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Parallel Imports: The Principle of Domestic Exhaustion of Trademark Rights and the Strict Non-infringement Exception

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Abstract: With the development of globalization, parallel importation has been one of the efficient instruments to promote free trade worldwide. However, the trademark protection involved in parallel importation is complex as it concerns many elements. There is no consensus among countries on the legal nature of parallel imports. This essay comprehensively applies the case law rules, the comparative research rules, the literature analysis and the historical analysis method, analyzing reasons for the dilemma of parallel imports and different postures of countries and regions towards it. Some countries oppose parallel importers based on the theory of domestic exhaustion of trademark rights, while other supports the act for the theory of international exhaustion of trademark rights. Then the essay compares different legal measures taken by the United States, the European Union, the United Kingdom and China in the face of parallel imports, and finally concludes that China should adhere to the principle of domestic exhaustion of trademark rights and the strict non-infringement exception for the balancing of private rights and public interests.

Keywords: Parallel imports, Exhaustion of trademark rights, The non-infringement exception.

1. Introduction

1.1. Definition of Parallel Imports

1.1.1. Parallel Imports

Parallel importation refers to the act of importing without the authorization of the owner of intellectual property rights in the imported state where the imported product that has been lawfully placed on the market by the owner himself or with the owner's consent in another country or region. Such unauthorized imports are referred to as parallel imports because they often run parallel to duly licensed imports. Also termed gray-market goods [1]. A well-known example of parallel import is the import of medical devices. Parallel importation of medical devices leads to increased availability of medical devices at a lower price [2].

1.1.2. Gray Market Goods: Parallel Import Goods

Parallel-imported goods are goods that have been produced in other countries or regions and entered the market of a particular country or region for sale through informal channels. These goods are

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usually purchased through formal channels but, due to price or other factors, are brought in and sold by other dealers or individuals from other countries without the authorization of the right owner in the importing country. Parallel imports are usually legal, but may lack the warranty and after-sales service support of the original manufacturer.

1.2. The Characteristics of Parallel Import

The characteristics of parallel imports mainly include the following three aspects: (1) It occurs in the market of cross-border international trade. (2) The targeted products are often legal goods that the trademark owner themselves or authorizes others to place in overseas markets, and have completed legal entry procedures, so they are also known as "genuine products". (3) Competition between domestic trademark registrants or licensed users (domestic legal providers) and domestic parallel importers often results in parallel importers offering lower prices than domestic legal providers, leading to market competition.

1.3. Rationale e of Parallel Imports

1.3.1. The Goods with the Same Trademark but in Different Price in Different States

Parallel imports appear due different levels of economic development and different market conditions in different countries (regions). Regional economic disparities causes price gap of the same goods among countries or regions. When the selling price of the same commodity in state A is lower than that in state B, the merchants in state B are drove to import the commodity from state A and resell it in state B to earn more profits. “The fluctuation of currency exchange rate creates opportunities for importing and selling such goods at a discount rate lower than the local price level [3]."

1.3.2. Reasons for Different Prices in Different Countries

Different countries adopt different prices because: (1) Different countries have different formulas, qualities, etc. (2) Different financial policies such as taxation and exchange rates in different countries result in price differences for goods of the same quality. (3) Consumers in different countries have varying levels of price affordability.

1.4. Supporting and Opposing Parallel Imports: the Two Theoretical Controversies

1.4.1. The Issue of Whether Parallel Import Complies with the Law

With the development of trade liberalization, the construction of free trade zones, and the rise of online marketing, there is an urgent need for legislative and judicial responses from various countries regarding the legitimacy of parallel imports of trademarks, namely whether the infringement claim of the trademark rights of the importing country stands in case of parallel imports.

As an international trade issue closely related to intellectual property, this issue is not only one of the focal points in international trade competition, but also one of the long-standing and controversial thorny issues in intellectual property law.

1.4.2. The Exhaustion of Trademark Rights

There are two theoretical disputes based on trademark rights exhaustion, namely the domestic exhaustion of trademark rights and the international exhaustion of trademark rights

Continental legal system: In the late 19th century, Joseph Kohler, a scholar from Germany, first proposed the theory, which was accepted by the German Supreme Court.

