order to curtail the over exploitation of the right as the main aim of intellectual property is to disseminate knowledge to the maximum number. An inherent mechanism to this end inside intellectual property regime is the concept of what is commonly called as exhaustion of rights. Under the exhaustion of rights once a product containing IP is sold by the IP owner to a consumer, the rights of the IP owner to control the resale of that particular sold product gets exhausted i.e. he cannot further control the resale of the product. The important thing is the first sale should take place for

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1 Geoffrey M. Hodgson, Editorial, *Introduction to Ownership by A. M. Honor*, Business School, University of Hertfordshire, Hatfield, UK, 1961.

exhaustion to kick in and hence it is often called as the 'first sale doctrine'. And the exhaustion can take place in three ways as per the current legal scenario: national exhaustion (rights getting exhausted once sold in the national boundaries), international exhaustion (rights getting exhausted once sold anywhere in the world) and the regional exhaustion (rights getting exhausted once sold in a region).

The aim of this paper is to find out the underlying philosophy of exhaustion. The reason for this inquiry is to establish that the controversy regarding which mode of exhaustion needs to be recognized by a country is irrelevant because as per the philosophy underlying IP and exhaustion, only international exhaustion can prevail. The intellectual property is justified as property using two main theories of personality- one that of George Frederich Hegel and the other of Immanuel Kant. Therefore the help of their philosophy is taken to establish that resale of an IP protected product by the buyer does not violate the rights of the IP owner. This conclusion, is drawn, through their philosophy on property in general and their treatment of the intellectual property system. The paper is divided into three sections. The first part deals with the Kantian philosophy of property, intellectual property and his observations in limiting the rights of the IP owner. The second part deals with similar issues but the philosophy is that of the Hegel. Both these men have interestingly dealt with the property concept both as tangible and intangible nature differing from other scholars who are concerned with the ownership and rights of merely tangible objects. Kant and Hegel both have strived to demarcate and limit the intangible nature of goods so as to ultimately bring the outcome of the intangible property under the laws of tangible goods while at the same time appreciating the intricate nature of rights and duties to be associated with the same differing from the tangible property. And the last section deals with the analysis of case laws which are considered to be the cradle of the exhaustion doctrine to find out whether the ratio of these decisions falls within the framework of the personality theory, basically of that of Hegel, for his being the strongest.

Kant and Property

Kant opines that property is the relation between two persons and not that of the object and person contrary to which the object may not recognize the new possession. Kant's property concept is basically grounded upon possession, free will and acquisition of property. Kant is of the opinion that a property can be acquired by any person by first taking possession of it, then subsequently exercising your free will upon

it and later bringing it under your control.[2] One sees excess importance being attributed to the process of bringing under the control the object in order to establish true ownership by Kant. It is only by taking full control over the object that one gets full ownership. And the persons are linked through the rights that one possesses through the possession of the object. Thus private property arises from the concept of right which is the sum of conditions under which the choice of one can be united with the choice of another in accordance with a universal law of freedom.[3]

This phenomenon of unification of rights observed by Kant takes place in trade or exchange of objects. So when a purchaser buys an intellectual product, the right over the "tangible product" transfers to him while the intangible property may not move completely. It amplifies the factor that rights determine the relation of a seller and a purchaser of a property. Kant opines that a property becomes a private property of a person if the person can establish that the use of that object without his permission by any other person wrongs the person's rights. Any object belonging to a person should also be under the person's physical capacity to use. This is indeed the situation even in the vending of the IP product to the purchaser. The buyer brings under the control the same good which he has purchased thus completely making it his property. This means that the IP owner cannot exercise control over the sold good as he does not have the control over the tangible product. As there exists both tangible and intangible contents in an intellectual product, IP owner can exercise his rights only upon the intangible creation and not on the tangible physical product which upon sale becomes the purchaser's absolute property. This view is supported by Kant as he clearly differentiates the intangible and tangible nature in an intellectual creation. An action by a person is considered to be right if the same right co-exists with the rights of other person and as per Kant any action which affects the lawful right/freedom of another, puts the object beyond the possible use of that object. This observation by Kant is important in the discussion of the exhaustion for two reasons: (i) the control of resale by the owner of intellectual property cannot exist with the freedom of individual property freedom of every purchaser as resale or alienation of the property is an incident of ownership, restriction of which is prohibited under the Kantian system of property rights and (ii) the resale restriction will also

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2 Immanuel Kant ,*Metaphysics of morals,* 'How to acquire something external as one's Own', section 5.

3 *Ibid.*

result in making the property stagnant in one's hand creating the depriving the further resale which might be the choice of use of the purchaser, and a prohibited act under Kantian system. A property right is not merely a right to a thing, but also sum of all the principles having to do with things being mine or yours which are the incidents of ownership including resale.[4] As per Kant, a right to a property is legal and recognizable as in the eyes of law if it does not conflict with a similar right of any other person and any person hindering such right of mine does me wrong regarding the right to use of that property. The purchaser of the IP product does not conflict with any of the IP owner's rights, as the purchaser does not exercise the monopoly right but only the normal rights in a normal property context and hence hindering the enjoyment of the product by the IP owner is unlawful.

Emmanuel Kant: Intellectual Property and Exhaustion

Kant talks about IP in the sense of intelligible possession[5] i.e. possessing without actually holding it. Kant also argues that whoever wants to assert that he has a thing as his own must be in possession of an object since otherwise he would not be wronged by another's use of it without consent and is what practical reason holds. Right itself is intelligible possession as per Kant. Also Kant says it is not appropriate to speak of possessing a right to intelligible possession of that object but rather of possessing it merely rightfully for a right is already an intellectual possession of an object and it would make no sense to speak of possessing a possession.[6] Extending this observation by Kant to our discussion guarantees that the intellectual property owner exercises merely an intelligible possession of the IP product even at the creation of the intellectual property and upon sale of the product the purchaser brings under control the product and thus ends the possession of the IP owner and he cannot further possess any rights.

Kant further attempts to justify the reproduction right of an author in his work "On the Wrongfulness of the unauthorized publishing." He opines that 'book' is not the immediate sign of a concept; rather it is a discourse to the public.[7] Kant is of the opinion that even though one may feel prima facie that unauthorized publishing i.e. reproduction of a work

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4 Immanuel Kant, *On Property Right, Metaphysics of morals,* sec.10.

5 *Id.,* section 1.

6 *Id.,* section 5.

