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## **Making Rules in the WTO: Lessons from Article 6 of the TRIPS Agreement**

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This article analyzes rule making in the WTO with special reference to Article 6 of the TRIPS Agreement. Two competing approaches to parallel imports characterized the Uruguay Round negotiations: to prohibit parallel imports or to permit them. The contracting parties were adamant in holding to their competing positions; therefore, the negotiators designed Article 6 of the TRIPS Agreement with an open texture so that both of these competing approaches could be legitimized. Consequently, the nature of Article 6 of the TRIPS Agreement is extremely complex, leading to disharmonious legal regimes and practices at the domestic level. Moreover, the wording of Article 6 has resulted in a disguised form of protection of embedded producer interests at the cost of consumer interests. Against this background, this article argues for the need to establish the true nature of Article 6 of the TRIPS Agreement, that is, as embodying international exhaustion rules in light of the Paris and Berne conventions.

Keywords: exhaustion, open texture, parallel imports, rule making, trade negotiations

## 1. Concept of Parallel Imports (Exhaustion)

Four terms – *parallel imports*, *grey market for imports*, *first sale*, and *exhaustion* – are often used to refer to a single concept in the context of intellectual property rights. In this article these terms are used interchangeably – though the terms *parallel imports* and *exhaustion* are used more frequently – to mean that when an owner of intellectual property rights (IP) produces or licenses another company to produce the IP products in more than one country, and when such products are commercialized on the markets, those products are supposed to be available for export and import anywhere else in the world. This means the licensor or licensee in one country cannot prohibit the importation of the same goods (protected under the same IP) from another country. To put it another way, the right is exhausted to prohibit importation of the same goods from another country. Another way to express this is to say that parallel (same) products can be imported from anywhere else in the world.

This exhaustion doctrine is developed in three variants: international exhaustion, regional exhaustion, and domestic exhaustion. Let us take an example: A company called “A” has a patent on a particular good – say widgets – and A has licensed his patent to a company called “C” in California to produce widgets and sell them in the United States except in the New England area. Similarly, A has licensed a company called “N” in New Hampshire to produce widgets and sell them within the New England Area; A has licensed a company called “D” in Denmark to produce widgets and sell them in Denmark; and A has licensed a company called “F” in France to produce and sell widgets in France. Further, A has licensed a company called “I” in India to produce widgets and to market them all over the world except on the markets of the EU and the United States. Let us say that all these licensee companies have produced widgets and brought the product to the market. In this context, disrespecting the contract between licensor A and licensee companies C, D, I, and N, if the products are exported or imported from these four different producers for sale on the market anywhere else in the world including the segmented market areas of C, D, I, and N, that would be called international exhaustion. If the products from the companies D and F are brought on the market of the EU beyond Denmark and France, then the rights of company D or company F to restrict each other to sell only within the national boundary will be exhausted and their market will be extended to the whole EU. This is an example of regional exhaustion. Similarly, if widgets are produced both in California and New Hampshire, segmentation at the domestic level is exhausted when goods from C and N companies are transported and sold to one another’s segmented areas.

This example shows how parallel imports and corporate power of market segmentation often turn out to be competing concepts. This raises challenging policy questions, such as whether corporate power of market segmentation under sanctity of contract should be allowed to prevail over parallel imports or not, and whether consumer welfare should be subordinated to embedded producer interests or not. These questions are discussed below in the context of Article 6 of the Agreement on Trade Related Aspects of Intellectual Property Rights (TRIPS). However, before these issues are discussed, it is important to examine the nature of Article 6 and the circumstances under which it was designed.

## **2. Nature of Article 6 of the TRIPS Agreement**

Article 6 of the TRIPS Agreement reads as follows:

For the purpose 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.

Is the language used in this provision clear enough to determine what is the rule about exhaustion? Or, put another way, what jural relations has this provision created for the members of the WTO? These questions demand an explication of the provision rather than a “yes” or “no” answer.

