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# Market Integration and (the Limits of) the First Sale Rule in North American and European Trademark Law

Irene Calboli
*Marquette University Law School*, Irene.Calboli@marquette.edu



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# MARKET INTEGRATION AND (THE LIMITS OF) THE FIRST SALE RULE IN NORTH AMERICAN AND EUROPEAN TRADEMARK LAW

**Irene Calboli***

## I. INTRODUCTION

The relationship between exclusive trademark rights and the free movement of goods across international borders has historically represented one of the most heated topics of discussion in the international trademark debate.[1] In a previous work published a few years ago, I analyzed this topic in the context of European trademark law and the case law of the Court of Justice of the European Union (ECJ).[2] In this

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* Associate Professor of Law and Director, Intellectual Property and Technology Program, Marquette University Law School; Spring 2011 CIPLIT Visiting Professor of Law, DePaul University College of Law. I would like to thank Eric Goldman for the invitation to speak at the "Exhaustion and First Sale in Intellectual Property" conference held at Santa Clara University School of Law on November 5, 2010, and for his insightful suggestions during the research and writing of this Article. I also thank the conference participants and my colleagues Michael O'Hear and Josh Sarnoff for useful conversation and comments on earlier drafts of this Article. Finally, I thank Marquette University Law School for research support, Jeremy Hager for research assistance, and the editors of the Santa Clara Law Review, and in particular Mike Foy, Lara Muller, and Farid Zakaria, for their assistance during the editing process of this Article.

1. The literature on this topic is extensive. *See*, *e.g.*, TIMOTHY H. HIEBERT, PARALLEL IMPORTATION IN U.S. TRADEMARK LAW 1 (1994); Friedrich-Karl Beier, *Territoriality of Trademark Law and International Trade*, 1 I.I.C. 48 (1970); Christopher Heath, *Parallel Imports and International Trade*, 28 I.I.C. 623 (1997); John C. Hilke, *Free Trading or Free-Riding: An Examination of the Theories and Available Empirical Evidence on Gray Market Imports*, 31 WORLD COMPETITION L & ECON. REV. 75 (1988); Herman Cohen Jehoram, *Prohibition of Parallel Imports Through Intellectual Property Rights*, 30 I.I.C. 495 (1999); E.C. Vandenburgh, *The Problem of Importation of Genuinely Marked Goods is not a Trademark Problem*, 49 TRADEMARK REP. 707 (1959); Charles Worth, *Free Trade Agreements and the Exhaustion of Rights Principle*, 1 E.I.P.R. 40 (1994).

2. *See* Irene Calboli, *Trademark Exhaustion in the European Union: Community-Wide or International? The Saga Continues*, 6 MARQ. INTELL.

Article I advance this analysis in a larger context: the tension between the national exercise of trademark rights and the free movement of goods within free trade areas (regional trade agreements among sovereign countries) in general, with particular attention to the issues related to differences in product quality. Notably, in this Article I explore the effectiveness, and the limitations, of the principle of "trademark first sale" in promoting the free movement of goods in free trade areas. To this end, I compare the application of this principle and the resulting market integration achieved by two of the most prominent free trade areas in the current international context: the North American countries with the adoption of the North American Free Trade Agreement (NAFTA) and the members of the European Union (EU). Based upon this comparison, I provide some specific suggestions and policy considerations as to the possible approaches that members of existing and future free trade areas can follow to promote and guarantee effective market integration and free movement of goods in their respective territory.[3]

The principle of "trademark first sale," which is also known as "trademark exhaustion,"[4] represents a milestone in

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PROP. L. REV. 47 (2002) (providing a detailed analysis of the development of the principle of trademark exhaustion under European trademark law).

3. Because of the complexity of this topic and the limited scope of this Article, this Article focuses on the analysis of the principle of trademark first sale, or trademark exhaustion, only within trademark law and policy. This Article does not address other relevant issues related to the relationship between the free movement of goods and international trade in general, nor elaborate on the economic aspects, positive and negative, of parallel imports for corporations and national economies. Likewise, this Article does not address the frequent antitrust issues that can arise as a result of the monopolistic exercise of trademark rights with respect to gray market goods nor other means to control product distribution, such as licensing clauses, contracts, or torts. This Article also does not extensively elaborate on the differences between the theories of "universality" and "territoriality" of trademark protection and the preference for a system of "trademark territoriality" that has characterized the harmonization of trademark laws among members of the International Community. Finally, this Article does not explore the effect of the Internet and e-commerce on the traditional territorial interpretation of the principle of trademark exhaustion.

4. *See* FREDERICK M. ABBOT, THOMAS COTTIER & FRANCIS GURRY, INTERNATIONAL INTELLECTUAL PROPERTY IN AN INTEGRATED WORLD ECONOMY 270 (2007). This Article uses the terms "trademark first sale," "trademark exhaustion," and "exhaustion of trademark rights" interchangeably as synonyms.

trademark theory. Trademark law grants trademark owners the right to prevent third parties from using identical or similar signs to identify confusingly similar products in the market.[5] Nevertheless, once a trademark owner has introduced into the market a product, or a batch of products, these rights are considered "exhausted" with respect to those products, and the trademark owner can no longer rely on trademark rights to control the products' future circulation.[6] This principle was developed by the courts in the nineteenth century to balance the rights of trademark owners to prevent the inappropriate use of their marks with the rights of retailers, second-hand dealers, and consumers to freely display, advertise, and resell the products that they lawfully purchased in the market, even if those actions directly compete with the trademark owners' business activities in the same market.[7] Since then, courts have invariably repeated and confirmed this principle, which has also been incorporated in most national trademark legislations.[8]

Traditionally, there has been little dispute about the application of the principle of trademark first sale within national markets—once distributed for sale in a national market, products are generally free to move within the domestic territory despite trademark owners' desires to control future product distribution in that market.[9] In contrast, fierce disputes have characterized the application of this principle in the context of international trade with

5. *See* discussion *infra* Part II.A.

6. *Id.*

7. *See* Apollinaris Co. v. Scherer, 27 F. 18 (C.C.N.Y. 1886); John A. Young, Jr., *The Gray Market Case: Trademark Rights v. Consumer Interests*, 61 NOTRE DAME L. REV. 838, 840 (1986).

8. *See* discussion *infra* Parts II.A, III.A–B.

9. One exception to this principle, however, is the case of countries allowing concurrent registration owned by different entities in separate parts of the country as, for example, in the United States. In such a case, the goods carrying one of the concurrently registered marks can circulate only in the specific part of the United States covered by the registration and cannot be marketed in the part of the United States designated for the other concurrent registration. Trademark (Lanham) Act of 1946 § 2(d), 15 U.S.C. § 1052(d) (2006) [hereinafter Lanham Act]. Another exception to this principle is the coexistence of non-registered and registered marks in the same jurisdiction. This Article does not analyze these issues, nor the relationship between state and federal trademark registrations in countries permitting the registration of marks under their state law and not only at a federal level, as for example in the United States.

respect to the parallel imports of "gray market goods"—i.e., genuine (originally manufactured) products, which are imported into a country from unauthorized third party importers after their first authorized sale by trademark owners in another part of the world.[10] To some extent, the surge in global trade over the past two decades has heightened these disputes,[11] particularly in the developed world economies, driven primarily by the concerns expressed by multinational corporations against the arbitrage of consumer goods from low-cost to high-cost jurisdictions.[12] Although multinational corporations are interested in the benefits of free trade to reduce manufacturing costs and decrease tariffs, quotas, and other trade restrictions, they generally fear and oppose gray market goods because of the competition that these goods create in the high cost domestic markets where they are imported, and the resulting loss of profits for trademark owners (multinational corporations) in those markets.[13]

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10. This Article uses the terms "parallel imports" and "gray market goods" interchangeably as synonyms. Both parallel imports and gray market goods refer to the situation where products carrying a certain mark are imported into a market and sold there without the consent of the owner of the mark. J. THOMAS MCCARTHY, 5 MCCARTHY ON TRADEMARKS AND UNFAIR COMPETITION § 29:46 (4th ed. 2010). The products are "genuine" and not counterfeit goods, and have been manufactured by or under license from the trademark owner. *Id.* They are, however, formulated or packaged for a particular jurisdiction and are imported into a different country than the one intended by the trademark owner. *Id.* For extensive analysis on these definitions and relevant literature and case law, see *id.* *See also* Heath, *supra* note 1, at 623 (explaining that the term parallel imports "refers to goods produced and sold legally, and subsequently exported" and that "there is nothing 'grey' about them").

11. *See* MCCARTHY, *supra* note 10, § 29:51–51.75 (offering an overview of the regulation of parallel imports in the United States).

12. *Id.* § 29:46, n.1 (including several references to professional articles explaining how to prevent or diminish the risk of parallel imports for corporations).