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Common law system: The U.S. Supreme Court also confirmed the theory in the Adams v. Burke (84 U.S. 453 (1873)).

It is considered that the goods using the registered trademark have been lawfully placed on the market by the right owner or other entitled persons, and the trademark owner ‘s trademark rights in these products have been realized and their rights have been extinguished due to exhaustion. The right owner thus lost control over the resale of the product.

The theoretical community agrees that "first-time sales" of goods are not an issue when it comes to trademark rights. However, there is a debate between domestic and international exhaustion of trademark rights, leading to two major theoretical discussions on the legitimacy of parallel imports.

1.4.3. Oppose Parallel Importers Based on the Theory of Domestic Exhaustion of Trademark Rights

If a trademark has been registered in various countries around the world, and after the trademark owner licenses the goods bearing the mark to enter the market of a country, if the trademark rights on the goods will be exhausted only in that country’s market, then selling the goods in another country or region without permission constitutes trademark infringement.

1.4.4. Supporting Parallel Importers Based on the Theory of International Exhaustion of Trademark Rights

If the trademark rights on the goods have been exhausted not only domestically but also worldwide, then selling goods bearing the trademark in another country or region does not constitute infringement [4].

1.4.5. No Consensus on the Legitimacy of Parallel Imports among Countries

Some international conventions related to trademark rights, such as the Paris Convention for the Protection of Industrial Property, the Agreement on Trade Related Aspects of Intellectual Property Rights (TRIPS), as well as the Madrid Agreement on the Registration of Marks, do not explicitly mention or address the legitimacy of parallel imports or its opposition [5].

Especially TRIPS explicitly avoids this issue. According to relevant scholars, in the negotiation process of TRIPS, many states, even including Germany, Japan, Finland, Norway and other countries, supported the international exhaustion principle of intellectual property rights and advocated the legalization of parallel imports. However, they were strongly opposed by other countries like the U.S., Canada, France, Australia and others. Therefore, the debate on exhaustion of rights exhausted the negotiators and ultimately reached a compromise solution, namely Article 6 of TRIPS, which stipulates that "for the settlement of disputes under this Agreement, no provision of this Agreement shall be applied to the issue of exhaustion of rights involving intellectual property rights".

Currently, only the European Union has clear provisions in regional treaties. The European Economic Area (EEA) agreement generally applies the principle of exhaustion of rights, which means that the exhaustion of trademark rights theory is adopted within the member states of EEA, but also providing exceptions, that is, if the condition of the goods changes or for the damaged condition of such products after being put on the market, or otherwise the trademark reputation is damaged due to repackaging, etc., the exhaustion of trademark rights within community does not apply and parallel imports are prohibited.

Obviously, various countries have not reached a consensus on the issue of parallel imports.

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parallel imports. They were strongly opposed by countries such as the United States, Canada, France, Australia and others [6].

Russi legalized the Parallel imports in 2022. On June 21st, the plenary session of the Russian State Duma (lower house of parliament) approved a legal amendment submitted by the Russian Federation government to legalize "parallel imports" in Russia. The amendment to the law stipulates that the use of patent achievements and brand logos reflected in "parallel imported" goods does not constitute infringement, and Russian companies that "parallel imported" goods without the permission of intellectual property holders shall not bear relevant civil, administrative, and criminal responsibilities. On June 22, the Council of the Russian Federation (upper house of parliament) reviewed and quickly approved the draft law titled "Legalization of Parallel Imports of Goods in the Russian Federation".

2. Latest Regulations and Cases of Parallel Importation in the United States, EU, England and China

2.1. U.S. Regulations and Cases of Parallel Imports

2.1.1. U.S. Code on Parallel Importation of Trademark

Article 1526 of Chapter 19 of the United States Code stipulates rules of merchandise bearing American trademark regarding parallel import in U.S. federal law. The main content is that the United States prohibits the parallel import of any goods with registered trademarks in the United States, unless the the goods is imported with proper licenses from the trademark owner.