While designing rules on parallel imports in the Uruguay Round, the negotiators for the various parties mainly presented three different positions. The United States<sup>1</sup> and Switzerland<sup>2</sup> argued for domestic exhaustion, i.e., to prohibit parallel imports, the EU<sup>3</sup> argued for regional parallel imports, i.e., regional exhaustion, and other countries, including Australia,<sup>4</sup> India,<sup>5</sup> and New Zealand,<sup>6</sup> argued for an international exhaustion rule, that is, to permit parallel imports.<sup>7</sup> To prohibit parallel imports would mean to allow protection of domestic producers from foreign competitors by prohibiting importation of parallel products produced by foreign firms under intellectual property licenses granted by the domestic firms. To allow regional parallel imports would mean goods produced under intellectual property licenses could be imported only within the regional trading block. An international exhaustion rule would imply no prohibition on exportation or importation of goods produced anywhere else in the world irrespective of an intellectual property license.<sup>8</sup> It is clear that these three variants would produce three different results.

At the end of the day, Article 6 of the TRIPS Agreement was designed to give latitude to the members so that all of the competing concepts of exhaustion could be legitimized. As a result, members have different domestic rules on the issue of parallel imports. Essentially, this approach has caused disharmony among the legal regimes

and practices among the WTO members.<sup>9</sup> Moreover, it has resulted in a disguised form of protection of the embedded interests of producers at the cost of consumer interests. There are notably two schools of thought on the issue of exhaustion. Some argue the principle of exhaustion is a necessary ingredient in balancing the exclusive rights of intellectual property owners and the needs of markets.<sup>10</sup> Others argue that to apply the exhaustion of rights doctrine on only a domestic scale has a protectionist effect, since a ban on parallel imports avoids competition from abroad.<sup>11</sup>

*Prima facie* Article 6 of the TRIPS Agreement authorizes members to manage the issue of exhaustion on their own. The “open texture” nature of this provision basically offers three options to WTO members: permit parallel imports, prohibit parallel imports, or be silent. Members who permit parallel imports comply with the TRIPS regime. Members who prohibit parallel imports also comply with the TRIPS regime. Members whose legal system is silent on parallel imports also comply with TRIPS.

In the face of this open texture,<sup>12</sup> each member decides what would be proper for that member. The private sector basically licenses intellectual property rights through a mechanism of contract law, and in many cases these contracts segment the market. The legality and validity of such segmentation of the market might become exhausted when parallel imports are permitted. This might lead to a critical public-private dichotomy of law. However, a prohibition on parallel imports would allow market segmentation. The only precondition of the TRIPS Agreement is that whichever way members choose to go, it should be non-discriminatory.<sup>13</sup> Thus the question arises of how free WTO members are to choose one of these options in designing their domestic legal regime if their choice would be disharmonious with the legal regimes of other members.

### **3. Is the Open Texture of TRIPS Article 6 Neutral and Harmonious?**

Why was Article 6 of the TRIPS Agreement designed to be an open texture provision? The article is certainly evidence of the failure of the Uruguay Round negotiations to transmute competing concepts into a coherent framework of rules. Some of the contracting parties to the GATT 1947 favoured parallel imports, advocating for the expansion of consumers’ welfare; at the same time, other contracting parties to the GATT advocated instead for the interests or welfare of producers. The Uruguay Round negotiations could not arrive at a convincing balance between these competing interests, and the result was a provision with an open texture.

Longdin identifies the provision as embodying neutrality in WTO rule making, because it consists of a hands-off approach.<sup>14</sup> As the Uruguay Round Agreement did not line up on either side of the contentions – permission for or prohibition of parallel

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imports – perhaps it could be termed a “neutral rules making approach”. But in reality it is not neutral. The form of Article 6 of the TRIPS Agreement is indeterminate. Therefore, its true nature can be better elucidated in terms of H.L.A. Hart’s theory of “open texture”.<sup>15</sup> The open texture of this provision gives freedom to WTO members to devise rules as they deem good and proper from their own points of view. The final outcome will not be neutral but rather disharmonious, and thus it will serve the interests of the more powerful members.