7 Immanuel Kant, *Metaphysics of morals, II What is a book,* section 32.

is unjust, still it can be justified as the 'book' itself is a corporeal thing, whose legitimate possession entitles a person to make copies of it as part of ownership over the same.[8] This he says due to the fact that what an author possesses is the right over the intellectual thought and appropriation of the tangible property or copy of the book does not affect the intellectual property of the author and therefore cannot control the right of the purchaser from reproducing the copy he legitimately possess, let alone resale, through reservation.[9] Thus he tries to differentiate between the tangible and intangible nature of a product created out of intellect. This is clearly an attempt by Kant to imply that the property possessed by the IP owner should be limited so as not to restrict the legitimate enjoyment of the purchaser. But the same limitation of the author is negated by Kant stating his definition of literary work as a discourse to the public which the author alone can perform. The publisher merely speaks through publishing to the public in the name of the author and on behalf of him. Kant opines that since publication is an act a publisher can do only in the name of the author with his consent as it is his prerogative to communicate to the public, purchaser cannot exercise the same. As per Kant only those acts which one can do in his own constitutes a legitimate act.[10] Further Kant restricts only the reproduction of the copy while he approves other acts incidental to the ownership and Kant says "... it does not matter to whom the copy of the speech belongs, whether it is in the author's handwriting or the print, to make use of it for oneself or to carry on trade with it is still an affair that every owner of it can carry on in his own name and at his discretion. However, to let someone speak publicly, to bring his speech as such to the public ... is undoubtedly an affair that someone can execute only in another's name".[11] Thus from the above statement Kant establishes that resale of a product of IP by the purchaser is lawful thus exhaustion is established. He needs to be only a legitimate purchaser. Kant also states that it would be against the will of the author to communicate to the public his speech without his consent while in resale nothing of the sort takes place. He continues his justification of reproduction right of the author saying that reproduction right is a positive right and positive right cannot be inferred from complete

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8 *Ibid.*

9 *Ibid.*

10 Immanuel Kant, *On the Wrongfulness of the unauthorized publication of Books*, section ii , 8:83.

11 *Ibid.*

ownership.[12] Right to alienate certainly attaches itself to the incidents of the ownership other than like right of reproduction. We see upon analysis of the work of Kant that the only concern he expresses over unauthorized use of a work is interfering with the right of communication to the public that the author possess and if that is not disturbed by a purchaser then no act of the purchaser wrongs the author. Kant says to acquire a full right over a thing or property; one must be able to do whatever one wants in "one's own name "with that property.[13] This is the essence of ownership. He negates right to publish i.e. reproduction from giving into the hands of the owner of a copy. Since it is an activity which can be done only in the name of the author and not by purchaser's name as the intellectual property still remains the property of the author.

Reselling the tangible property which the purchaser had bought from the IP owner is a perfectly legal act which can be done by the purchaser in his own name. He does not allow the passing off of the books of the author as his own creation but rather that he sells it as his tangible property as he rightfully is. Thus exhaustion can be a valuable exception to the monopoly right granted which is justified under the Kantian philosophy of property.

Hegelian Philosophy of Property

Hegel's theory is alternatively acknowledged as the personality theory for the approved reason that he bases his philosophy on the personality of a person. His theory propounds that property is the reflection of the personality of the person owning it. Property provides a unique or especially suitable mechanism for self-actualization, for personal expression and for dignity and recognition as an individual person.[14] Hegel's concept revolves around mainly three concepts namely free will, freedom and abstract right. As a general proposition, ownership over a property brings along with it certain rights attached incidental to the ownership, which itself is a right. And the origin of this right, as per personality theory is the free will.[15] Freedom is the essential character of a will and will without freedom is nullity as spirit in oneself spreads its wings to the fullest possible extend through this free will.[16] Will as per

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12 *Ibid.*

13 *Ibid.*

14 Justin Hughes, "The Philosophy of Intellectual Property", 77 Geo. L.J. December, 1998,287.

15 Georg Frederich Hegel, *Philosophy of right*, (Translated by S.W Dyde) Batoche Books Kitchener, 2001,p.4.

16 *Ibid.*

Hegel is a special way of thinking which translates the thoughts into reality.[17] This free will is true substance of property concept of Hegel.

Man possess or owns only what he wills or wishes to possess as no one need to possess something they do not will to possess. This inner spirit is at the first instance intelligence which develops itself to the form of the will. Hegel considers this inner spirit/freedom to an idea. And a person must give to his freedom an external sphere in order to reach the completeness of his idea. It is through the exercise of this free will, which is the development of the inner spirit, that a person acquires property. This complete free will, when it is conceived abstractedly is in a condition of self-involved simplicity[18] which in the context of intellectual property constitutes the idea of a person. This abstract right which is free gets more concrete existence, as it is in need of it, when they are expressed on a property. Thus abstract right gets a tangible shape when it acquires property. This property in Hegelian terms is the external world. Thus the free will internalizes the external world. A person's personality and his free will are the same in the initial stage. And the property over which he acquires ownership is external and opposite of him. It is the merger of these two opposites that take place upon acquiring property. Therefore it is through personality that acquisition of property and thus it reflects one's personality. This personality is the capacity to possess rights and constitutes basis of abstract right.[19] This abstract right is then transferred to the first possible conversion of the right i.e. possession. Possession according to Hegel is the crux of ownership. It is the first mere possibility of owning something.[20] But it is not the perfect right but certainly provides some authority. Property ownership is established as per Hegel through three levels of development of this abstract right: possession, use of it and the relinquishment of the same.

The property becomes the expression of the will and a part of the personality and it creates ambience for further free action. As per Hegel, the value of the property lies not in satisfying our needs but in superseding and replacing the personality reflected in the object.[21] Then how can one replace the personality in an object? Trading would be the obvious manner. In other words Hegel believes that it is trading characteristic

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17 *Id*, Addition.

18 *Id.*, section 34.

19 *Id.*, section 31.

20 *Id.*, section 41.

21 *Ibid.*

that makes property valuable for a person. This confirms to the free movement of the goods which 'was' one of the objectives of the intellectual property. Therefore restricting the reselling of the product by the intellectual property which was legitimately purchased goes against the purpose of the property both in Hegelian terms and also as per the object of the intellectual property law. Statute renders the right to vend to the IP owner realizing the incentive it can provide to the IP owner but to what extend? It would be against rationale to think statute would intend to allow perpetual control over the product sold which might create stagnancy in value of the property.