2.1.2. U.S. Cases on Parallel Importation

PERUGINA chocolate comes from Italy and is produced in Italy. Society des produits Nest, S.A. (Nest S.P.N.) is the proprietor of the trademark PERUGINA. For decades, the appellant, Casa Helvetia, Inc., was the authorised distributor of PERUGINA chocolate in Puerto Rico. On 28 November 1988, however, Nestle abandoned Casa Helvetia and appointed its subsidiary Nestle P.R. as the exclusive distributor in Puerto Rico. In March 1990, Casa Helvetia, without the consent of Nestle S.P.N., began purchasing chocolate manufactured in Venezuela through intermediaries, importing it into Puerto Rico and distributing it under the brand name PERUGINA.

Nesle S.P.N. and Nesle P.R. (hereinafter collectively referred to as "Nesle") filed a lawsuit under the Lanham Act of 1946, accusing Casa Helvetia of infringing Nesle S.P.N.'s registered trademark and Nesle P.R.'s exclusive distribution rights. They claim that Casa Helvetia's use of the PERUGINA label "may mislead consumers into believing that Venezuelan chocolate is the same as Italian chocolate and is sold in Puerto Rico with Nestle's authorization".

The district court initially denied Nestle's motion, holding that the differences between Casa Helvetia's imports and Nestlé's products were not sufficient to constitute infringement. However, the Court of Appeals for the First Circuit reversed the District Court's decision, holding that trademark owners and exclusive licensees are entitled to protection under the Lanham Act from the importation of so-called “grey goods” even if the goods are legally licensed as trademarks in the country of origin.

The appeal court hold that the mere licensing of production abroad does not support an inference of consent to import the licensed products into the United States. When a product that caters to foreign local conditions competes with a physically different product with the same name in China, consumers are likely to be confused. In this case, foreign products can be legally called "copying or imitating" domestic trademarks, because using the same name is "not in line with the facts at all" [7].

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2.2. Regulations and Cases of Parallel Importation in EU

2.2.1. Regulations Related to Parallel Importation in EU

The most important regulations of parallel import in EU are stipulated in the PROTOCOL 28 of Agreement on the European Economic Area (EEA) and Article 7 of Directive No. 2008/95/EC. Both agreements stipulate the exhaustion of trademark right principle, that is, within the community, goods that has been put on the market with the permission of the trademark owner can be freely imported into another community member, and the trademark owner has no right to prohibit it, unless the condition of the goods has been changed or impaired after being put on the market.

In addition to the uniform provisions of the European Union, countries can also make specific provisions on parallel imports. For example, the German Act on the Protection of Trade Marks and other Signs stipulates the exhaustion doctrine principle of trademark rights in Section 24. But it is basically a domestic transformation of the community treaty, and the content is basically the same.

2.2.2. Cases on Parallel Importation in EU

2.2.2.1. Centrafarm v. American Home Products

The defendant, Centrafarm, had eliminated the SERENID trademark attached to a pharmaceutical product sold by the plaintiff in the United Kingdom by replacing it with the SERESTA trademark used by the plaintiff for the same pharmaceutical product in the Netherlands and then parallel importing it for sale in the Netherlands.

In this case, the European Court of Justice held that the defendant's replacement of the trademark was manifestly excessive and that the plaintiff was therefore fully entitled to prohibit any parallel importation of the trade mark without its consent [8].

2.2.2.2. Harman International Industries Inc. v. AB S.A.

Harman, a multinational group of companies producing microphones, headphones and audio playback equipment, sued AB for infringement of its trademark rights by purchasing the trademarked goods in question from suppliers other than Harman's authorized distributors responsible for the Polish market and selling them on the Polish market.

The court held that the principle of exhaustion of rights applies to goods placed on the market within the EEA. If goods are placed on the market outside the EEA, the owner may object to the importation of those goods within the EEA without his consent, even if they are listed in other countries with the consent of the trademark owner [9].

2.3. Regulations and Cases of Parallel Importation in UK

2.3.1. Legal Provisions on Parallel Importation of Trademark

As the EU issued the Directive No. 2008/95/EC, which stipulated the exhaustion of trademark right principle, Britain had not left the EU. Therefore, the British Trademark Law also stipulated the exhaustion doctrine principle, in Article 12, and the content was consistent with the Directive No. 2008/95/EC. That is, the trademark owner has no right to prohibit the parallel import of goods within the scope of the European community.