A curious point is that it is not only Article 6 of the TRIPS Agreement that has embodied open texture in dealing with exhaustion; other intellectual property rights conventions have also opted for a similar path. For example, the World Intellectual Property Organization (WIPO) Copyright Treaty, 1996, and the WIPO Performers and Phonograms Treaty, 1996, have opted for open texture on the issue of parallel imports. Nevertheless, there is a qualitative distinction between the open texture modality adopted by TRIPS Article 6 and the open texture modality adopted by WIPO treaties. For instance, Article 6.2 of the WIPO Copyright Treaty<sup>16</sup> and Article 8.2 of the WIPO Performers and Phonograms Treaty (WPPT), 1996,<sup>17</sup> have the same language. The striking difference between TRIPS Article 6 and these WIPO treaties is that, presumably, under the former WTO members have three broad options – prohibit, permit, or be silent – but under the latter the contracting parties have only one option, that is, they are required to legalize parallel imports but can determine conditions on their own.

Nothing except the interest of legitimizing a mechanism for promoting constructed advantage at the domestic level justifies WIPO and TRIPS bearing different modalities on exhaustion of intellectual property rights despite the Cooperation Agreement between the two organizations.<sup>18</sup> Simultaneously, to suppose that TRIPS Article 6 allows members to choose any of the three options discussed above would be explicitly to ignore Articles 1-12 and 19 of the Paris Convention, 1883, provisions that are obligatory to WTO members under Article 2 of the TRIPS Agreement itself. Under Article 5(A)(1) of the Paris Convention, importation of a product by a patentee or a licensee into the country where the patent has been granted of goods manufactured in any of the countries of the Union (members of the Paris Convention) cannot be forfeited. Likewise, Article 5(B) of the Paris Convention provides that under any circumstances the protection of industrial designs shall not be subject to any forfeiture, either by reason of failure to work or by reason of the importation of articles corresponding to those which are protected. Similarly, Articles 9 and 10 of the Paris Convention provide that only importation of goods bearing false indication of mark and goods unlawfully bearing a mark will be forfeited. Importation

of genuine goods produced within the Union cannot be forfeited. Under articles 13 and 16 of the Berne Convention, 1886, imported, legally produced goods cannot be seized. These provisions of the Paris Convention and Berne Convention clearly recognize the regime of parallel importation.

This distinction between the Paris Convention and Article 6 of the TRIPS Agreement raises the question of whether the TRIPS Agreement allows its members to derogate from their obligations under the Paris Convention. Article 2 of the TRIPS Agreement provides a clear answer to this question in that it states that WTO members shall comply with their obligations under the Paris Convention and nothing in the TRIPS Agreement shall allow WTO members to derogate from their obligations under the Paris Convention and thus maintain disharmonious legal regimes. Now, this poses the issue of how WTO members could resort to Article 6 of the TRIPS Agreement in contravention of the Paris and Berne Conventions. To put it plainly, members of the WTO are not supposed to design rules to prohibit importation of legally produced goods simply by cushioning against the open texture of Article 6 of the TRIPS Agreement. This interesting linkage between TRIPS and the Paris Convention, bolstered by Article 2 of the TRIPS Agreement, helps in filling a gap in the open texture and further offering a valuable insight into the true nature and meaning of Article 6 of the TRIPS Agreement.

#### **4. What are the U.S. Laws and Practices?**

Some specific examples in this regard can be taken from the domestic legal regime of the United States. Until the United States enacted § 526 of the Trade Act in 1922, parallel import into the United States was perfectly legal. Section 526 of the Trade Act, 1922, was enacted in response to a decision by a Court of Appeals in *A. Bourjois & Co. v. Katzel*,<sup>19</sup> in 1921. The Court of Appeals declined to enjoin the parallel importation of goods bearing a trademark that a U.S. company had purchased from a foreign company. The Supreme Court subsequently reversed the decision of the Court of Appeals, but before the decision of the Supreme Court was delivered on January 23, 1923<sup>20</sup> Congress had already enacted § 526 of the Trade Act, 1922. In the *Bourjois* case the Supreme Court held that, “A foreign manufacturer, who has sold his business in this country, with his goodwill and trade-marks, cannot come to this country and use his old trade-marks in competition with plaintiff, in view of the terms of the Trade-Mark Act Feb. 20, 1905, § 10, 15 U.S.C.A. § 90, authorizing assessments.”