Hegel considers person as natural property and considers that he as a person has certain inalienable qualities of personality. This provides according to Hegel the ultimate substance to the person that is the inner personality. Alienation of such part of personality thus is prohibited under the Hegelian system and only those forming part of the personality attached to the object owned that is the external property becomes alienable. It is from this premise one may start the analysis of the treatment of intellectual property by Hegel.

Hegelian concept of Intellectual Property.

As per Hegel a person has certain features of personality with which he is directly endowed, and one acquires through expression of his personality. This he calls as mental endowments which includes invention, art, science, etc that he considers as objects of exchange, which are things to be bought and sold.[22] However, he argues that it contains a spiritual side which is the inner spirit residing inside the person. How can then one possess the same? Hegel points out the difficulty in considering these mental treasures as properties of exchange stems from the issue of incapability of possessing the same i.e. being intangible. How can then they be propertied? Hegel answers it as – through relinquishment. Through relinquishment of one's inner spirit, one can give an external appearance to the same turning it into tangible property which one can possess.[23] Hegel admits that at the first glance mental endowments may appear to be property but the spirit lowers its inner side to the level of the directly external. Hence it becomes external property. The importance of this observation is that giving mental endowment a tangible existence makes all the laws applicable to the product created out of intellectual

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22 *Id.*, section 43.

23 *Ibid.*

property which is of vital importance to our current discussion of the paper. The implication of the same is that, the moment an innovative idea or knowledge is turned into a copyright subject matter or patentable invention, the intellectual property of the owner ends and the normal property rights begins. Such a conclusion would mean not even the reproduction right may be retained by the intellectual property owner but Hegel has an answer for this problem too (discussed later). Relinquishment of the mental possession takes place as it passes to the external world. Therefore in the case of exhaustion, when the restriction is placed by the intellectual property owner on the intellectual property rights that he "possess" and prohibiting a legitimate purchaser from reselling it does not find justification under the Hegelian analysis as IP ends upon externalization.

Now as stated above, as per the Hegelian law of property, absolute ownership is established through acquiring, using and relinquishing a thing. Analyzing the position of the purchaser in a Hegelian framework, one acquires property using personality of the purchaser which comes under the complete ownership of the purchaser. Hegel states that when a property which is under the obligation of a complete ownership of a person's personality, it would be unjustified to control his personality by another person subduing the purchasers complete enjoyment. The purchaser's act of purchasing replaces the personality of the IP owner with that of the purchaser. Thus according to Hegel the purchasers even possess the right to reproduce the IP product since reproduction of a person's personality is the right of the personality. What property of external sphere does is giving visible existence to my will and hence property.

The next stage is the use of a property. Hegel says that use is the realization of my want through the change, destruction or consumption of object, which in this way reveals that it has no self and fulfills its nature.[24] As per Hegel, when a purchaser is admitted to the fullest use of a thing completes the ownership of the purchaser. Thus nothing is left upon the other to appropriate. When I come into possession of a thing and as a consequence not only what is directly laid upon is mine, but what is connected with it also.[25] The total use of a thing cannot be mine while the abstract right property is somebody else's. Reading these observations of Hegel simultaneously gives a safe deduction that a person

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24 *Id.*, section 59.

25 *Id.*, section 61.

who purchases the product might have a want of resale which is the change that he desires of the object, and thus it cannot be restricted by anyone as he, being admitted to the fullest use becomes the owner of the object unless the buyer wills to put the user such a restriction. Hegel negatives the proposition that an object can be someone's while the same is the property of the other i.e. in intellectual property terms, creation of unrestricted monopoly.[26]

The last stage of completion of ownership is the relinquishment of a property. It is in the context of relinquishment that Hegel talks more about IP. When a person takes into possession of a thing, the right to relinquish also gets attached to the property. However, certain part of personality of the owner cannot be alienated. An owner's present desire to alienate a piece of property is connected to the recognition that the property either is not or soon will not be an expression of him.[27] This means that through alienation one relinquishes his personality with the knowledge that from that moment the purchaser expresses his personality as his freedom chooses will obviously include the right of further alienation. When a person relinquishes his property, he returns to his self-personality, being the process by which he establishes himself as an idea or complete legal or moral person and does away with the old relation. What is peculiar to a mental production is that it can be externalized for others to produce.[28] Hegel argues that literary work and an invention constitutes not just mere idea of the author but also the "mechanical genius" of making it i.e. publishing in the case of literary work and industrial production in the case of invention which may be internalised by the purchaser and thereby exercise the same in the manner similar to that of the creator.[29] Same time the new owner comes into possession of the general power to express him in the same way including reproduction. Reproduction of a book is merely a mechanical labour and therefore no personality is involved. And moves on to expressly state that "Since the purchaser of such a product of mental skill possess the full use and value of his single copy, he is complete and free owner of that one single copy, although the author of the work or inventor of the

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26 The object would be wholly penetrated by my will and yet contain something impenetrable namely the empty will of another.

27 Georg Frederich Hegel, (Translated by S.W Dyde), *Philosophy of right*, ,Batoche Books Kitchener, 2001, section 65.

28 *Id.*, section 68.

29 *Ibid.*

apparatus remains the owner of the general method of multiplying such products. The author or inventor has not directly of the general method, but may reserve it for his private utterance."[30] This clearly is nothing but exhaustion doctrine. Hegel ingeniously has recognized the importance of the right of reproduction of the author which is "the general method of multiplying" in the words of Hegel, which could be retained by the author of the work or the inventor. Hegel justifies the retention of this right of reproduction by stating that it is the only mode in which the author could express his work to the world[31] without which the author may not be motivated to create more of the works.[32] But that does not prohibit, the purchaser from making copies of the purchased tangible property that he owns. He further says that an intellectual property cannot arbitrarily withhold the right to the object alienated, not even the right to reproduce, but then the law may protect the reproduction right due to the peculiar nature of the property as the whole means of wealth of possessing the property lies in the fact that the author or the inventor may reproduce the same and make it enable it to the public.

Hence Hegel finds the limitation that is to be drawn for the monopoly granted by the statute to the IP owner for his creation and except for the mode of creation i.e. reproduction or making, the other rights of the intellectual owner need not be protected further over the copy or product vended. Thus Hegel supports the international exhaustion doctrine.

Analysis of case laws using Hegelian system of property

This section of the paper aims at analyzing the initial case laws which paved path for the development and shaping of the exhaustion doctrine. Exhaustion doctrine is a judge made doctrine and not the creation of statute. The aim of this section is to exhibit that the reason the courts relied on while deciding the cases falls in line with the Hegelian theory even though the courts have not expressly referred to him.