13. The corporate opposition to the unauthorized importation of gray market products is well exemplified in the position adopted by the International Trademark Association (INTA). In a position paper prepared by the 2006–2007 INTA Parallel Imports Committee, INTA advocated that a regime of national exhaustion was in the best interest of trademark owners. INTA specifically "supports the principle that international exhaustion should not apply to parallel imports in the absence of clear proof that the trademark owners expressly consented to such imports." *See* INTA, *Position Paper on Parallel Imports*, July 2007, *available at* http://www.inta.org/Advocacy/Documents/INTA ParallelImports2007.pdf.

In response to these concerns, the protection of trademark rights, and intellectual property in general, has played an increasingly important role in international trade negotiations in the past decades.[14] The fundamental relationship between intellectual property and international trade is at the heart of the Agreement on Trade Related Aspects of Intellectual Property (TRIPS), which was enacted in 1994 as an integral part of the General Agreement of Tariffs and Trade (GATT) negotiations that led to the creation of the World Trade Organization (WTO).[15] Still, because of diverging national interests among WTO members, the exhaustion of intellectual property rights and the regulation of parallel imports of gray market goods proved too controversial to be addressed within the context of TRIPS. As enacted, TRIPS declares that nothing in the Agreement can "be used to address the issue of the exhaustion of intellectual property rights."[16] Absent an official position at the international level, WTO members have continued to follow their preferred policies on the issue, thus perpetuating the existing controversy in this area.[17]

Notwithstanding the silence in TRIPS and the corporate opposition to the principle of trademark first sale, the relevance of this principle to promote free trade is undisputable.[18] As repeated in most free trade agreements, the main purpose of free trade is to eliminate *all barriers* to

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14. *See, e.g.*, Laurinda L. Hicks & James R. Holbein, *Convergence of National Intellectual Property Norms in International Trading Agreements*, 12 AM. U.J. INT'L L. & POL'Y 769 (1997); J.H. Reichman, *Intellectual Property in International Trade: Opportunities and Risks of a GATT Connection*, 22 VAND. J. TRANSNAT'L L. 747 (1989).

15. Agreement on Trade-Related Aspects of Intellectual Property Rights, April 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1C, LEGAL INSTRUMENTS—RESULT OF THE URUGUAY ROUNDS Vol. 31, 33 I.L.M. 83 (1994) [hereinafter TRIPS].

16. *Id.* art. 6.

17. On the silence of TRIPS regarding the issue of the exhaustion of all intellectual property rights, not solely trademarks, see S.K. Verma, *Exhaustion of Intellectual Property Rights and Free Trade—Article 6 of the TRIPS Agreements*, 29 I.I.C. 534, 539 (1998). *See also* Hanns Ullrich, *TRIPS: Adequate Protection, Inadequate Trade, Adequate Competition Policy*, 4 PAC. RIM. L. & POL'Y J. 153 (1995).

18. *See, e.g.*, Herman Cohen Jehoram, *International Exhaustion versus Importation Right: A Murky Area of Intellectual Property Law*, 4 G.R.U.R. INT'L 280 (1996).

"legitimate trade"[19] and to promote the unrestricted circulation of goods in the international, regional, or national market.[20] Accordingly, international trade or trade among members of free trade areas can effectively be "free" only if, among other trade barriers, the exercise of national trademark rights is considered exhausted with respect to the distribution of gray market goods after their first lawful sale in any country of the world (international trademark exhaustion) or at least within the territory of the members of free trade areas (regional trademark exhaustion).[21]

In recent years, however, even in countries adopting regimes of international or regional trademark exhaustion, multinational corporations have increasingly raised an additional argument against the principle of trademark first sale to prevent the importation of gray market goods: the "material different product quality" of the goods they distribute in separate national markets.[22] Notably, multinational corporations frequently manufacture or package products with minor variations in their quality or post-sale services to satisfy local preferences, take advantage of local requirements, or simply to diversify international markets. Still, they usually market these materially different products under the same mark in separate countries because of the advantages of brand recognition given the widespread international movement of goods and people.[23] In recent

19. *See* discussion *infra* Part III.A–B; *see also* North American Free Trade Agreement, U.S.-Can.-Mex. Art. 1701(1), Dec. 17, 1992, 32 I.L.M. 289 (1993) [hereinafter NAFTA].

20. On the differences between national and international exhaustion, see generally Jesper Rasmussen, *The Principle of Exhaustion of Trade Mark Rights Pursuant to Directive 89/104 (and Regulation 40/94)*, 4 E.I.P.R. 174 (1995).

21. *See* discussion *infra* Part III.

22. HIEBERT, *supra* note 1, at 153.

23. Corporations usually cannot, however, intentionally market products of different quality under the same mark in a single jurisdiction. For example, all cans of Coca-Cola Classic distributed in the United States by The Coca-Cola Company have to be the same in terms of formula, etc., even if The Coca-Cola Company can use the "main" mark Coca-Cola for other lines of (qualitatively identical) products in the same market (e.g., Coca-Cola Zero), or can decide to change the quality of *all* Coca-Cola Classic cans marketed in the United States in the future. Companies can at times market products of different quality (e.g., special releases), but these differences have to be clearly advertised to consumers. In contrast, the intentional distribution of identically looking goods of different quality (e.g., Coca-Cola Classic with different ingredients) is considered a misleading use of a mark that could lead to cancellation of the

years, multinational corporations have repeatedly argued that consumers may be confused if two seemingly identical but materially different products are sold in the same national market under the same mark as a result of the importation of gray market products.[24] In several instances, national courts have accepted this argument and blocked the importation of materially different gray market products (also from members of the same free trade area) into their national territory.[25] Not surprisingly, this has in turn undermined the process of international market integration and free trade in general.

This Article explores this intricate aspect of trademark law and international trade, with particular attention to the argument of "materially different product quality" and its impact on the effectiveness of the principle of trademark first sale to promote free trade internationally and, in particular, within free trade areas. The reminder of this Article proceeds as follows. Part II recounts the history of the principle of trademark first sale and illustrates the alternative national positions that countries have traditionally adopted with respect to the admissibility of gray market goods into their territory. Part III analyzes the different approaches to the principle of trademark first sale and the importation of materially different gray market goods adopted, specifically, by NAFTA and EU members, and the resulting process of market integration in those free trade areas. Part IV compares the approaches adopted by NAFTA and EU members and stresses that, in general, effective market integration in free trade areas can be achieved only by adopting uniform national rules that permit parallel imports from other members combined with the prohibition of domestic measures that limit the importation of genuine but materially different products. In particular, Part IV suggests that members of free trade areas can facilitate the long term free movement of genuine but materially different products in their territory by harmonizing, or at least approximating,

mark and would amount to consumer fraud, at least in the United States. *See* 15 U.S.C. §§ 41–58 (2006).

24. *See* discussion *infra* Part IV.A. (considering the issues related to the distribution of gray market products of "materially different" quality in the national jurisdictions of Canada, the United States, and Mexico).

25. *See* discussion *infra* Part IV.A–B.

national product standards and by adopting the same common standards. As a complementary and more immediate solution, however, Part IV highlights that members of free trade areas can individually adopt national principles of mutual recognition of products coming from other members, or accept into their territory the importation of gray market goods carrying labels that disclose to the public any material difference in product quality. Because of the possible conflicts of the mutual recognition approach with the WTO principles of non-discrimination and most-favored-nation, this Article concludes that the acceptance into the domestic markets of the importation of gray market goods adequately labeled to prevent consumer confusion seems to represent the most effective (although imperfect) approach to currently promote free trade in free trade areas alongside the harmonization of technical standards.

## II. THE RELATIONSHIP BETWEEN TRADEMARK FIRST SALE AND FREE TRADE

This Section offers an overview of the principle of trademark first sale, and the relationship between this principle and international trade. First, this Section illustrates the basic functions of trademarks, the traditional scope of trademark protection, and the theory behind the principle of trademark first sale as a means to remove trademark owners' control on product distribution in the market. Second, this Section emphasizes the impact of the principle of trademark first sale in international trade and the different approaches taken by individual countries, which are divided into national, international, and regional trademark exhaustion.

### *A. Basics of Trademark Protection, Trademark First Sale, and Free Trade*

Trademarks perform a variety of functions in the modern economy. First, trademarks enable producers to inform consumers about the origin and the quality of their products in a market increasingly dominated by similar and competing products.[26] In addition to indicating commercial origin and

26. *See* William M. Landes & Richard A. Posner, *Trademark Law: An Economic Perspective*, 30 J.L. & ECON. 265, 265–66 (1987) ("[T]rademark law . . .

guaranteeing consistent product quality, trademarks are also valuable advertising tools and manifestations of trademark goodwill that attract consumers because of the reputation or other values that the public attaches to, and associates with, the marks.[27] Historically, trademark law has protected these different trademark functions.[28] As mentioned before, the core of trademark rights resides in the ability of trademark owners to exclude third parties from using identical or similar marks on identical or similar products when such use could lead to a likelihood of consumer confusion.[29] For the owners of famous marks, trademark protection also extends to identical or similar signs used on non-similar products when this use is likely to take unfair advantage of, or damage, the mark's distinctiveness or reputation.[30]

The right of trademark owners to exclude others from using identical or similar marks has been traditionally limited, however, by the limits imposed upon trademark owners by the principle of trademark first sale or trademark exhaustion. This principle explicitly provides that the right

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can best be explained on the hypothesis that the law is trying to promote economic efficiency."); *see also* Nicholas S. Economides, *The Economics of Trademarks*, 78 TRADEMARK REP. 523, 526 (1988); William P. Kratzke, *Normative Economic Analysis of Trademark Law*, 21 MEM. ST. U. L. REV. 199, 205 (1991).