In fact, the U.S. Trademark Act – the Lanham Act – does not prohibit parallel import and is fairly comparable to the Paris Convention, 1883. The Lanham Act still carries the same principle as enunciated in *Apollinaris Co. Ltd. v. Scherer*<sup>21</sup> in 1886

that once a trademarked product is placed on the market, trademark rights may not be used to control the product's further destination. So, it is not the trademark law but rather the customs laws that prohibit the parallel imports of trademarked products in the United States. For example, § 1526 (a) of the Tariff Act, 1930, of the United States<sup>22</sup> prohibits importation of goods having a trademark registered in the United States without the consent of the owner of such trademark. This provision clearly recognizes the power of market segmentation designed by the owner of the trademark and forbids importation of any such goods without the consent of the rights holder in the United States. The provision clearly shows how governments construct advantage for their domestic producers at the cost of foreign competitors.

Further, § 1526 (b) of the Tariff Act, 1930, allows seizure and forfeiture of any such merchandise imported into the United States. Similarly, § 1337 of the Tariff Act, 1930, prohibits importation of goods that infringe a valid and enforceable patent or copyright in the United States. The language used in § 1526 is different from the language of § 1337. The former clearly prohibits parallel imports without the consent of the owner, but the latter gives space to be interpreted in either way, i.e., parallel imports could be prohibited or might be allowed because the words "infringe a valid and enforceable" are open to interpretation. What can be said to infringe a valid and enforceable intellectual property right is a critical question in the context of § 1337. In fact, illegally produced, counterfeit, false, and misrepresented goods infringe valid and enforceable intellectual property rights. By contrast, parallel imports are imports of legally produced goods.

In the famous *Kmart Corp. v. Cartier, Inc.*<sup>23</sup> case, the U.S. Supreme Court held that a grey-market good is a foreign-manufactured good, bearing a valid United States trademark, that is imported without the consent of the United States trademark holder. Therefore, except in the case of parent-subsiary and same-owner importation, the parallel import is illegal in the United States. The major legal issue in this case was whether Rule 133.21(C) of the Customs Service Regulation was consistent with § 1526 of the Tariff Act or not. The petitioner in the U.S. District Court had asked for an injunction against implementation of Rule 133.21(C), as the rule made possible parallel imports in contravention to § 1526 of the Tariff Act. The petitioner insisted that § 1526 of the Tariff Act would forbid all kinds of parallel imports. The District Court denied the argument of the petitioner and justified Rule 133.21(C) consistent with § 1526. In the appeal the judgment of the District Court was reversed *in toto* by the Court of Appeals. The Supreme Court of the United States defined three possible situations of parallel imports (grey market) and among them justified one. In doing so,

the Supreme Court validated Rule 133.21(C) (1) & (2), and invalidated Rule 133.21(C) (3).<sup>24</sup>

Three situations involving parallel imports are identified. First, a foreign firm having a trademark licenses its trademark to a U.S. firm to register it in the United States and use it in the United States. At the same time, if the foreign firm or a third party imports the trademarked goods into the United States and distributes or sells them in the United States without the consent of the U.S. trademark holder, such action would constitute a parallel import. In this situation the domestic firm (U.S. firm) would be a prototypical victim because it would be forced into sharp intra-brand competition involving the very trademark it purchased. Believing that this type of parallel import could jeopardize the U.S. trademark holder's investment, the Supreme Court justified prohibition of parallel imports under § 1526 of the Tariff Act.