The first case decided recognizing exhaustion was *Bloomer* v. *Mcqueen*[33]. The court tried to limit the extent of the rights of the intellectual property owner in the present case. When the machine passes into the hands of the owner it comes outside the protection of the monopoly

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30 *Id.*, section 69.

31 "The alienation of a single copy of a work need not entail the right to produce facsimiles because such reproduction is one of the universal ways and means of expression which belong to the author."

32 *Ibid.*

33 55 U.S. 539 (1852).

granted by the statute. The machine becomes his absolute private Property. This means that IP ends as the sale of the object takes place wherein a normal property right begins. The court further held that it would be hardly the intention of the legislature to deprive the legitimate purchaser of the benefits of the ownership by protecting intellectual property. The reasonable understanding from this ratio of the court is that court identified the property of the IP owner as the intellectual substance and the same when converted into the tangible form and purchased by the buyer, exists merely as tangible product which is under the ownership of the purchaser.

In *Mitchell* v. *Hawley*,[34] the court considered the license agreement set out by the intellectual property owner. In this case the court held that if the patentee had delivered the patented good for use to the purchaser, then the purchaser may continue to use it as long as he wishes to use it. This means that the ownership is completed by the transfer of the object to the purchaser for use. Hegelian system too confirms that use of a thing concretes ownership of a thing. The court further held that upon resale, the patentee is believed to have been parted with the intellectual property and further quoted the above ratio of *Bloomer* v. *Mcqueen*. Similar line of judgement was followed in *Adams* v. *Burke*[35], wherein court held that "...the sale by a person who has the full right to make, sell, and use such a machine carries with it the right to use of that machine to the full extent to which it can be used..." The court explained that in the present case use amounted to further resale and that it was lawful to do so as he was the absolute owner of the coffin.

In *Keeler* v. *Standard Folding Co*[36], court held that if a patentee has sold his products restricting the use of the same within a territory, the purchaser has the freedom to use, sell or dispose the same anywhere in the country provided they are rewarded once for their creation. The reward theory too confirms the Hegelian theory since once you relinquish your property through which you relinquish your personality which allows you to get reward only once. Having manufactured the material and sold it for a satisfactory compensation, whether as material or in the form of a manufactured article, the patentee, so far as that product of his invention is concerned, has enjoyed all the rights secured to him by his letters patent, and the manufactured article and the material of which

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34 83 U.S. (16 Wall.) 544.

35 84 U.S. 455 (1873).

36 157 U.S. 659 (1895).

it is composed go to the purchaser for a valuable consideration, discharged all the rights of the patentee previously attached to it or impressed upon it by the act of congress under which the patent was granted."[37] Thus court expressly declares that the intellectual property does not pass to the purchaser as it has ended upon the sale and the mere tangible property rights begin. Court addressed the question whether a purchaser who bought the patented article from a lawful seller should again pay him to resell it. Quoting *Adams* v. *Burke*[38], court explained that a person who bought a product from a person having right to sell can resell the same as it has become the absolute unrestricted property of the purchaser.

Thus it is sufficiently clear that the court has decided these cases in the context of Hegelian philosophy pertaining to property demarcating and through separating the rights of the IP owner and the purchaser upon the selling of the product. The ratio of these decisions falls within the framework of ownership concept of property by Hegel enunciating his principles of use and alienation theory. The limitation of these judgements however should be pointed out. The courts have allowed the freedom to the monopolist to restrict the purchaser through contracts. But this yet again is against the Hegelian perspective since personality cannot move from one person to another if reasonable characteristics of the personality is restricted through contract and hence the exchange of objects cannot take place, negating the space for contractual restriction.

Thus the author presumes that the preceding sections have shed light into the fact that the controversy regarding which particular mode of exhaustion to be followed by a nation is ill-founded and unwanted. The philosophy underlying IP regime in general and the exhaustion in specific supports the universal exhaustion of rights i.e. international exhaustion and the same need not be restricted within the national or regional boundaries. The so called flexibility in TRIPS in Article 6[39] regarding exhaustion, which apparently is a compromise between developed and developing countries, too becomes irrelevant in this context once international exhaustion can be the only mandate. Thus it is futile to classify exhaustion regime into national, regional and international driven by the monopolist interest for profit. Thus the ownership over the

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37 157 U.S. 659 (1895) at p.662.

38 84 U.S. 455 (1873).

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

tangible property remains within the purchaser while the IP owner retains his right over his intellectual property, striking balance between IP holder's rights and that of a genuine purchaser. The same conclusion is drawn based on the property characteristic of intellectual property thus further supporting the universal nature of the doctrine

The welfare impact of such a conclusion reflects in the case of parallel imports which can occur only in the international exhaustion regime. As widely known parallel imports can be welfare enhancing for the consumers regarding affordability and access to IP products. The IP owner at the same time does not suffer any lose in revenue as he reaps the first award for selling the product where again the balance of incentive of the IP holder and the public interest is visible. Thus the philosophy of international exhaustion furthers the aim of intellectual property regime.

Concept of Exhaustion under Intellectual Property Rights

Vishnu Sankar P. *

Introduction

Exhaustion as per the mere literary meaning of the word suggests the action of using something up or the state of being used up.[1] In the context of intellectual property too we have a similar implication for the word. What are being used up here are certain rights that are granted to the intellectual property holder by the statute, by an act of transfer of the product containing the intellectual property. The word 'transfer' is not well accepted as it is mere sale that is often recognised for exhaustion of certain rights to take place. Thus in simple terms exhaustion of intellectual property rights takes place when the intellectual property owner or any person authorised on his behalf sells the product , upon the very first authorised sale, the right to control resale or the distribution of the sold piece of product gets exhausted.[2] Hence the doctrine is called as the first sale doctrine. The doctrine of first sale is, in essence, a limit on the copyright owner's right of distribution and springs from the distinction drawn between property rights and intellectual monopoly rights like patents and copyright[3].It is based on the logic that once an intellectual property owner has parted with the title to a particular copy or piece of product containing the invention or the work, successive possessors of the same should not be put into trouble having to negotiate with the owner each time they contemplate a further sale or other transfer.[4]This warranties the need to differentiate between the intellectual property rights and the general property rights over the physical object upon which the invention or the work is embedded.

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1 See, http://www.merriam-webster.com/dictionary/exhaustion, (access on 25/12/2016).

2 Enrico Bonadio, "*Parallel Imports In A Global Market: Should A Generalised International Exhaustion Be The Next Step?*", European Intellectual Property Review, 2011, Vol. 33, No. 3, pp. 153-161, Available at http://openaccess.city.ac.uk/4106/1/Parallel%20Imports%20in%20a%20Global%20Market.pdf (access on 25/12/2016).

