



International Chamber of Commerce

The world business organization

Policy statement

Exhaustion of intellectual property rights

Commission on Intellectual and Industrial Property, 7 January 2000

[French version](#)

ICC, the International Chamber of Commerce, is the world business organization. It is the only representative body that speaks with authority on behalf of enterprises from all sectors in every part of the world. Founded in 1919, it represents today over seven thousand member companies and associations from over 130 countries. ICC's purpose is to promote international trade, investment and the market economy system. As the world business organization, ICC firmly believes that the protection of intellectual property stimulates international trade and investment, and encourages transfer of technology, which are all essential for economic growth. ICC has therefore closely followed the debate on the exhaustion of intellectual property rights, whose outcome will have important implications for international trade and investment, as well the protection of intellectual property.

Background

The concept of exhaustion of intellectual property rights is of great importance to companies because it influences the extent to which the distribution of goods protected by their intellectual property rights can be controlled. According to the exhaustion concept, once an intellectual property right holder has sold a product to which its intellectual property rights are attached, it cannot prohibit the subsequent resale of that product as his intellectual property rights in that product are said to have been "exhausted" by the first sale.

Under a system of national exhaustion, the rightholder (whose rights arise by virtue of that national jurisdiction) loses the right to control resale, in that particular country, of intellectual property protected goods which were sold with his consent. He will however be able to prevent importation of goods sold abroad under a different jurisdiction, even if they had been sold with his authorization (parallel imports). Under a regime of regional exhaustion such as the one applicable within the European Union, the right to control re-sale of goods sold with the consent of the rightholder is exhausted within that particular region only. Provided there has been substantive and extensive economic and judicial harmonization in that particular region, parallel imports within that region will in principle be allowed, while rightholders will retain protection against parallel imports from third countries.

The issue of exhaustion of intellectual property rights is controversial and has been discussed for many years in various international and regional fora. One of the most topical discussions is taking place in the European Union where the European Commission is trying to determine whether the EU's current regime of regional exhaustion with respect to trademarks should be extended to embrace the concept of international exhaustion i.e. sale in any jurisdiction with the consent of the trademark proprietor exhausts (or negates) his rights arising under any other jurisdiction.

In order to better ascertain the views and concerns of its members from various sectors and countries on this issue, ICC conducted a survey of its membership. As the question of exhaustion of rights is relevant to all forms of intellectual property rights (and different intellectual property rights are often associated in the same product), the survey addressed the issue in relation to patents, trademarks as well as copyright. This paper reflects the general sentiment of the responses received to the survey. A more detailed analysis of the results broken down into responses by sector and regions, and summarizing arguments given by each sector, is annexed herewith.

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Exhaustion of intellectual property rights in the context of international trade and investment

ICC is a strong supporter of free and fair international trade, and believes that effective intellectual property protection helps encourage trade and investment, as well as economic development. When determining their policy on the exhaustion of intellectual property rights, policy makers should consider what type of exhaustion regime will be most beneficial to trade, investment, and economic development in the long term.

One view, shared by a small minority of ICC members, is that international exhaustion of rights will allow for greater competition which in turn will benefit consumers and remove artificial entry barriers from individual markets. According to this perspective, increasing globalization, mass international travel and the advent of electronic commerce will render all distinctions of a national nature obsolete. Proponents of this view note that the Internet continues to have a dramatic effect on the trend towards cross border trade in consumer goods and believe that the Internet will breed a greater consumer awareness of world-wide price discrepancies which must, over a period of time, have an equalising effect on markets and prices.

The great majority of ICC members, however, believe that introducing a regime of international exhaustion in the absence of a single global market will in fact be detrimental to trade and investment, and undermine the incentive provided by intellectual property rights to invest in innovation and brand reputation. The reasons cited below are relevant to all intellectual property rights; however, the various forms of intellectual property rights have their own particularities and should also be considered individually.