27. *See* Frank I. Schechter, *The Rational Basis of Trademark Protection*, 40 HARV. L. REV. 813, 818 (1927) ("The true functions of the trademark are, then, to identify a product as satisfactory and thereby to stimulate further purchases by the consuming public.").

28. *See, e.g.*, Anselm Kamperman Sanders & Spyros M. Maniatis, *A Consumer Trade Mark: Protection Based on Origin and Quality*, 11 E.I.P.R. 406 (1993). See also the famous passage of the United States Senate Reports introducing the Lanham Act and stating that trademark protection has a twofold purpose. S. REP. NO. 79-1333, at 3 (1946), *reprinted in* 1946 U.S.C.C.A.N. 1274, 1274. "One is to protect the public so it may be confident that . . . it will get the product which it asks for . . . . Secondly, where the owner of a trademark has spent energy, time, and money in presenting to the public the product, he is protected in his investment from its misappropriation by pirates and cheats." *Id.*

29. *See, e.g.*, Kamperman Sanders & Maniatis, *supra* note 28, at 406.

30. *See* TRIPS, *supra* note 15, art. 16(3). "Article 6*bis* of the Paris Convention (1967) shall apply . . . to goods and services which are not similar to those in respect of which a mark is registered, provided that the use of that trademark . . . would indicate a connection between those goods or services and the owner of the registered trademark and provided that the interests of the owner of the registered trademark are likely damaged by such use." *Id.* Because of its limited scope, this Article does not elaborate on individual national anti-dilution provisions and leading cases.

of a trademark owner "to control distribution of its trademarked product does not extend beyond the first sale of the product."[31] Thus, "[the] resale by the first purchaser of the original article under the producer's trademark is neither trademark infringement nor unfair competition."[32] The only exception to this principle is that trademark rights are not exhausted, and trademark owners can oppose future product distribution, when third parties have altered the quality of the marked products without the consent of trademark owners after the first authorized sale of the products in the market.[33] In these instances, trademark owners can oppose the future circulation of the products that they have initially distributed because consumers rely on the marks affixed to those products as signs of authenticity as to the products' origin and quality, and would thus believe that those quality alterations originate with, or are authorized by, trademark owners.[34] This, in turn, would undermine the traditional functions of trademarks as indicators of commercial origin and guarantors of consistent quality, and would also unfairly affect and damage the reputation of trademark owners.[35]

Theoretically, the principle of trademark first sale finds its rationale in the assumption that trademarks must not be used as a tool to control market distribution or as a means of market division contrary to their function as indicators of commercial origin and product quality.[36] Whether third parties resell trademarked products after their first authorized sale in the market with or without the trademark

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31. Sebastian Int'l, Inc. v. Longs Drug Stores Corp., 53 F.3d 1073, 1074 (9th Cir. 1995). The premise of the first sale is that "the consumer gets exactly what the consumer bargains for, the genuine product of the particular producer." *Id.* at 1075.

32. *Id.* at 1074.

33. *See* MCCARTHY, *supra* note 10, § 29:37 (offering an extensive analysis of the relevant statutes and cases under U.S. law). Because of its limited scope, this Article does not elaborate on the issue of the sale of "expired" products and whether the principle of first sale is applicable in those instances. According to this Author, in the instance of products with a mandatory expiration because of safety standards, the sale of expired products is directly forbidden regardless of whether the products are sold by trademark owners or third party importers. 15 U.S.C. §§ 41–58 (2006).

34. *Id.*

35. *Id.*

36. Beier, *supra* note 1, at 61–62; Cohen Jehoram, *supra* note 18, at 280. *See also* MCCARTHY, *supra* note 10, § 29:51.75 (discussing the quality function of trademarks in the context of parallel imports).

owners' authorization, these sales do not imperil traditional trademark functions nor do they create consumer confusion with respect to the marked products—the products are and remain genuine (original) products and the marks continue to indicate to consumers the products' commercial origin and quality regardless of the identity of the actual distributor of the goods.[37] Undoubtedly, the unauthorized sale of genuine products limits trademark owners' ability to control the channeling of their products in the market, including their ability to portray the goods under specific conditions of desirability or exclusivity. These sales also create additional competition for trademark owners.[38] Trademark law, however, has never protected the ability of trademark owners to design the conditions under which products are released into the market because this would necessarily create trademark monopolies.[39]

Historically, the origin of the principle of trademark first sale dates back to the late nineteenth century, when unprecedented economic change led to a rise in product manufacturing and a growing availability of commercial goods.[40] As a result of these changes, product distribution became increasingly sophisticated, adding new layers of intermediaries to the traditional channels of product marketing.[41] To counter trademark owners' attempts to

37. *See* Yamaha Corp. of Am. v. United States, 961 F.2d 245, 248 n.2 (D.C. Cir. 1992) ("'Genuine' goods are goods that are in fact manufactured by the same manufacturer that supplies the U.S. trademark holder. . . . [T]hey *are* the genuine article, although they may not have been intended for distribution in the U.S. market.").

38. *See, e.g.*, Vincent N. Palladino, *Gray Market Goods: The United States Trademark Owners' View*, 79 TRADEMARK REP. 158 (1989) (offering a comprehensive survey of the history and case law on parallel imports and concluding that these imports cause detriment to trademark owners and consumers); *see also* INTA, *supra* note 13.

39. *See, e.g.*, Beier, *supra* note 1, at 72 ("[T]hese economic interests are not protected by trademark law. They can only be considered within the framework of the law against unfair competition, by contract law, and the law of torts.").

40. For the evolution of the functions of trademarks, see generally Thomas D. Drescher, *The Transformation and Evolution of Trademarks—From Signals to Symbols to Myth*, 82 TRADEMARK REP. 301 (1992).

41. *See, e.g.*, Sidney A. Diamond, *The Historical Development of Trademarks*, 73 TRADEMARK REP. 222, 237 (1983). "The industrial revolution was characterized by an enormous growth of industry as modern manufacturing methods replaced the handwork of older times. . . . Along with the growth of distribution came the use of advertising to acquaint the consuming public with the availability of the goods." *Id.*

control product distribution after a product (or a batch of products) had been introduced into the market, courts on both sides of the Atlantic concluded that manufacturers could not use trademark rights to bind the buyers of their goods—retailers and consumers—to their desired terms of subsequent sale, for example, by fixing prices for retailers or preventing secondary markets for used goods.[42] This position directly responded to the pressing need to delineate "a necessary demarcation line between two colliding properties: the intellectual property right of the producer and the common proprietary right of the owner of [the] product he has bought."[43] To avoid extending trademark rights beyond the traditional scope of trademark protection—protecting consumers and competition in the market—courts and trademark theorists agreed that the proprietary owner of a product "should remain free to enjoy the specific privileges of traditional ownership: he should be free to resell or otherwise dispose of his property."[44]

As mentioned earlier, the acceptance of the principle of first sale has rarely been questioned for the unauthorized sale of genuine goods originating within national markets.[45] Countries worldwide, however, "have struggled with the question whether [trademark owners] ought to be able to block" parallel imports of genuine products originating outside the national markets.[46] In the past, both American

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42. *See* HIEBERT, *supra* note 1, at 28–36 (surveying the early decisions in this respect in the United States and the United Kingdom); Beier, *supra* note 1, at 49–50 (analyzing the most relevant decisions in the United States, United Kingdom, Germany and the European market, and stressing the role of the Max Planck Institute in following the developments on the issue).

43. Cohen Jehoram, *supra* note 18, at 280 (recounting that "[t]he dogmatic explanation of this exhaustion rule . . . has been provided by the patriarch of intellectual property law: Josef Kohler"). *See also* HIEBERT, *supra* note 1, at 29–30 (commenting on Kohler's role in creating the doctrine of universality in trademark law).

44. Cohen Jehoram, *supra* note 18, at 280. Trademark owners, however, can still impose distribution and post-sale restrictions with ad hoc contracts and specific clauses in licensing agreements. The instances nonetheless fall outside the scope of trademark law and, because of its limited scope, outside the scope of this Article.

45. *See* discussion *supra* Part I.