3 Pranesh Prakash,"Exhaustion: Imports, Exports and The Doctrine of First Sale in Indian Copyright Law",Manupatra Intellectual Property Reports, Vol.1, p.637 available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=17737232011, (access on 25/12/2016).

4 Ibid, at 638.

The tension arises due to the same as their claims to be a conflict of interest between the intellectual property owner and the purchaser of the physical product. The selling of the physical object, as claimed by the intellectual property owner, carries with it the sale of the intellectual creation of the owner of the ip. Thus he demands for the restriction of sale of the physical object over which the purchaser ascertains absolute ownership. Thus by putting restriction upon the rights over the intellectual creation, the owner of ip in effect restricts the transfer of the property i.e. the physical object owned by the purchaser. This is inconsistent with the common law principle of rule against restraint of alienation. The first sale doctrine aims to reconcile this dispute.

The paper aims to find out the philosophy underlying the concept of exhaustion. There are various theories put forward from different jurisdictions identifying the underlying principle of exhaustion. The English Jurisprudence is often said to have developed the theory against the background of implied license theory under the contract law while the German jurist Joseph Kohler, who is considered to be the patron of the exhaustion theory has depended upon the theory of ' one time reward theory'.[5] Another major theory put forward is the law of servitudes in property law.[6] But the author finds these theories alone to be based on shaky grounds for the inherent flaws in the theories which makes the concept of exhaustion subtle but is not dealt in this paper. The paper proceeds upon the assumption that the concept of exhaustion draws its roots from the common law concept of rule against restraint of alienation. The doctrine developed in the American land, indeed is recognised to have its base in the rule against restraint of alienation.[7] The first part of the paper analyses the development of the common law concept of the rule against restraint of alienation, the causes and the rationale underlying the same. The second portion of the paper analyses the case laws that led to the development of the concept of exhaustion in the intellectual property context and it will be depending upon the principles employed by the judges to restrict the monopoly rights of the owner that i would be drawing my conclusions that the concept of exhaustion has its roots in the common law rule against restraints.

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5 Christopher Heath. *Parallel Imports In Asia,* Max Plank Series on Asian Intellectual Property set, Kluwer Law International, (Vol.9, 1st edition, 2004). Also see ; John Chipman Gray, *Restraints on the Alienation of Property,* Boston Book Company, Boston, (2nd ed. 1895).

6 Glen O. Robinson, "Personal Property Servitudes", 71 U. Chi. L. Rev. 1449 (2004) pp.1449-1524. Also *see:* Yonatan Even, *Property, Appropriability and the First Sale Doctrine,*[Draft—Israel L&E—5/25/07] pg.55.Availableathttp://portal.idc.ac.il/en/ilea/annualmeeting/documents/making%20sense%20of%20the%20first% 20sale%20doctrine.pdf (access on 22/7/2014)

7 DMCA Section 104 Report, U.S. Copyright Office August 2001,A Report of the Register of Copyrights Pursuant to §104 of the Digital Millennium Copyright Act. Available athttps://www.copyright.gov/reports/studies/dmca/sec-104-report-vol-1.pdf (access on 25/12/2016).

Rule against Restraint of Alienation

Restraint on alienation is a concept which has evolved in the context of landed property. The concept should be understood in a qualified sense. This is because the restraint on landed property differed as the society underwent changes and changing public policy.[8] It was differing depending on the country and stage of society, to the restraints and modifications suggested by the convenience and dictated by civil institutions.[9]It is now an accepted common law principle that absolute restraints kept by a transferor of land upon the land or chattels over which a purchaser ascertains absolute ownership is illegal and void.[10] However the journey to this present position was indeed a rough one.

But this was not the position during early centuries. It was feudal governance during those periods. It was perfectly legal with the public policy of the feudal society to keep restraints on any land transferred either through sale or any means. It was considered to be repugnant to the interests of feudal lords to allow free alienation.[11]Thus free alienation of land and chattels was considered something against the public policy.[12]The landed property was never meant to be alienated outside the family of the feudal lord upon the fear of land going outside family status. The vassals of the lord could not alienate the property without the consent of the lord. Even among the family the transfer could take place only with the consent of the chief of the family. This creation of the interests in the lands of the vassals was later called as the doctrine of feuds and was considered to be in tune with the then existing public policy demands. The later development of the property law saw the shift of property being held on the basis of status to the ability to alienate beyond the family and not controlled by the status but the will of the people. [13]Another major important concern for the control was over the produces in the land.[14]

During the feudal periods soldiers were allowed to cultivate in the lands of the King who acted as the lord causing double ownership, provided they

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8 Kenelm Edward Digby, "An Introduction to the History of the Law of Real Property With Original Authorities", Available at https://archive.org/details/historyoflawofre00digb.(accessed on 14/09/2014).

9 Carl D. Stephan, 'Conditions in Restraint of Alienation of Real Property", (1894).Historical Theses and Dissertations Collection. Paper 373, pg.2. Available at https://scholarship.law.cornell.edu/cgi/viewcontent.cgi?referer=https://www.google.co.in/&httpsredir=1&article=1378&context=historical_theses (accessed on 22/08/2014).

10 See. *Hood v. Oglanderm* 34, Beav.513, Shaw v. Ford, 7,Ch. D. 669,674.

11 J.H.C Morris and W. Barton Leach, *The Rule against Perpetuities,* Stevenson and Sons, London, (2nd Edition, 1962).

12 Sir William Holdsworth, *A History of English Law,* Sweet *and* Maxwell, London, Vol.III, (2nd Edition, 1941).

13 Maine, Henry, *Ancient Law Its Connection with the Early History of Society and Its Relation to Modern Ideas,* John Murray, London, (1 ed. 1861).