- By restricting companies' ability to control the marketing and distribution of their goods across markets in the current international economic context, international exhaustion reduces the commercial incentive to invest in innovation, brand reputation, and customer service. Companies who invest in innovation, or the reputation of their branded products, need to recover the costs of their investments. This cost recovery justifies the risks associated with the development of today's new technologies and products and is essential for stimulating research and development required for the future. Financial returns from internationally successful products are also used to fund the development of products which may be less profitable but are beneficial to general social welfare or to the local economy or culture (e.g. local or experimental cultural works, drugs for rare diseases etc). If the returns from internationally successful products are reduced because of the effect of parallel trading, the potential for investment in commercially riskier products may be jeopardized. In the long term, therefore, international exhaustion could discourage investment in innovation and brand reputation, with negative consequences for social and consumer welfare.
- Economic studies have shown that charging different prices to different users is optimal and necessary to achieve an appropriate rate of return that reflects the collective willingness of consumers to pay for the product, and to ensure that products reach markets which would otherwise not be served. However, if these international price differences come under pressure by an international exhaustion regime, the intellectual property owner will be forced to choose among a number of options. First, he may choose to withdraw the product from low priced markets altogether, denying access to beneficial products. Second, the right holder may be compelled to converge prices internationally to stop leakage from the lower priced market to the higher priced market and such convergence will inevitably exclude less developed regions. Intellectual property holders may also reduce the investment in manufacture, supply and customer service in certain countries, further reducing consumer welfare. In the long run, a regime of international exhaustion could limit instead of encourage

trade and investment and deprive consumers in certain markets of innovative products that they could have afforded under a differential pricing system.

- The level of intellectual property protection still varies from country to country (e.g. the length of the term of copyright protection; the criteria for patentability etc). A regime of international exhaustion of rights could lead to a convergence of the substance of intellectual property protection towards the lowest common denominator if right holders are not be able to prevent the importation of goods that do not conform to the standard of intellectual property protection required in the importing country. This could in turn lead to a partial expropriation of the intellectual property owner's rights.

Core issues for business

The outcome of the debate on the exhaustion of rights will determine the extent to which companies will be able to control the distribution of their goods - an issue of fundamental importance to businesses - and more specifically, the resale of their goods across different markets.

This debate therefore centres on the following issues:

1. Are businesses justified in treating different territories as different markets?
2. Are there legitimate reasons for businesses to differentiate goods - in terms of pricing, technical and other specifications, and presentation - for different markets?
3. Do businesses have a legitimate interest in being able to prevent goods destined for one market from finding their way into another?

The vast majority of ICC members would answer yes to the above questions for the following reasons.

1. Are businesses justified in treating different territories as separate markets?

Despite progress in trade liberalisation, advances in communications and the globalisation of the economy, there still remain today important differences in the economies and cultures, legal and regulatory systems, and the level of wealth and development of different countries and regions. Companies will therefore generally continue to need to treat different territories as separate markets, although how these markets are defined and the extent to which they are considered as distinct will depend on the product being marketed and its sensitivity to market and regulatory conditions.

2. Are there legitimate reasons for businesses to differentiate goods for different markets?

Different territories will often have different technical and safety standards, physical and climatic conditions, and market environments. Depending on the type of product, these will often oblige companies to tailor their products for that specific territory.

This can apply to products of all categories: chemicals may have to be conditioned differently for different climatic conditions for safety reasons; electrical goods may be subject to different safety and technical requirements in different countries; for products heavily dependent on brand image and presentation, colours, designs, formulations or names may vary according to the taste and cultural sensitivities in different countries (e.g. chocolate, coffee and perfumes, to take a few examples, are formulated differently to suit the taste and climatic conditions in different markets)

Again depending on the sector and product, companies may have to price their goods differently according to the market conditions and the costs of bringing the product to that particular market. The reality is that price differentials do exist and are due to very important factors, which have nothing to do with the exhaustion regime. These include different tax regimes, employment and social security

charges, the general state of the local economy, marketing and promotional expenditure, differences in legal protection and royalties paid etc. Artificial tariffs still exist around the world, and distort pricing in a way which leaves brand owners at the mercy of parallel traders. Some sectors, such as the pharmaceutical sector, are also subject to government price control regimes and are not able to control price differentials for their products.

3. Do businesses have a legitimate interest in being able to prevent goods destined for one market from finding their way into another?