46. HIEBERT, *supra* note 1, at 1 (quoting Kaoru Takamatsu, *Parallel Importation of Trademarked Goods: A Comparative Analysis*, 57 WASH. L. REV. 433 (1982)). Parallel importers sell products outside the distribution system designed by trademark owners, thus limiting the ability of trademark owners to maximize profits by using discriminatory pricing across jurisdictions, which in

and European courts have settled this issue by invoking the principle of "common origin" of trademarks and trademarked products.[47] Even if courts accepted the position that the nature of trademark rights is "territorial" and not "universal"—i.e., that trademark rights have independent existence in separate national jurisdictions[48]—they allowed the importation of gray market products that had been distributed in foreign countries when the marks affixed to the products belonged to, or were controlled by, the same entities inside and outside their jurisdictions (common origin).[49] Courts thus prevented the importation of gray market goods as trademark infringement only in two instances: when the marks were identical or confusingly similar to pre-existing national marks owned by unrelated entities;[50] or when unauthorized third party importers had altered the quality of

turn could reduce revenues for corporations and, by extension, for the economy of their countries. *Id.* at 2 (quoting the distributor of PENTAX cameras in the United States who complained about gray market goods because "up to 30% of [their] sales were lost to the diverters").

47. *See* discussion *infra* Part III.

48. *See* MCCARTHY, *supra* note 10, § 29:1 ("Under the territoriality doctrine, a trademark is recognized as having a separate existence in each sovereign territory in which it is registered or legally recognized as a mark."). In the nineteenth century, several countries instead applied the theory of "universality" of trademarks, which posits that a mark signifies the same source no matter where it is used in the world. Critically, on the principle of territoriality, see Graeme B. Dinwoodie, *Trademarks and Territory*: *Detaching Trademark Law from the Nation-State*, 41 HOUS. L. REV. 885 (2004); Timothy H. Hiebert, *Foundations of the Law of Parallel Importation: Duality and Universality in Nineteenth Century Trademark Law*, 80 TRADEMARK REP. 483, 487–95 (1990); Marshall A. Leaffer, *The New World of International Trademark Law*, 2 MARQ. INTELL. PROP. L. REV. 1, 28 (1998) ("[T]he territorial model of trademark law in such a world is an anachronism and, from a practical standpoint, hardly exists in its pure form.").

49. Hiebert, *supra* note 48, at 487–95. Because of its limited scope, this Article does not elaborate on the differences between common ownerships, subsidiaries, or strategic trademark assignments between parent companies and their local subsidiaries in other jurisdictions. These nuances, however, may still be significant under certain national laws with respect to the lawfulness of gray market products. *See* MCCARTHY, *supra* note 10, § 29:49. This Article, instead, refers to all marks controlled in some way by the same entities as "marks having a common origin" and distinguishes these marks from those which are owned by separate entities while discussing the application of the principle of first sale and the lawfulness of gray market products in the particular jurisdictions at issue.

50. This does not include, however, the strategic assignment of marks in separate jurisdictions to bypass the principle of trademark exhaustion. Because of its limited extent, this Article does not elaborate on the important aspects of this issue for parallel imports.

the products without the knowledge and the consent of trademark owners after the first sale of the products into a foreign market by trademark owners.[51] To date, several countries continue to permit the importation of gray market goods manufactured under the same mark and sold in different countries by multinational corporations under the principle of common origin.[52] Still, as this Article elaborates, influential corporate interests have increasingly challenged this position and have used product diversification across separate national markets as an increasingly important means to control international trade and prevent the importation of gray market goods.[53]

### *B. Trademark Territoriality and Alternative Approaches to Trademark First Sale*

Although not unanimously accepted, the modern interpretation of trademark rights is based primarily on the principle of territoriality.[54] An explicit expression of national sovereignty, the principle of territoriality of trademark rights is at the heart of the Paris Convention for the Protection of Industrial Property (Paris Convention)[55] and TRIPS,[56] the

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51. *See* discussion *infra* Part III.

52. For example, Canada, the United States and Mexico still apply the principle of international exhaustion of trademark rights. *See infra* Part III.A; *see also* CHRISTOPHER HEATH, PARALLEL IMPORTS IN ASIA 1 (2004).

53. *See, e.g.*, HIEBERT, *supra* note 1, at 151; MCCARTHY, *supra* note 10, § 29:50–51.75.

54. Although the same marks are used by the same corporations to identify the same products in separate national markets, trademark rights are territorial in nature insofar as they are acquired nationally based upon requirements set by national laws to identify products within the national territory, and enforced nationally based upon national principles of trademark infringement and dilution. *See* MCCARTHY, *supra* note 10, § 29:1; Dinwoodie, *supra* note 48, at 887. Further, trademark disputes are decided nationally by national institutions selected according to national laws. Dinwoodie, *supra* note 48, at 887.

55. Paris Convention for the Protection of Industrial Property, Mar. 20, 1883, 21 U.S.T. 1583, 828 U.N.T.S. 305, *available at* http://www.wipo.int/treaties/en/ip/paris/pdf/trtdocs_wo020.pdf [hereinafter Paris Convention]. The Paris Convention was originally enacted in 1883, and subsequently revised in Brussels in 1900, Washington in 1911, The Hague in 1925, London in 1934, Lisbon in 1958, and Stockholm in 1967. *Id.* Article 6(3) of the Paris Convention expressly provides that "[a] mark duly registered in a country of the [Paris] Union shall be regarded as independent of marks registered in other countries of the Union, including the country of origin." *Id.* art. 6(3). One hundred seventy-three countries worldwide are currently members of the Paris Convention. *See Paris Convention Contracting Parties*, WORLD INTELLECTUAL

two most relevant international treaties on the harmonization of national trademark laws. Still, nothing in the Paris Convention or TRIPS establishes a common position for members with respect to trademark exhaustion, and national first sale rules remain a choice for each jurisdiction.[57] In particular, Article 6 of TRIPS states that "[f]or the purposes of dispute settlement under this Agreement . . . nothing in this Agreement shall be used to address the issue of the exhaustion of intellectual property rights."[58] According to the Paris Convention and TRIPS, however, member countries should prevent, and allow trademark owners to object to, the importation into their territory of gray market goods that carry marks identical or similar to pre-existing and unrelated national trademark rights outside the principle of common origin. Under the Paris Convention and TRIPS these occurrences explicitly constitute infringement of national trademark rights because of the resulting likelihood of confusion for consumers in the markets where these goods are imported.[59]

In the absence of a mandatory international guideline harmonizing national positions on trademark first sale,

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PROPERTY ORGANIZATION, http://www.wipo.int/treaties/en/ShowResults.jsp?lang=en&treaty_id=2 (last visited Mar. 7, 2011).

56. TRIPS, *supra* note 15. To date, 153 countries are members of the World Trade Organization (WTO). *See Members and Observers*, WORLD TRADE ORGANIZATION, http://www.wto.org/english/thewto_e/whatis_e/tif_e/org6_e.htm (last visited Mar. 7, 2011). Although TRIPS entered into force in 1996, developing countries and least-developed countries enjoyed additional transition periods to implement TRIPS (which has now been extended until 2013, and until 2016 for pharmaceutical patents and undisclosed information). *See Understanding the WTO: The Agreements; Transition Arrangements: 1, 5 or 11 Years or More*, WORLD TRADE ORGANIZATION, http://www.wto.org/english/thewto_e/whatis_e/tif_e/agrm7_e.htm (last visited Mar. 7, 2011).

57. In the EU this choice falls with European Institutions. *See* discussion *infra* Part. III.B.

58. TRIPS, *supra* note 15, art. 6. On the drafting of Article 6 of TRIPS, see Cohen Jehoram, *supra* note 1, at 508 (noting that this provision represents a compromise between two opposite approaches: "[t]he US Proposal [to introduce its own national system,] national exhaustion[,] and the [pleas of] developing countries . . . for the opposite," international exhaustion); Stanislaw Soltysinsky, *International Exhaustion of Intellectual Property Rights Under the TRIPS, the EC Law and the Europe Agreements*, 4 G.R.U.R. INT'L 316, 317–20 (1996); Verma, *supra* note 17, at 552–62 ("A review of TRIPS started in 2000 and it was believed that one issue which may be considered was the question of parallel import[ation] and [trademark] exhaustion.").

59. *See* Paris Convention, *supra* note 55, arts. 9, 10, and 10*bis*; TRIPS, *supra* note 15, art. 16.

members of the Paris Convention and TRIPS have thus adopted different approaches with respect to the geographical extent of their national regimes of trademark exhaustion.[60] As indicated in Part I, these positions are based directly on differing national interests regarding free trade and the importation of genuine gray market goods into their markets, and can be grouped into three categories: national exhaustion, international exhaustion, and regional exhaustion of trademark rights.