14 Ibid.

serve the King in military services.[15]The land was tied up ultimately to the lord whatever be the improvements made by the tenant. Lands were cultivated for the benefit of the lord. In fact, it was to control the produces or to levy royalties that the feudal lords placed restrictions on alienation. The transformation of property law was to make land, in some degree a substitute for money, by giving it all facilities of transfer and all the prompt application of personnel property.[16] Land slowly began to be treated as commodity. The concept of property began to change from that of a source of family wealth to that of private ownership aimed at breaking the chain of status control over the land.[17]

The concept of private property was absent during the early periods indicating a system of common ownership. Before the inception of the concept of ownership, it was community settlement that prevailed. In primitive times, there were community settlement (often termed as community ownership) without any individual claims on land and the produces from the land too belonged to the community.[18] The concept of private ownership began with the recognition of the same among the Kings ascertaining ownership on the lands they had acquired. The Kings upon acquiring such lands began to place conditions upon those people who lived in those lands if they wanted to use the land for any purpose. They were obliged to enjoy the land under those strict conditions. These people could never own these lands or any produces or improvements they made to these lands since ultimately they all reverted to the King. In simple terms whatever be the improvements or additions one does to the land in which one lives, the ownership ultimately rested with the King incapacitating the right to alienate the land by the vassal. The King was the superior landlord. This nature of ownership was called as the "allodial title". [19]

The land first became alienable to the religious and ecclesiastical people in the society who served the Kings and in gratitude to the service, they were

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15 Kenelm Edward Digby, "An Introduction to the History of the Law of Real Property With Original Authorities", Available at https://archive.org/details/historyoflawofre00digb.(accessed on 14/09/2014).

16 Claire Priest, "Creating An American Property Law: Alienability And Its Limits In American History", Harvard Law Review, Vol.120, Number 2, 2006, p. 387.

17 Ibid.

18 Kenelm Edward Digby, "An Introduction to the History of the Law of Real Property With Original Authorities", Available at https://archive.org/details/historyoflawofre00digb.(accessed on 14/09/2014).

19 The title means that the King is the absolute owner of the land and anyone who challenges it is killed and whoever heeds to the conditions of the King becomes the possessor of the land and can produce and enjoy the land but the ultimate owner being the King himself.

allowed to own and alienate the land given to them by the King as gifts.[20]They were called as bolands, which was free from all burdens and had attached with it the right to alienate[21]. This power to restrict the enjoyment of the interests in the land slowly trickled down to the feudal lords. As stated above they imposed conditions upon the lands during transfers in order to keep the land within the family by reversion of title back to the family head whatever be the transfers they made. The lord maintained a control over the property being transferred. Thus, a complete restraint on transfer of lands was placed upon transferee.

With the arousal of the private property concept, the reversion back policy was the first one to be done away with. The main reason for the same was the discomfort that the public and the courts felt regarding the improvements and produces made in the lands going into the hands of the landlords and the Kings, who were not responsible for the improvements or the produce made in the land. The philosophy of individual freedom penetrated the society and people began to rebel to the unfair restrictions of alienability placed upon their lands. Vassals began to abstain from producing or improving the lands reducing the commercial value of the land and thus leading to economic stagnation. The vassals began to realise the commercial value and the importance of ownership in the economic terms. This compelled the State to act in response to the discomfort and changing public policy. The first step to do away with the restraints of the lords was taken during the time of Henry I who introduced the concept of sub-infeudation.[22] Thus in cities and burrows land began to be circulated.

Later Henry I further relaxed the rule bystating that right of alienation maybe achieved for the lands, which are purchased but maybe restricted for the inherited property.[23] Therefore as response to this law feudal lords began to put conditions of fees if the land was alienated without their consent. Finally, this practice too was swept away by the Statue of Quia Emptores by Edward I, which established the free right of alienation. This triggered for the development of the concept of absolute ownership and restraints on alienation forming part or incidental to it. Thus, creation of the freedom of absolute ownership concept over the land swept away the feudal policy of reversion back and the control of

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20 Kenelm Edward Digby, "An Introduction to the History of the Law of Real Property With Original Authorities", Available at https://archive.org/details/historyoflawofre00digb.(accessed on 14/09/2014).

21 Ibid.

22 Sub-infeudation is the practice by which tenants, holding land under the king or other superior lord, carved out new and distinct tenures in their turn by sub-letting or alienating a part of their lands

23 Carl D. Stephan, *Conditions in Restraint of Alienation of Real Property*, (1894). Historical Theses and Dissertations Collection. Paper 373. . Available at https://scholarship.law.cornell.edu/cgi/viewcontent.cgi?referer=https://www.google.co.in/&httpsredir=1&article=1378&context=historical_theses. (accessed on 22/08/2014).

resale of the land. Realising the commercial value of the property and mainly due to the improvements made on it, people began to use these lands and produces of the same for paying off debts. The notion of the public policy changed completely. The restriction on enjoyment of the lands over which they had a rightful possession was felt to be repugnant to the interest created on the transferred land. This led to the creation of the fee simple lands i.elands, which were capable of being transferred without restrictions called as fee simple estates. Thus, the reversion back policy was replaced by right to transfer the land.

This being the changes that took place in the society and the legal response to it, the judiciary too had contributed to this wave of change. The courts began to declare that once an absolute ownership over the land is transferred to a purchaser upon receiving adequate consideration, no interest, which hampers the interest of absolute ownership, could be placed upon the purchaser.[24] This was commonly called as the theory of repugnancy. The theory was based on the principle that right to alienation being incidental to the absolute ownership cannot be restricted as it is against the full enjoyment of the interest created by the transfer of estate. Thus, ownership began to presuppose right to alienation. This was based upon the notion of public policy, as it would not be in the public interest to allow restricted transfers of the land and the notion of absolute ownership guaranteeing full enjoyment of the thing owned. The court has held that one cannot make an absolute gift or other dispositions, particularly an estate in simple fee and yet at the same time impose such restrictions and limitations upon its use and enjoyment as to defeat the object of the gift itself in the same transaction and that right to transfer is incidental to the ownership.[25]Any restraints, which completely took away the right to alienate (disabling restraints), were declared void by the courts.[26]

A restraint on alienation maybe treated as complete and perfect as if no person whatever was named in as much as the name of the person who alone is permitted to purchase might be so selected as to render it reasonably certain that he would not buy the property and the property could not be alienated at all. The court further held that one cannot restrict the right to alienate incidental to ownership in a transfer since one cannot restrict what is given by law through a contract.[27] .Even when partial restraints are recognised by the courts, those partial restraints that took away the complete right of alienation were considered complete

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24 *Attwaterv.Attwater* (1853) 18 Beav. 330

25 *Potter* v.*Couch*(1891),141 U.S. 296.

26 *Hood* v. *Oglander* 34 Beav. 513.

27 *Potter* v. *Couch*(1891),141 U.S. 296.

restraints and hence held void. This complete restraint keeps land away from commercial transactions and circulation. This leads to tying up of property ultimately leading to economic stagnation. The situation was grave when it came to the chattels and the trade was really hampered by the restriction on alienation placed on chattels by the producers in order to increase their monopoly. This led to the trade restraints and anti-trust issues. Thus, the courts began to realise the trade restraints that restraints on alienation was causing. This is the evolution of the rule against restraint of alienation. Thus, it is clear that it was indeed to resist the creation of monopoly of the feudal lords that the rule against the restraint evolved.