Under the second situation, the U.S. Supreme Court visualized three possible conditions with respect to parallel imports: (a) a U.S. subsidiary of the foreign parent, (b) a foreign subsidiary of a U.S. parent, and (c) the same firm in the United States and in the foreign market – where the trademarked goods would be imported into the United States after being manufactured abroad. The Supreme Court justified parallel import under conditions (b) and (c) in line with Rule 133.21(C) (1) & (2) and invalidated Rule 133.21(C) (1), which had allowed parallel import under condition (a). The rationale of the court was that in case (a) the U.S. company does not have control over the manufactured goods and therefore is not an “owner” of the produced goods, but in cases (b) and (c) the U.S. company holds direct control over the manufactured goods and therefore is an “owner” and an owner can import its goods from abroad into the United States, which has been the practice since the enactment of § 526 of the Tariff Act, 1922, and § 1526 of the Tariff Act, 1930.

Third, a U.S. firm holds a trademark in the United States and grants a licence abroad to an independent foreign firm to manufacture the good and use the trademark in the particular foreign location (segmented market). If the foreign firm exports the trademarked goods into the United States, such an action would be tantamount to a parallel import and banned under § 1526 of the Tariff Act.

This jurisprudence of the U.S. Supreme Court is especially important from the perspective of constructed advantage, which shows how laws are framed to protect domestic producers and help to create advantage for them over their competitors from around the world. The U.S. laws discussed above also show how laws can pose an implicit limitation to the non-discriminatory principles of the GATT/WTO.

## **5. Conclusion**

Article 6 of the TRIPS Agreement evidences the difficulties that underlie rule making in the WTO. When the ways in which members apply certain concepts differ diametrically and the members show reluctance in making trade-offs, it is extremely difficult to transmute such concepts into a harmonious framework of rules. The current negotiations in the Doha Round are also fraught with the same problem of transmuting concepts into harmonious constructs. Many approaches have been proposed to address this problem, and among them is the idea of open texture as employed in Article 6 of the TRIPS Agreement.

The scope of this article does not extend to discussing the specific problems of rule making in the Doha Round. But one of the surest lessons for the Doha Round from Article 6 of the TRIPS Agreement is that open texture inevitably results in disharmonious domestic trade rules and policies, which further derogates and weakens free trade – the foundation of international trade, peace, and cooperation. Currently, as a result of the open texture of Article 6 of the TRIPS Agreement, different members of the WTO have disharmonious domestic legal regimes with respect to parallel imports. For example, Australia, Brazil, China, India, Japan, New Zealand, and other WTO members have legitimized parallel imports, or, in other words, adopted the rule of international exhaustion. The European Union has adopted a regional rule of exhaustion. The United States has prohibited parallel imports. This disharmony among the legal regimes of the members certainly poses a stumbling block to international trade.

The disharmony is basically the result of the act of disconnecting the true nature and meaning of Article 6 of the TRIPS Agreement from Article 2 of the TRIPS Agreement and thus from WTO members' obligation to comply with the Paris Convention and the Berne Convention. In a nutshell, the problem of disharmony caused by Article 6 of the TRIPS Agreement can be addressed either by amending Article 6 itself or by establishing jurisprudence by the Dispute Settlement Body. However, Article 6 of the TRIPS is not on the agenda of the Doha Round negotiations; therefore, either a fresh negotiation to look at it is in order, or it demands interpretation by the Ministerial Conference or the Dispute Settlement Body. Either way, the issue needs to be addressed.