Undoubtedly the least friendly position with respect to free trade, the principle of *national exhaustion* provides that national trademark rights are considered exhausted only when a product, or a batch of products, have been distributed for sale into the domestic territory by the owner of the mark, or with his consent by, for example, an affiliated company, a licensee, distributor, or agent.[61] Under this principle, trademark owners cannot object to the future commercialization of those products after their first sale in the domestic market unless third parties alter the product quality so as to create consumer confusion.[62] Trademark owners, however, can still oppose the importation into the domestic market of genuine goods bearing their trademark (of the same or different quality) that have been first distributed outside the national territory by trademark owners themselves or with their consent. Likewise, trademark owners can object to the reentry of genuine products that have been exported outside the domestic market after their authorized first sale in the domestic territory.[63] Not surprisingly, trademark owners have traditionally favored this principle versus other categories of trademark exhaustion because it affords them the ability to price

60. *See* Soltysinsky, *supra* note 58, at 317–20.

61. To date, national exhaustion with respect to trademark rights seem to be a less frequent choice among WTO members, even though most members practice national exhaustion with respect to patents and copyrights. *See* INTA, *supra* note 13, at 5. National trademark exhaustion is nonetheless the principle favored by multinational corporations and the INTA because it is the most favorable toward trademark owners. *See id.*

62. *See* discussion *supra* Part II.A.

63. *See generally* Rasmussen, *supra* note 20, at 174 (describing the effects of the different types of trademark exhaustion).

differentiate and control product distribution across different jurisdictions.[64]

More favorable toward free trade, the principle of *international exhaustion* states instead that national trademark rights are considered exhausted after a product, or a batch of products, have been distributed for sale by the owner of the mark or with her consent anywhere in the world.[65] In countries adopting international exhaustion, trademark owners cannot object to the importation of gray market goods carrying their marks that were first marketed outside the national market or the reentry of genuine goods that were exported abroad after their first domestic sale.[66] Trademark owners, however, are still free to oppose the importation of products that have been altered without their consent; this is intended to protect consumers against confusion, and to protect the reputation of the trademark owners.[67] In some of the jurisdictions applying international exhaustion, trademark owners can object also to the importation of gray market products that, although genuine, are of materially different quality than the products distributed under authorization by trademark owners in the national market.[68] Theoretically, this objection is justified because these differences in quality could lead to consumer confusion. As indicated earlier, however, these differences are often the result of corporate strategies and are directly intended to prevent parallel trade and control international product distribution.[69]

Lastly, as a hybrid solution between national and international exhaustion for countries desiring to promote free trade, but mainly at a regional (rather than worldwide) level, a third type of trademark exhaustion has emerged in the past half century—*regional exhaustion*. Under this principle, national trademark rights granted by each member of a regional agreement are exhausted after the trademark owner places a product, or a batch of products, on the market

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64. INTA, *supra* note 13, at 5.

65. *See, e.g.*, Verma, *supra* note 17, at 539.

66. *Id.*

67. *See* TRIPS, *supra* note 15, art. 16 (providing the general principle against trademark infringement that member countries have to follow); Paris Convention, *supra* note 55, arts. 9, 10, and 10*bis* (same).

68. *See* discussion *infra* Part III.A.

69. *See* discussion *infra* Part IV.A–B.

in any of the national territories of the members of the agreement.[70] Under this regime, trademark owners cannot object to the further circulation of their products within the boundaries of the regional agreement regardless of which country the first sale of the products occurred within the region.[71] Trademark owners, however, may still oppose the importation of gray market products that have been introduced into the market outside the national territory of the members of the regional agreement as well as the reentry of products that have left the regional market to be exported outside the territory of the members of the regional agreement.[72] As elaborated below, to date, the most notable example of a regional integration adopting the principle of regional exhaustion of trademark rights is the European Union.[73]

## III. AN OVERVIEW OF TRADEMARK FIRST SALE IN NORTH AMERICA AND EUROPE

This Section examines the positions taken with respect to the principle of trademark first sale and the importation of materially different gray market products by the members of NAFTA and the EU, respectively. Both NAFTA and the EU seek to create free trade areas, but differ considerably in the level of integration achieved among their members. First, this Section introduces NAFTA and illustrates the national regimes on trademark exhaustion adopted by Canada, the United States, and Mexico. Second, this Section describes the creation of the European internal market and the adoption of the principle of regional exhaustion to promote free trade in the EU.

### *A. NAFTA and the Laissez Faire Approach to National First Sale Rules*

The adoption of NAFTA in 1994 marked the creation of a free trade area covering Canada, the United States, and

70. *See* Rasmussen, *supra* note 20, at 174.

71. *Id.*

72. See discussion *infra* Part III.B for the cases decided by the Court of Justice of the European Union (ECJ), clarifying that trademark owners in the EU can not prevent the parallel trade within the European market but can oppose the importation of gray market products coming from outside the EU.

73. *See* discussion *infra* Part III.B.

Mexico,[74] the purpose of which was, in principle, to eliminate all barriers to trade and facilitate free movement of goods across member countries.[75] Adopted two years prior to the implementation of TRIPS, NAFTA was also the first international trade agreement to impose detailed obligations on its members to protect intellectual property rights.[76] Specifically, Article 1701 of NAFTA requires that member countries provide "adequate and effective protection and enforcement of intellectual property rights" in each Party's territory;[77] these measures, however, should not "become barriers to legitimate trade."[78] According to Article 1704, NAFTA members can also specify licensing practices or conditions in their domestic law that may have an adverse effect on market competition and they can also adopt measures to prevent and control these practices or conditions subject to the general principles of the agreement.[79]

Despite this commitment to promote free trade and integrate the markets of member countries, NAFTA does not address the issue of exhaustion of intellectual property rights, including trademark exhaustion.[80] Instead, similar to TRIPS, NAFTA leaves member countries free to adopt their preferred position with respect to the geographical extent of their national rules on trademark first sale and the importation of gray market goods into their territories.[81] In the absence of any guidance or harmonization in this area, NAFTA members

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74. NAFTA, *supra* note 19.

75. NAFTA, *supra* note 19, art. 102. "The objectives of this Agreement . . . are to . . . eliminate barriers to trade in, and facilitate the cross-border movement of, goods and services between the territories of the Parties, . . . promote conditions of fair competition in the free trade area . . . ." *Id.* *See also* discussion *infra* Part IV.A.

76. NAFTA, *supra* note 19, Ch. 17. Most likely as a result of the ongoing TRIPS negotiation at the time of the adoption of NAFTA, NAFTA provisions are largely modeled after TRIPS. *See* Hicks & Holbein, *supra* note 14, at 791.

77. NAFTA, *supra* note 19, art. 1701(1).

78. *Id.* *See also, e.g.*, George Y. Gonzalez, *An Analysis of the Legal Implications of the Intellectual Property Provisions of the North American Free Trade Agreement*, 34 HARV. INT'L L.J. 305, 306 (1993) (discussing NAFTA treatment of intellectual property rights).

79. NAFTA, *supra* note 19, art. 1704.

80. *See* Gonzalez, *supra* note 78, at 308 (noting the lack of common rules on the issue of parallel imports among NAFTA members).

81. *Id.* *See also* Theodore H. Davis Jr., *Territoriality and Exhaustion of Trademark Rights Under the Laws of the North Atlantic Nations*, 89 TRADEMARK REP. 657 (1999) (describing the approach adopted by Canada and the United States with respect to parallel imports).

thus continue to adopt their pre-NAFTA national policies. Nevertheless, even without an ad hoc harmonization of national rules, NAFTA members adopt consistent national positions with respect to trademark first sale and the importation of genuine but materially different goods into their territories. Notably, NAFTA members individually practice the principle of international trademark exhaustion within their respective territories and allow, although with some variations, the importation of materially different gray market goods from other NAFTA members as well as from other foreign jurisdictions.

International exhaustion of trademark rights has been the general rule in Canada since the late 1880s.[82] Canadian law has long established that once products have entered the stream of trade anywhere in the world, their importation into the national territory is permitted and does not constitute trademark infringement when the same or affiliated owners control the marks both inside and outside Canada (common origin marks).[83] Based upon the general principles of trademark protection, Canadian law only prohibits as trademark infringement the importation of products bearing marks identical or similar to marks already in use in the national territory when these marks are not owned or controlled by the same entity and the importation of those goods could create consumer confusion.[84] Still, Canadian

82. Condy v. Taylor (1887), 56 L.T.R. 891 (Ch.) (stating that no trademark infringement occurs when the goods are genuine goods manufactured by trademark owners).

83. *See* Wilkinson Sword (Can.) Ltd. v. Juda (1966), 51 C.P.R. 55 (Can.); Wella Canada Inc. v. Pearlon Products Ltd. (1984), 4 C.P.R. 3d 287 (Can. Ont. H.C.J.); Coca-Cola Ltd. v. Pardham, (1999) 85 C.P.R. 3d 489 (Can. F.C.A.). For further analysis, see Davis, *supra* note 81, at 721–30.