Rationale for the Rule against Alienation

(a) Theory of repugnancy- The courts were of the opinion that any restriction, which is created against the interest created by the seller, which hampers the full enjoyment of the property, cannot be justified and hence null and void.

(b) Trade and general public policy – The tying up of property keeps the land away from commerce leading to freezing of capital and trade deficit. The effect of the same is more seen in the case of chattels. This hampers the public interest as competition is suppressed.

(c) Grant individual freedom and social utility. It avoids creation of double monopoly by creating just a single absolute owner.

(d) Restraint makes exchange of goods impossible.

(e) Unnatural increase in market value again due to monopoly

Development of Exhaustion Doctrine

Exhaustion doctrine is a doctrine developed by the courts. Various reasons such as the price fixing, territorial division techniques employed by the intellectual property owners in order to extend the monopoly rights conferred by the statutes made the courts to restrict these practices of the ip owners in recognition of the public policy. As we saw in the case of land and chattels during the feudal period, the intellectual property owners were trying to ascertain the rights over the property, which has been already transferred to a lawful buyer. In both the cases of landed property and intellectual property, what is in fact created is monopoly and thus concentration of wealth through the restrictions on transfer of the object upon which the purchaser has the absolute ownership. In the landed property and chattels context, the monopolist was the landlord while in the intellectual property context it is the owner of the intellectual property. In the context of intellectual property, the intellectual property owner restricts the further sale

claiming when the sale of an object by the seller containing the intellectual property takes place, what is in fact sold is the intellectual property, which is the sole statutory right of the intellectual property holder. Therefore, through exercising a statutory right what is in fact curtailed is both a common law right of absolute ownership.

The earliest case, which dealt with the concept, was *Bloomer* v. *Mc Quewan*[28]. The appeal was filed by Bloomer who was an assignee of the administrator of the original patent holder to whom the right to construct and use and to vend to others the right to construct and use was given during the extended period of the patent. Mc Quewan claimed through a license granted during the original term of the patent the right to construct and use the patent machine. Mc Quewan acquired this right from one Barnet who had received the right from the Collin and smith who did not have the right to construct and use themselves and could only license to Barnet. The defendants purchased right use the machine from the Barnet along with the right to construct and use certain number of machines. The defendants continued to use the machine even during the extended patent period. The plaintiffs challenged that the defendants did not have the right to use the machine during the extended period of patent since they had acquired right only to use it during the original patent period. The court while deciding whether it constitutes infringement to use the machine after the expiration of the original patent period, the court distinguished between an assignee and an ordinary purchaser of a patent machine. The court found that the franchise holder or the assignee of a patent stands in a different footing from that of the ordinary purchaser who has purchased the good for using it in the ordinary pursuits of life. The franchise holder who acquired his rights from the patent holder gets a portion of the patent rights granted by the statute i.e. he is selling the statutory rights to make, use, sell the product, and hence shall terminate when the statutory right of the patentee ends. While the normal purchaser does not purchase any statutory rights but the product as a whole and does not gather any statutory monopoly rights from the patentee.

In using it, he exercises no rights created by the intellectual property law, nor does he derive title to it by virtue of the franchise or exclusive privilege granted to the patentee. "The inventor might lawfully sell it to him, whether he had a patent or not, if no other patentee stood in his way. And when the machine passes to the hands of the purchaser, it is no longer within the limits of the monopoly. It passes outside of it, and is no longer under the protection of the act of Congress".[29] The court further finds that the property so sold by the patentee

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[28] *55 U.S. 539 (1852)*

[29] *Bloomer* v. *Mc Quewan, 55 U.S. 549 (549).*

becomes the private individual property of the purchaser. Thus, the court clearly differentiates between the intellectual property rights of the ip holder and that of the normal property ownership of the purchaser who lawfully acquired the same. Upon this premise, the court concluded that the defendants who used the machine as a part of their normal business purpose could continue to use the machine even during the period of extension of the patent. Court also further held that if the rights granted under the statute to the ip holder be so construed that it could deprive a legitimate purchaser who purchased the unlimited absolute ownership over an article from using the same property as he wishes, it would be an inappropriate interpretation of the law. The implication of this language of the court is that using intellectual property rights one cannot restrict the ownership of a legitimate purchaser.

In another landmark case *Mitchell* v. *Hawley*[30] the patentee for the improvements in the machine making felting hats, licensed another person the right to make, use and sell and give license for the same to another person's during the time of the patent but shall not have the same after the expiration of the original patent period. Bayley, a licensee, constructed four machines, being two sets, and sold the machines, "with the right to run" the same, to the persons from whom the respondents bought the machines who were referred to as the licensees to run and use the machine. After the expiration of the patent, the same was extended and the complainants became the assignees during the extension period and the complainants wanted to restrain the respondents from using the said four machines purchased from the licensee under the original patents. The court in the present case depended on the above case *Bloomer* v. *Mc Quewan* and reiterated the exact words as in the case splitting the intellectual property rights and the normal property rights. The court however found the case against the respondents since the intermediate licensee, i.e. Baylee, had only the right to construct and use only during the time of patent period and he could not transfer a better title than what he possessed and thus the respondents obtained only the right to use and construct during the original period of patent.

In *Adams* v. *Burke*,[31] letters patent was granted to Merrill & Horner for a certain improvement in coffin lids, giving to them the exclusive right of making, using, and vending to others to be used, the said improvement. Merrill& Horner, the patentees, by an assignment duly executed and recorded, assigned to Lockhart & Seelye, of Cambridge, in Middlesex County, Massachusetts, all the right, title, and interest which the said patentees had in the invention described in the said

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30 *83 U.S. (16 Wall.) 544*

31 84 U.S. 453 (1873)

letters patent, for, to, and in a circle whose radius is ten miles, having the city of Boston as a center. They subsequently assigned the patent, or what right they retained in it, to one Adams. Burke was an undertaker who had purchased the said coffins from the Adams and used it outside the limits assigned for Adams to use. Hence, Adams filed a suit against Burke for patent infringement.