## Endnotes

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- 1 See Multilateral Trade Negotiations Uruguay Round, *Suggestions by the United States for Achieving the Negotiation Objective*, MTN.GNG/NG11/W/14/Rev.1 (17 October 1988).
- 2 See Multilateral Trade Negotiations Uruguay Round, *Synoptic Tables Setting Out Existing International Standards and Proposed Standards and Principles Prepared by Secretariat*, MTN.GNG/NG11/W/32/Rev.1 (29 Sept. 1989).
- 3 See Multilateral Trade Negotiations Uruguay Round, *Guidelines and Objectives Proposed by the EC for the Negotiations on Trade Related Aspects of Substantive Standards of Intellectual Property Rights*, MTN.GNG/NG11/W/26 (7 July 1988).
- 4 See Multilateral Trade Negotiations Uruguay Round, *Trade-Related Intellectual Property Rights Submission by Australia*, MTN.GNG/NG11/W/55 (8 Dec. 1989).
- 5 See Multilateral Trade Negotiations Uruguay Round, *Standards and Principles Concerning the Availability Scope and Use of Trade-Related Intellectual Property Rights Communication from India*, MTN.GNG/NG11/W/37 (10 July 1989).
- 6 See generally Louise Longdin, *Parallel Importing Post TRIPS: Convergence and Divergence in Australia and New Zealand*, 50 THE INTERNATIONAL AND COMPARATIVE LAW QUARTERLY 54, at 54-55 (2001).
- 7 See also DANIEL GERVAIS, THE TRIPS AGREEMENT: DRAFTING HISTORY AND ANALYSIS 199 (London, Sweet & Maxwell, 3rd ed. 1998).
- 8 For conceptual analysis of these different types of exhaustion rules see FREDERICK ABBOT, THOMAS COTTIER, & FRANCIS GURRY, THE INTERNATIONAL INTELLECTUAL PROPERTY SYSTEM: COMMENTARY & MATERIALS 1779-1817 (Kluwer Law International, 1999).
- 9 See CAROLYN DEERE, THE IMPLEMENTATION GAME: THE TRIPS AGREEMENT AND THE GLOBAL POLITICS OF INTELLECTUAL PROPERTY REFORM IN DEVELOPING COUNTRIES 75-76 (Oxford, Oxford University Press, 2009).
- 10 See FREDERICK ABBOT ET AL., *supra* note 8, at 605.
- 11 See PETER DRAHOS & RUTH MAYNE, GLOBAL INTELLECTUAL PROPERTY RIGHTS: KNOWLEDGE, ACCESS AND DEVELOPMENT 44 (New York, Palgrave Macmillan, 2002); see also A. Yusuf & Andres M. von Hase, *Intellectual Property Protection and International Trade—Exhaustion of Rights Revisited*, 16 WORLD COMPETITION 115-135, 128, (1992).
- 12 See H. L. A. HART, THE CONCEPT OF LAW 135 (Clarendon Press, 2nd ed., 1994).
- 13 See Art. 4 of the TRIPS Agreement.
- 14 See generally Louise Longdin, *Parallel Importing Post TRIPS: Convergence and Divergence in Australia and New Zealand*, 50 THE INTERNATIONAL AND COMPARATIVE LAW QUARTERLY 54, at 54-55 (2001).
- 15 See HART, *supra* note 12, at 126.
- 16 See WIPO Copyright Treaty (WCT) adopted in Geneva on December 20, 1996, available at < <http://www.wipo.int/treaties/en/>> visited on February 17, 2009.

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- 17 *See* WIPO Performances and Phonograms Treaty (WPPT) adopted in Geneva on December 20, 1996, available at < <http://www.wipo.int/treaties/en/>> visited on February 17, 2009.
  - 18 *See* WIPO-WTO Cooperation Agreement, available at <[http://www.wto.org/english/tratop\\_e/TRIPs\\_e/wtowip\\_e.htm](http://www.wto.org/english/tratop_e/TRIPs_e/wtowip_e.htm)> visited on February 18, 2009.
  - 19 *See* 275 F. 539 (CA2 1921).
  - 20 *See* 260 U.S. 689 (1923).
  - 21 *See* 27 Fed. 18 (SDNY 1886).
  - 22 *See* Tariff Act of 1930, 19 U. S. C. § 1526 (1930).
  - 23 *See* 486 U. S. 281 (1987).
  - 24 *See* Rule 133.21(C) of the Customs Service Regulation (1987).

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