84. *See* Consumers Distributing Co. v. Seiko Time Canada Ltd. (1984), 1 C.P.R. 3d 1, 13–14 (Can. S.C.C.). This decision was codified in the Canadian Trade-marks Act of 1985, SC 1952-53, c. 49, as amended, RSC 1985, c. T-10 (Can). Section 7(b) provides that "[n]o person shall . . . direct public attention to his wares, services or business in such a way as to cause or be likely to cause confusion in Canada . . . between his wares, services or business and the wares, services and business of another." Canadian Trade-marks Act, R.S.C. 1985, c. T-13 § 7(b). Section 19 states that a national registration "gives to the owner of the trade-mark the exclusive right to the use throughout Canada of the trade-mark in respect of those wares or services." *Id.* § 19. Section 20 provides that "[t]he right of the owner of a registered trade-mark to its exclusive use shall be deemed to be infringed by a person not entitled to its use under this Act who sells, distributes or advertises wares or services in association with a confusing trade-mark or trade-name . . . ." *Id.* § 20.

courts have occasionally objected to the importation of gray market goods carrying common origin marks when these goods were materially different from the products authorized in the Canadian market and when these differences could harm consumers or the public good.[85] For example, Canadian courts have prevented the importation of genuine gray market goods because the goods had been damaged and the distributor had replaced the labels that were originally removed by trademark owners.[86] Canadian courts have also prevented the importation of gray market goods because the formulation of those goods was different than the products sold nationally and could cause consumer confusion.[87] Canadian courts have also carefully scrutinized the importation of products that required compliance with technical standards and only allowed their sale if importers disclosed to the public any differences with respect to product standards.[88] Generally, however, Canadian courts have been "relatively sympathetic" toward unauthorized parallel importers and rarely prohibit the importation of gray market goods into Canada when the importers use labels to cure the risk of a likelihood of consumer confusion because of products' material differences after the products have been distributed into the national territory.[89]

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85. In this respect, the position of Canadian courts has been defined as "inconsistent." Davis, *supra* note 81, at 730. "The significance of material differences in goods sought to be imported to the exhaustion of trademark rights has been the subject of inconsistent decisions under Canadian law." *Id.* *Compare* Mattel Canada Inc. v. GTS Acquisitions Ltd. (1989), 27 C.P.R. 3d 358 (Can. F.C.A.), *with* Smith & Nephew Inc. v. Glen Oak Inc. (1996), 68 CPR 3d 153 (Can. F.C.A.). *Compare also Consumers Distributing*, 1 C.P.R. 3d 1, *with* Sharp Electronic of Canada Ltd. v. Continental Electronic Info. Inc. (1988), 23 C.P.R. 3d 330 (Can. B.C.S.C.).

86. Dupont of Canada Ltd. v. Nomad Trading Co. (1968), 55 C.P.R. 97 (Can. Que. S.C.).

87. *See* H.J. Heinz Co. of Canada Ltd. v. Edan Foods Sales Inc. (1991), 35 C.P.R. 3d 213 (Can. F.C.T.D.) (finding potential consumer confusion between the formulation of ketchup in Canada and the United States because of the different tomatoes used in the respective products).

88. *Consumers Distributing*, 1 C.P.R. 3d 1. *But see Sharp Electronic*, 23 C.P.R. 3d 330 (enjoining the further importation of facsimile machines because the goods were "inherently different in quality" from those sold by the plaintiff in Canada).

89. Davis, *supra* note 81, at 732. *Consumers Distributing*, 1 C.P.R. 3d, at 24–25 (noting that the notice affixed to the products neutralized the significance of any difference in the products' warranties). *See also* Nestle Enterprises Ltd. v. Edan Sales Inc. (1991), 37 C.P.R. 3d 480 (Can. F.C.A.) (stating that "[t]he

Similar to Canada, the United States has also traditionally followed a system of international exhaustion,[90] and has prevented parallel imports only for products that carry marks identical or similar to marks already in use in the United States by third parties.[91] U.S. law explicitly allows parallel imports of gray market goods when "both the foreign and the U.S. trademark are owned by the same person or business entity" or the owners of these marks are "parent and subsidiary companies or otherwise subjected to common ownership and control."[92] Similar to Canada, U.S. courts nonetheless have allowed trademark owners to prevent the importation of gray market products when they "differ materially" from the goods authorized for sale in the domestic market even if the marks share a common ownership or control inside and outside the United States.[93] This rule was

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evidence does not satisfy . . . that Mountain Blend is an 'inferior' product. It is simply different from the plaintiff's pure coffee blends and that difference is adequately stated on the label.").

90. Originally, U.S. courts allowed parallel imports based on the principle of "universality" of trademark rights. *See* Hunyadi Janos Corp. v. Steger, 285 F. 861 (2d Cir. 1922); Fred Gretsch Mfg. Co. v. Schoening, 238 F. 780 (2d Cir. 1916); Apollinaris Co. v. Scherer, 27 F. 18 (C.C.N.Y. 1886). In A. Bourjois & Co. v. Katzel, 275 F. 539 (2d Cir. 1921), *rev'd*, 260 U.S. 689 (1923), the Supreme Court affirmed that marks have separate existence in separate national territories. *See also* American Circuit Breaker Corp. v. Oregon Breakers Inc., 406 F.3d 577 (9th Cir. 2005) (noting that in *Katzel* the Supreme Court "marked a dramatic change in trademark law by adopting the principle of 'territoriality' of trademarks and moving away from the rule of 'universality' "); HIEBERT, *supra* note 1, at 103.

91. The U.S. Tariff Act prohibits the importation of a product "that bears a trademark owned by a citizen of . . . the United States and is registered in the U.S. Patent and Trademark Office." *See* Tariff Act of 1930 § 526(a), 19 U.S.C.S. § 1526(a) (2006). The Lanham Act bars the importation of goods with a mark that will "copy or simulate" a registered trademark. Lanham Act § 42, 15 U.S.C. § 1124 (2006). The Lanham Act also applies the traditional provisions against infringement to confusingly similar products. Lanham Act §§ 32(a) (registered marks), 43(b) (unregistered marks), 15 U.S.C. §§ 1114(a), 1125(b).

92. K-Mart Corp. v. Cartier, Inc., 486 U.S. 281, 289 (1988) (indicating that the "extraordinary protection" afforded by the Tariff Act § 526 is exclusively for domestic U.S. trademark owners that have no corporate affiliation with the foreign manufacturer). For further analysis on this principle and other judicial references on the point, see MCCARTHY, *supra* note 10, § 29:49.

93. This principle follows two decisions of the D.C. Circuit: Lever Bros. Co. v. United States, 877 F.2d 101 (D.C. Cir. 1989) and Lever Bros. Co. v. United States, 981 F.2d 1330 (D.C. Cir. 1993). The court confirmed that when a mark is applied to physically different goods, the mark is not "genuine" for the American consumer and the affiliation between the producers does not reduce the confusion that could result from those differences. *Lever Bros.*, 877 F.2d 101; *Lever Bros.*, 981 F.2d 1330.

adopted in the *Lever Brothers* cases to avoid the potential confusion that could otherwise be created for consumers if two seemingly identical products are sold in the U.S. market under the same marks but have different material characteristics.[94] As an exception to the *Lever Brothers* rule, however, the U.S. Customs Service Regulations provide that materially different products can still lawfully enter into the U.S. territory when importers properly label those goods with a notice stating: "This product is not authorized by the United States trademark owner for importation and is materially different from the authorized products."[95] As a result, as long as products are properly labeled according to the U.S. Customs Regulations, trademark owners cannot rely on the *Lever Brothers* rule (and on material product differences) to prevent the importation of otherwise genuine products into the U.S. market. In other words, under U.S. Customs Service Regulations, proper labeling can guarantee that marks continue to serve the traditional trademark functions—indicating to consumers that the marked products are the same goods, in terms of commercial origin and quality, which were first distributed in the market by trademark owners.[96]

Finally, like Canada and the United States, Mexico also adopts a system of international trademark first sale as a domestic policy.[97] According to Article 92(II) of the Mexican

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94. *Lever Bros.*, 877 F.2d at 103; *Lever Bros.*, 981 F.2d at 1331. *See also* Societe Des Produits Nestle, S.A. v. Casa Helvetia, Inc., 982 F.2d 633, 639 (1st Cir. 1992) (stating that "under section 42, as under section 32, the question of whether [defendant] infringed the PERUGINA mark hinges on whether physical or like material differences exist between the Italian-made and Venezuelan-made products"). For a detailed survey of the relevant U.S. cases, see MCCARTHY, *supra* note 10, § 29:50–51.75.