The court began to expand and explain the rationale behind the holdings in different cases wherein the courts have held that the right to use does not get extinguished upon the expiration of the patent. The rationale, as the court has opined, was that "*the sale by a person who has the full right to make, sell, and use such a machine carries with it the right to the use of that machine to the full extent to which it can be used in point of time.*"[32] So the question arises as to what is the meaning and extends of the same of the word "use to the fullest extend". The court was specifically concerned with the product in question in the present case (coffin) and the products of like nature. The court opined that in such products the sole value of the product lies in the use of the same and therefore once the patent owner has sold the same to a lawful purchaser and having received the royalty for the same, then patentee could not further restrict the use of the product and the purchaser can use it as he wishes.[33] In the specific case the undertaker could use the coffin only for selling it to others and use and sale in the instant case mergers. Therefore, the use extends to sale too. Therefore, the territorial limitation upon the sale and use of the coffin limited by the contract was held void.

The position in the case *Adams* v. *Burke* was further clarified in a subsequent case that followed that is *Keeler* v. *Standard Folding-Bed Co.*,[34] In this case the complainants were the Standard Folding – Bed Co who were the assignees of the patentee of a improvement in the wardrobe bed steads, for the area of Massachusetts. The company of the patentee holds the patent rights for the area of Michigan. The defendant that is Keeler purchased a car load of beds from Michigan and sold at Massachusetts and also in Boston which is the principal place of business of the defendants. The court in this case was clearly trying to recognise the right of the person, who has purchased an article from the patentee, to dispose of the same as he wishes. "Where the patentee has not parted, by assignment, with any of his original rights, but chooses himself to make and vend a patented article of manufacture, it is obvious that a purchaser can use the article in any part of the United States, and, unless restrained by contract with the patentee, can sell or dispose of the same. It has passed outside of the monopoly, and is no

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32 84 U.S. 455 (1873)

33 *Adams v. Burke* 84 U.S. 453. at 456.

34 157 U.S. 659 (1895)

longer under the peculiar protection granted to patented rights."[35]The court further went on to analyse the position of an ordinary purchaser and was trying to answer a number of questions pertaining to it. The court first enquired the question what are the rights of a purchaser who has bought an product from the patentee himself in the area assigned to the patentee and does the purchaser obtain an absolute property right over the product which enables him to use and vend the same in any part of the country.

The court also addressed the issue of territorial division strategy used by the patentee and whether a purchaser of an article from an assignee of a territory, pay to the local assignee for the privilege of using and selling his property. The court in order to address these questions relied on all the cases stated above especially Adams v. Burke. the court was of the opinion that these cases where, no doubt, authorities stating that the purchaser of an patented product had the absolute right to use the product until the product gets worn out. The court further added that the case of *Bloomer* v. *Mcqueen* was also an authority for the proposition that the purchaser chaser of a patented machine has not only the right to continue the use of the machine as long as it exists, but to sell such machine[36]. The court also further depended upon *Adams v. Burke*[37] for concluding that certain instances can arise as in the case in the case, wherein the use and the sell of an patented product gets merged and the right to use accompanies with it the right to sell[38]. The court further opined that, "when the royalty had once been paid to a party entitled to receive it, the patented article then becomes the absolute, unrestricted property of the purchaser, with the right to sell it as an essential incident of such ownership".[39]The ultimately concluded that "Upon the doctrine of these cases, we think it follows that one who buys patented articles of manufacture from one authorized to sell them becomes possessed of an absolute property in such articles, unrestricted in time or place".[40]

Turning to the copyright cases the one which stands out among them is *Bobbs-Merrill Co.* v. *Strauss.*[41]Bobbs Merrill was the copyright owner of a book named castaway. They have attached a notice in the book stating that the price of the book and that no dealer should sell the book below that price. The defendants purchased the book from an a wholesale dealer and sold it below the prescribed

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35 157 U.S. 659 (1895) at 662

36 Ibid at 662

37 *84 U.S. 453 (1873)*

38 157 U.S. 659 (1895) at 664

39 157 U.S. 659 (1895) at 667.

40 Ibid.

41 210 U.S. 339 (1908).

price. Plaintiffs sued for copyright infringement. The court in this specific case addressed the extend of the right to vend guaranteed by the copyright statute. The court in the instant case opined that the purchaser who buys the product from an authorised seller may sell it gain. "What does the statute mean in granting 'the sole right of vending the same'? Was it intended to create a right which would permit the holder of the copyright to fasten, by notice in a book or upon one of the articles mentioned within the statute, a restriction upon the subsequent alienation of the subject-matter of copyright after the owner had parted with the title to one who had acquired full dominion over it and had given a satisfactory price for it? It is not denied that one who has sold a copyrighted article, without restriction, has parted with all right to control the sale of it. The purchaser of a book, once sold by authority of the owner of the copyright, may sell it again, although he could not publish a new edition of it."[42]The court was of the opinion that the right to make copies was the main right guaranteed under the copyright statute and vending right was to facilitate the same and does not allow creating a right by attaching a notice to the copyrighted work.

The complainants had argued that the rights created by the statute were the absolute ownership of the copyright owners and therefore they could decide up to which length they need to part their rights and also could reserve certain rights to themselves when they a sell a product. The court in order to nullify this argument analysed the nature of the intellectual property and the rights guaranteed for the creation of the same. Quoting another case for the same court opined "The copyright is an exclusive right to the multiplication of the copies, for the benefit of the author or his assigns, disconnected from the plate, or any other physical existence. It is an incorporeal right to print and publish." The court further held that the copyright owner could not restrict the purchasers of a copyrighted material by fastening a notice to it as such a right is not granted under the statute. And also in the instant case the defendant purchased the book from whole sale dealers who did not undertake to sell the book at the stipulated price in the notice even though they were aware of the notice and hence all the more not liable.

Conclusion

Thus from the above analysis it is clear that the concept of exhaustion developed mainly as a response towards the undesirable extension of the monopoly rights by the intellectual property owner. The courts aim was to restrict the owner of the intellectual creations from restraining a legitimate purchaser of

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[42] 210 U.S. 339 (1908) at 350.

a property from enjoying his property who may have an legitimate expectation of enjoying the same. The court therefore has taken refuge under the general property laws having roots in the common law to do the same. The effort of the court to split the intangible element and the tangible element in an product containing intellectual property sheds light in this direction. The principles employed by the courts too are pointing in this direction. The courts in the cases pertaining to the exhaustion had either skipped or answered in negative regarding the question whether they could limit the further sale by contract. But depending on my presumption that exhaustion drawing its roots from restraint of alienation, common law and courts has clearly demarcated that legal right to sell cannot be controlled through an express contract provided an absolute ownership is present.[43]

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43 *Potter* v. *Couch* (1891),141 U.S. 296.