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2.3.2. Cases on Parallel Importation of Intellectual Properties in UK

Given that the UK regulations are the same as the EU, it is also clear from UK's jurisprudence that there is no right for a trademark owner or trademark licensee in the United Kingdom to prohibit its subsidiaries established in European community from importing the same trademark goods into the country.

2.4. Regulations and Cases Related to Parallel Importation in China

2.4.1. Intellectual Properties Sector Law on Parallel Importation

There is no provision of "the exhaustion of trademark rights" or "parallel import" in Chinese Trademark-related law.

Regulations of the People's Republic of China on Customs Protection of Intellectual Property Rights (2018 Revision) Article 2, Article 3, Article 5 provides that import should not infringe Chinese trademark rights. But customs administrative protection is subject to judicial review in China.

There are different judgments on parallel import in judicial precedents in China.

2.4.2. Cases on Parallel Importation of Intellectual Properties in China

In the case of Victoria's Secret Store Brand Management Co., Ltd. v. Shanghai Jintian Clothing Co., Ltd., the defendant Jintian bought genuine underwear merchandise from LBI-the foreign parent company of Plaintiff, Victoria's Secret [10]. Then the defendant Jintian sold the merchandise to a number of domestic retailers on a wholesale sales basis.

The court hold that the goods sold by the defendant are genuine goods purchased from LBI and imported through proper channels, not counterfeit goods.

First, no infringement of tm use on goods: the defendant's use of the plaintiff's registered trademark in the process of selling the goods on the hangtags, hangers, bags, and brochures is a part of the sales behavior, and will not cause confusion and misidentification of the source of the goods to the relevant public.

Second, infringement of tm use on services: the defendant prominently used the "VICTORIA'S SECRET" logo in many places in the sales shop. This behavior went beyond the necessary scope to indicate the goods sold, and it had the function of indicating and identifying the source of the service, which constituted an infringement on the exclusive right of the above-mentioned service trademark.

From the perspective of the relevant legal provisions, the sales behavior of Schiff is not in line with the infringement of the exclusive right to use registered trademarks as expressly stipulated in Article 57 of the Trademark Law of the People's Republic of China.

Based on the evidence provided by Schweppes, the products it sold were legally imported genuine products, not counterfeit products. In judicial practice, such products belong to "parallel imported" products. Therefore, in order to better balance the relationship between the trademark owner, distributors, other operators, consumers in general, and national public policy. If the goods originate from the trademark owner and the trademark owner has realized the commercial value of the trademark from the "first" sale, the trademark owner should not be given the right to prevent others from "second" sales. The right to prevent others from making a "second" sale should not be granted to the trademark owner.

The applicable geographical issues in parallel imports, and the national economy and public policy is closely linked. China adheres to the basic national policy of opening up to the outside world, actively promotes the "Belt and Road" international collaboration, pursues trade cooperation and smooth flow, and guarantees the freedom of circulation of legitimate goods and services of the countries along the "Belt and Road" [11].

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3. The Principle of Domestic Exhaustion of Trademark Rights & The Strict Non-infringement Exception

3.1. Unravel the Dilemma of Parallel Imports

3.1.1. Principles: Domestic Exhaustion of Trademark Rights & Prohibiting Parallel Import

The solution of parallel imports in China requires adherence to the principle of domestic trademark rights exhaustion, with the exception that parallel imports that do not differ materially are lawful.

The principle of regionality of trademark rights is the most important, and the exhaustion of trademark rights comes as the second. The exhaustion principle is within the geographical scope covered by the trademark right, the trademark owner's right to the goods within the scope of the market exhaustion. Even in cases where the foreign trademark owner and the importing country's trademark owner are the same entity, the connotations and reputation of these two trademark rights are different, and they are based on the laws of different countries, and are therefore independent of each other. Importing country to determine whether the parallel importation of infringement is not based on the exhaustion of trademark rights in foreign countries. The principle of exhaustion of rights cannot be used as a theoretical basis to support parallel imports [12].

3.1.2. Exception: No Damage of the Functions of Trademark Rights

The exception of domestic exhaustion of trademark rights is strictly restricted. Such behavior should have no damage of the functions of trademark rights, which subject to the material difference principle:

(1) Domestic legal goods and parallel imported goods originate from the same entity or the same actual controlling entity. There is no harm to the source identification function of trademarks.