In most sectors, manufacturers of products need to be able to control the distribution of their products in different markets for the same reasons which require them to tailor their products to each market. If products not destined for a particular market are sold there, they may not conform to the appropriate safety, technical, regulatory norms, with the resultant safety and health risks this entails. For example, motor oil is sold to a different specification in the USA where there is a much lower incidence of diesel powered vehicles. This means that oil marketed in the USA under a recognisable brand name may be inferior to the quality of oil marketed under the same brand in Europe. The same problem can arise in the market for foodstuffs where some countries have different standards regarding additives, and consequently parallel traded goods might actually be illegal, with the potential to damage the reputation of the brand in those countries.

The presentation or form of such products may also not correspond to another market's culture, taste or expectations, so that products relying heavily on brand reputation may suffer from negative effects on its brand image.

In addition, the inability to control and trace products makes quality control by companies much more difficult. This has particularly serious consequences when this involves products with health and safety implications such as drugs, foodstuffs, chemicals, etc.

The distribution of different versions of a product on the same market also brings high risks of customer confusion which, in addition to being detrimental for the consumer, could cause brand image to suffer.

Businesses require organized distribution systems to be able to distribute their products in an orderly way. In many sectors, distribution arrangements are made on a territorial basis and distributors agree to distribute products on the basis that they will enjoy some degree of exclusivity in that territory. Not being able to control the flow of goods from one market to another would cause serious disruption to the distribution systems set up by businesses. In some industries, the timing of product launches (e.g. the movie industry relies on sequential distribution of their audiovisual works) in different markets is essential to their success. The inability to control flows of products between market would severely impede businesses abilities to control the timing of the marketing of their products.

Orderly distribution also makes it easier to detect counterfeit and pirated goods. Customs officials would find it increasingly difficult and certainly more time-consuming to distinguish between legitimate parallel imports and unlawful counterfeit copies as counterfeiters/pirates often disguise counterfeit/pirated material as parallel imports (where these latter are legal), making it much more difficult, if not impossible, for customs and enforcement authorities to detect such products. In addition, parallel imported products are very often used as masters for counterfeited/pirated ones.

Effects on consumers

One of the main arguments for moving towards a regime of international exhaustion is that it will increase competition, thereby leading to a general reduction in prices for consumers. It is unclear if

this will really be the case as the commercial incentive for parallel trading is the ability to profit from the margin between the lower priced market and the higher priced market. It is therefore more likely that the parallel trader will keep the difference in prices as profit rather than pass it on to the consumer in the form of a cheaper price.

Parallel trading will reduce the incentive for the authorized distributor, if not the intellectual property right owner himself, to sustain levels of investment in pre-sale and post-marketing services, and parallel importers themselves have no long term interest in investing in these services. A regime which allows parallel trading may therefore result in a reduction of such services for consumers.

Price is not the only criterion of importance to consumers. Consumers also want choice and goods which respond to local market requirements. As mentioned above, reduced financial returns from internationally successful products caused by parallel trading may jeopardize the funding of research and development of commercially riskier products, thereby reducing the range of products available to consumer. Price differentials also allow the manufacturer to serve more markets and, in particular, low price markets whose consumers would not be served by parallel trading. Consumers in these markets therefore are likely to benefit from a greater choice of goods under a regime where companies can control distribution across different markets.

As mentioned above, when goods tailored for one market find their way into another, there may be safety implications depending on the type of goods: goods of different specifications might find their way into markets where they are actually unsafe as a result. For example, instruction leaflets might be in the wrong language, necessary after-sales service might not be available, or the product may not comply with local safety or technical requirements, thus endangering the consumer.

Consumer confusion may also result from having two or more versions of the same product in the same market.

Conclusion

The issue of the exhaustion of rights is very complex. It affects businesses in different ways and to different degrees depending on their sector of activity, the market conditions in which they function, and the geographical region in which they operate.

The great majority of ICC members believe that, in the absence of a true single global market, a regime of international exhaustion would on balance be more harmful than beneficial to international trade and investment, and to innovation. Businesses have a legitimate interest - for reasons relating to commercial strategy, quality control, brand reputation, safety etc - in controlling the distribution of their goods across different markets, to ensure that products tailored for one market are not sold in another. There are also strong arguments that consumers would not necessarily be better off under a regime of international exhaustion.

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See appendix: [*Results of ICC survey on international exhaustion of intellectual property rights*](#)