95. 19 C.F.R. § 133.23(b). "Goods determined by the Customs Service to be physically and materially different . . . shall not be detained . . . where the merchandise or its packaging bears a conspicuous and legible label designed to remain on the product until the first point of sale . . . ." *Id.* "The label must be in close proximity to the trademark as it appears in its most prominent location on the article itself or the retail package or container. Other information designed to dispel consumer confusion may also be added." *Id.* *See also* MCCARTHY, *supra* note 10, § 29:50.50; Mark S. Sommers & Louis J. Levy, *US Customs Amends Gray Market Import Rule*, 117 TRADEMARK WORLD 32, 33 (1999).

96. MCCARTHY, *supra* note 10, § 29:50.50.

97. *See generally* Gonzalez, *supra* note 78, at 305–06 (analyzing the phenomenon of parallel imports in the NAFTA context with particular attention to Mexico); Bill F. Kryzda & Shaun F. Downey, *Overview of Recent Changes in Mexican Industrial Property Law and the Enforcement of Rights by the Relevant*

Industrial Property Law,[98] the registration of a mark cannot be used against "any person who markets, distributes, acquires or uses the product to which the trademark is applied for after the said product has been lawfully introduced on the market by the owner of the registered mark or his licensee."[99] Specifically, "[t]his case shall include the import of legitimate products to which the registered mark is applied, carried out by any person for their use, distribution or marketing in Mexico . . . ."[100] Gray market products are considered "legitimate" under the Mexican Industrial Property Law Regulations provided that they are introduced into the market of the country from which they are imported by the "owner or licensee of the registered mark" and that the owner of the mark inside and outside Mexico are "the same person or members of the same joint economic interest group, or their licensees or sublicensees."[101] Similar to Canada and the United States, however, Mexican law prohibits as trademark infringement the circulation of marked products when their quality has been altered by unauthorized third party importers,[102] or when the mark has been altered or removed altogether.[103] Still, the Mexican Industrial Property Regulations do not prevent the importation of materially

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*Government Authorities*, 21 CAN.-U.S. L.J. 99, 101 (1995) (considering the changes to the Mexican Industrial Property Law in 1994 as a result of Mexico's signing of NAFTA).

98. Ley de Fomento y Protección de la Propiedad Industrial, D.O. 4, June 27, 1991, amended by D.O. Aug. 2, 1994 (Mex.), *available at* http://www.wipo.int/wipolex/en/text.jsp?file_id=128816 [hereinafter Mexican Industrial Property Law].

99. *Id.* art. 92(II).

100. *Id.* This provision is applicable "pursuant to the terms and conditions laid down in the Regulations under this law." *Id.*

101. Article 54 of the Mexican Industrial Property Regulations provides that:

> it shall be presumed . . . that imported goods are legitimate where they meet the following requirements:
>
> > I. the introduction of the goods to the market of the country from which importation takes place must be done by the person who in that country is the owner or licensee of the registered mark;
> >
> > II. the owners of the mark registered in Mexico and in the foreign country must, on the date on which the importation of the goods takes place, be the same person or members of the same joint economic interest group, or their licensees or sub licensees.

Reglamento de la Ley de la Propiedad Industrial, D.O. Nov. 23, 1994 (Mex.), art. 54, *available at* http://www.wipo.int/clea/docs_new/pdf/en/mx/mx002en.pdf [hereinafter Mexican Industrial Property Regulations].

102. Mexican Industrial Property Law, *supra* note 98, art. 213(XX).

103. *Id.* art. 213(XXI).

different genuine gray market goods and do not require special labeling for those goods to be admitted and lawfully circulate in the Mexican territory.[104] Moreover, to date, Mexican courts do not seem to have halted or expressed concern as to the importation of materially different gray market goods into Mexico because of potential consumer confusion.[105]

### *B. The Harmonization of National First Sale Rules in European Trademark Law*

Since the original signing of the Treaty establishing the European Economic Community (EEC or Community) in 1957, the primary objective of the members of the EEC (now the EU) was the creation of an integrated European market where goods, services, people, and capital could move without restrictions.[106] Since then, the European Parliament, the European Commission (EC), and the Court of Justice of the European Union (ECJ) have carefully balanced the protection of intellectual property rights among member countries with the primary objective of promoting the free movement of goods in the European market.[107] As I have illustrated in a previous work, this has resulted in the development of a system of region-wide exhaustion where intellectual property

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104. Mexican Industrial Property Regulations, *supra* note 101, art. 54. The Mexican Industrial Property Regulations are also silent as to the case of imports concerning repackaged or relabeled goods. *Id.*

105. Although courts have not considered the repackaging or relabeling of gray market products, these instances could likely fall under the prohibition of Article 213 of the Mexican Industrial Property Law. Mexican Industrial Property Law, *supra* note 98, art. 213(XX and XXI).

106. Consolidated Version of the Treaty on the Functioning of the European Union, Mar. 30, 2010, 2010 O.J. (C 83) [hereinafter TFEU] as amended following the entering into force of the Treaty of Lisbon on December 1, 2009. Treaty of Lisbon, Dec. 13, 2007, 2007 O.J. (C 306). A complete list of the various amendments to the original Treaty establishing the European Economic Community (now European Union) is available at http://europa.eu/abc/treaties/ index_en.htm.

107. On the historical tension between the protection of intellectual property and the free movement of goods in the EU, see Friedrich-Karl Beier, *Industrial Property and the Free Movement of Goods in the Internal European Market*, 21 I.I.C. 131 (1990) [hereinafter Beier, *Industrial Property*]; Friedrich-Karl Beier, *The Doctrine of Exhaustion in EEC Trademark Law—Scope and Limits*, 10 I.I.C. 20 (1979); Herman Cohen Jehoram, *Harmonising Intellectual Property Law Within the European Community*, 23 I.I.C. 622 (1992); Ulrich Löwenheim, *Trademarks and European Community Law*, 9 I.I.C. 422 (1978); Willem Mak, *Trademarks and the European Common Market*, 6 I.I.C. 29 (1975).

rights, including trademark rights, are exhausted with respect to the territory of the EU after the first sale of a product, or a batch of products, in the EU; thereafter, those products can freely circulate within the European market.[108] As detailed below, the ECJ first adopted this principle as a measure to foster intra-Community trade leaving member countries free to adopt a broader regime, i.e., international exhaustion, in their national territory. As the European market integration intensified in the 1980s and 1990s, Community-wide exhaustion has become the general rule for all EU members.[109]

The adoption of the Community-wide exhaustion of trademark rights traces back to the 1960s. Originally, the ECJ turned to the antitrust provisions of the Treaty on the Functioning of the European Union (TFEU) to rule that attempts to block the free movement of goods across member countries were "incompatible with the common market."[110] Starting in the 1970s, the constant tension between the exercise of intellectual property rights and gray market goods within the EU prompted the ECJ to rely on the principle of free movement of goods, as settled in Articles 34 and 36 of the TFEU, in order to effectively integrate the European internal market. Article 34 prohibits quantitative restrictions on importation between "Member States" and other measures having an "equivalent effect,"[111] whereas Article 36 states

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108. This paragraph summarizes my previous detailed analysis of the principle of trademark exhaustion in the EU. *See* Calboli, *supra* note 2, at 47, 53–59. The creation of the European internal market imposed the acceptance of the principle of Community-wide exhaustion also with respect to patents and copyrights. This position is different from other jurisdictions, which practice international exhaustion with respect to trademarks, but national exhaustion with respect to patents and copyrights.

109. *Id.* at 53–60 (reconstructing the development of the principle of Community-wide exhaustion and the debates over the application of this principle as general standard among EU members). See also the ECJ position in Case C-335/96, Silhouette International Schmied v. Hartlauer Handelsgesellschaft, 30 I.I.C. 920 (1998).

110. Articles 101 and 102 (formerly 81 and 82) are the antitrust provisions of the TFEU. *See* TFEU, *supra* note 106, arts. 101–102. The ECJ applied these provisions in Joined Cases 56 & 58/64, Costen & Grunding v. EC Comm'n, 1966 E.C.R. 299; Case 24/67, Parke Davis v. Centrafarm, 1968 E.C.R. 55; Case 40/70, Sirena v. Eda, 1971 E.C.R. 69.