(2) Any post-market changes in product quality should not jeopardize the function of trademark quality assurance.

(3) The quality varies: prohibits parallel import.

(4) The services vary: difference views, import policy.

If parallel import is absolutely prohibited, it will easily form the monopoly position of trademark owners, exclude market competition and free trade, and it is bound to protect domestic monopoly and high price by prohibiting parallel import of the same goods at low prices, which will harm consumers' interests and become a non-tariff barrier to cross-country merchandise. When the foreign trademark owner and the trademark owner of the importing country are the same subject or have some essentially the same relationship, the domestic trademark owner can control the quality and characteristics of the imported goods. If the goods referred to by the same trademark are of the same quality and the reputation of the same trademark is basically the same in all countries or some countries, then the realistic basis on which the regional characteristics of trademark rights are based will be weakened or eliminated, and the territoriality of trademark rights will be weakened. Theoretically, the exhaustion of trademark rights can break through the geographical restrictions, and form the international (or regional) exhaustion of trademark rights. At this time, the parallel import of trademark rights does not constitute trademark infringement and should be allowed [13].

3.2. The Bases and Reasons in Favor of the Territoriality of Trademark Rights

3.2.1. National Sovereignty: Different Countries Have Different Politics, Economy, and Culture

One of the important features of trademark law is its national character, and its application must be confined to the geographical boundaries of the sovereign State. Although with the birth of a large

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number of international conventions such as TRIPs, the intellectual property legislation and implementation of various countries are becoming more and more consistent, the domestic laws of various countries are still an important basis for the delimitation of various intellectual property rights, including trademark rights, the allocation of rights and the confirmation of the boundaries of rights. The geographical boundaries of each country and judicial sovereignty as the limit to protect trademark rights, is still the basic foothold and starting point of trademark legislation and justice. This stems from the endowment of modern trademark law national competition tools and the superiority of territorial jurisdiction of sovereign states, but also trademark law as a system of civilization of social and historical roots of the inevitable requirements.

3.2.2. Different Goodwill: The Credibility (Popularity) of the Same Trademark in Different Countries May Vary Greatly

3.2.2.1. Different quality

In this day and age, trademarks are not just for identifying the source of goods, because even the same trademark of the same manufacturer may vary in quality due to differences in technology, management levels and raw materials across countries.

3.2.2.2. Different services

Even if the difference in quality is not great, the trademark owner's marketing methods, advertisement investment, quality guarantee and after-sale service in different countries may vary greatly.

4. Conclusion

With the development of globalization, parallel importation has been one of the efficient instruments to promote free trade worldwide. However, the trademark protection involved in parallel importation is complex as it concerns many elements. The U.S. and EU have accumulated a lot of experience. Both of them combine the protection of function and goodwill of trademark with balance of interest to determine the “likelihood of confusion”. The U.S. adopts non-physical material differences standard to determine the “likelihood of confusion” so as to prevent any risks of damages to function and goodwill of trademark while the European Court of Justice adopts physical and material difference standard to ensure the free movement of goods and integration of market inside EU. China needs to take the advantages of the U.S. and EU and widen the scope of consideration as appropriate so as to protect the function and goodwill of trademark.

The attitude of the Trademark Law towards parallel import is essentially a stopgap measure. In the long run, legislation is still needed to confirm the status of parallel imported trademark products. China is a major importer, which indicates that the behavior of parallel import is unavoidable. At the same time, China is a rapidly rising developing country, which indicates that our economic strength still lags behind developed countries, so allowing parallel import will have a negative impact on our country. These realities determine the reasonableness of the Trademark Law's blank attitude towards parallel imported trademark products. At the same time, with the decrease in China's tariff rates, China's position as a low-cost market in the global trade market will gradually be shaken, and the probability of parallel import and corresponding cases will increase. Therefore, the Trademark Law still needs to respond to parallel imports of goods to play a guiding role in the market through legislation and to establish a sound legal order for the parallel import of trademark products. Specifically, the law should support parallel imports, by recognizing the domestic exhaustion of trademark rights principle. Meanwhile, safeguards of consumer rights through the establishment of a

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substantial difference system is demanding to achieve a balance between private rights and public interests.

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