111. Article 34 (formerly 28) of the TFEU states that "[q]uantitative restriction on imports and all measures having equivalent effect shall be prohibited between Member States." TFEU, *supra* note 106, art. 34.

that domestic laws should not provide a means of "arbitrary discrimination or a disguised restriction of trade between Member States."[112] In several decisions, the ECJ stated that the primary purpose of trademark protection is to indicate commercial origin and that no reason subsists to prevent the free movement of goods carrying marks controlled by the same companies.[113] According to the ECJ, only when marks do not share a common origin would it be possible to prevent the importation of gray market products bearing identical or similar marks in a member country to prevent consumer confusion.[114]

While affirming the legitimacy of parallel imports of gray market goods within the European internal market, the ECJ conceded, however, the possibility of preventing the importation of products, which have been altered without trademark owners' consent.[115] The ECJ nonetheless limited

112. *Id.* art. 36. Article 36 (formerly 30) states that EU members can prohibit or restrict "imports, exports or goods in transit" based upon "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." *Id.* These prohibitions "shall not, however, constitute a means of arbitrary discrimination or a disguised restriction on trade between Member States." *Id.*

113. In Case 78/70, Deutsche Grammophon Gesellschaft mbH v. Metro-SB-Grossmarket GmbH, 1971 E.C.R. 487, the ECJ distinguished between the "existence" and the "exercise" of intellectual property rights and stated that the "exercise" should be consistent with the TFEU and protect only the "specific subject matter" of the right. The ECJ clarified the interpretation of "specific subject matter" in Case 16/74, Centrafarm BV v. Winthrop BV, 1974 E.C.R. 1183, 1194 and confirmed its view in Case 3/78, Centrafarm BV v. Am. Home Prods. Corp., 1978 E.C.R. 183 and Case 1/81, Pfizer Inc. v. Eurim-Pharm GmbH, 1981 E.C.R. 2913. For further analysis, see Calboli, *supra* note 2, at 54–56.

114. On the principle of "common origin," see Case 192/73, Van Zuylen Freres v. Hag AG, 1974 E.C.R. 731 (controversially stating that common origin included the case of companies "sharing the same origin" even if the marks were not owned by the same entities); Case 119/75, Terrapin Ltd. v. Terranova Industrie C.A. Kapferer & Co., 1976 E.C.R. 1039 (stating that the "common origin" doctrine was applied to a special case in *Hag I*); Case C-10/89, CNL-Sucal v. Hag AG, 1990 E.C.R. I-3711 (reversing the ECJ's position in *Hag I*); Case C-9/93, IHT Internationale Heiztechnik GmbH v. Ideal-Standard GmbH 1994 E.C.R. I-2782 (holding that the principle of "common origin" does not apply when marks have been voluntarily assigned). For further analysis on this point, *see* Calboli, *supra* note 2, at 56–59.

115. *See* Case 102/77, Hoffmann-La Roche & Co. v. Centrafarm Vertriebsgesellschaft Pharmazeutischer Erzeugnisse mbH, 1978 E.C.R. 1139, 1164–65; *see also* Ansgar Only, *Trade Marks and Parallel Importation—Recent*

these instances to circumstances where products had been materially altered by the importers—for example, repackaged or relabeled—after their first sale in the market and not to cases where the products were genuine (originally manufactured), and the product quality was materially different only because of production choices or market differentiation strategies directly originating with trademark owners.[116] Moreover, the ECJ developed the principle of "mutual recognition" of product requirements to prevent product discrimination and disguised restrictions to trade, and ruled that member countries may not "prohibit the sale in [their] territory of a product lawfully produced and marketed in another Member . . . even if the product is produced according to technical or quality requirements which differ from those imposed on its domestic products."[117] As a result of this principle, differences in product ingredients, presentation, or even technical standards would not qualify as a legitimate reason to prevent parallel imports and restrict free trade within the European market except in very limited and specific circumstances.[118] To prevent disguised barriers to intra-Community trade, European legislators also harmonized an increasing number of technical standards. In 1985, to address the growing need for standard harmonization, the European Council adopted the "New Approach to technical harmonization and standards"[119] and

*Developments in European Law*, 30 I.I.C. 521, 516 (1999) (providing a detailed survey of the cases where genuine products have been repackaged, rebranded, and relabeled).

116. Only, *supra* note 115, at 516–18.

117. Commission Communication, Oct. 3, 1980, Communication from the Commission concerning the consequences of the judgment given by the Court of Justice on 20 February 1979 in Case 120/78 ('Cassis de Dijon'), 1980 O.J. (C 256) 2, 2–3. The ECJ developed the principle of "mutual recognition" in the famous case *Cassis de Dijon*. Case 120/78, Rewe-Zentral AG v. Bundesmonopolverwaltung fur Branntwein, 1979 E.C.R. 649. In *Cassis de Dijon*, the ECJ stated that there was no valid reason why "provided that [the goods] have been lawfully produced and marketed in one of the Member States, [they] should not be introduced into any other Member State." *Id.* at para. 14.

118. In *Cassis de Dijon*, the ECJ limited those instances to the measures "being necessary to satisfy mandatory requirements relating in particular to the effectiveness of fiscal supervision, the protection of public health, the fairness of commercial transactions and the defense of the consumer." *Rewe-Zentral*, 1979 E.C.R. 649. *See also* TFEU, *supra* note 106, art. 36.

119. Council Resolution of 7 May 1985 on a new approach to technical harmonization and standards, 1985 O.J. (C 136) 1.

stated that EU legislators had to indicate simply the "essential requirements" for products, leaving it to independent European Standards Organizations to develop technical standards complying with these essential requirements.[120]

The principle of Community-wide exhaustion of trademark rights was ultimately codified in the First Council Directive 89/104/EEC (Trademark Directive),[121] and repeated verbatim in the Council Regulation EC/40/94 (Community Trademark Regulation).[122] The adoption of the Agreement for the European Economic Area (EEA) of May 2, 1992, extended this principle to the European Free Trade Agreement (EFTA) countries joining the EEA (Norway, Iceland, and Liechtenstein).[123] Notably, Article 7(1) of the Directive states that trademark rights "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."[124] Article 7(1) does not explicitly say, however, that Community-wide exhaustion is the *only* principle applicable within the EU (and now within the EEA).[125] In the years following the adoption of the Directive, member countries in favor of international exhaustion argued that this principle was simply a minimum

120. For a detailed summary of the process of harmonization of technical standards and the "New Approach to technical harmonization and standards," see Enterprise Directorate General, *Vademecum on European Standardisation*, EUROPEAN COMMISSION (2004) *available at* http://ec.europa.eu/enterprise/policies/european-standards/documents/vademecum/index_en.htm.

121. Council Directive 89/104, 1989 O.J. (L 40) 1 (EEC), now replaced by European Parliament and Council Directive 2008/95, 2008 O.J. (L 299) 25 (EC) [hereinafter Trademark Directive]. For a detailed analysis of the legislative history of the Trademark Directive and the drafting process of Article 7 on the exhaustion of trademark rights, see Cohen Jehoram, *supra* note 1, at 501.

122. Council Regulation 40/94, Dec. 20, 1993 on the Community Trade Mark, 1994 O.J. (L 011) 1 (EC), now replaced by Council Regulation 207/2009, 2009 O.J. (L 78) 1 (EC) [hereinafter CTM Regulation]. Article 13(1) of the CTM Regulation states that "[a] Community 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." *Id.* art. 13.

123. Annex XVII and Article 2(1) of the Protocol to the Agreement on the European Economic Area, Jan. 3, 1994, O.J. (L 1) 3 extended the effect of Article 7 of the Trademark Directive to the EEA from January 1, 1994.

124. Trademark Directive, *supra* note 121, art. 7(1).

125. *See, e.g.*, Nicholas Shea, *Does the First Trade Marks Directive Allow International Exhaustion of Rights?*, 10 E.I.P.R. 463, 463 (1995).

standard and that individual members of the EU were free to apply a broader rule.[126] Against this position, however, the ECJ clarified that EEA-wide exhaustion is the *only* applicable criterion within the European market and that national rules providing different exhaustion regimes needed to be amended.[127]

Finally, Article 7(2) of the Trademark Directive states that trademark rights are not exhausted where "there exist legitimate reasons for the proprietor to oppose further commercialization of the goods, especially where the condition of the goods is changed or impaired after they have been put on the market."[128] Although the ECJ has confirmed the possibility that "legitimate reasons" may prevent trademark exhaustion and the free movement of goods within the EEA, the ECJ has nonetheless interpreted this provision cautiously to prevent unnecessary trade restrictions. Specifically, the ECJ held that the unauthorized repackaging and relabeling of genuine products constitute two of the few "legitimate reasons" that trademark owners may invoke to prevent parallel trade within the EEA because they may lead to consumer confusion or provoke unfair detriment to the reputation of a mark.[129] The ECJ also clarified that the

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126. This position was strongly supported, among others, by Professor F. K. Beier, the Director of the Max-Planck Institute for Intellectual Property, Competition, and Tax Law. *See* Beier, *Industrial Property*, *supra* note 107, at 156–60. For a detailed reconstruction of the debates on this issue following the adoption of the Trademark Directive, see Calboli, *supra* note 2, at 60–66.

127. *See* Case C-335/96, Silhouette International Schmied v. Hartlauer Handelsgesellschaft, 30 I.I.C. 920 (1998). In *Silhouette*, the ECJ explicitly stated that "[n]ational rules providing for exhaustion of trade-mark rights in respect of products put on the market outside the EEA under that mark by the proprietor or with its consent are contrary to Article 7(1)." *Id.* at para 31. The ECJ confirmed this position in C-173/98, Sebago Inc. and Ancienne Maison Dubois et Fils AS v. GB-Unic SA, (1999) C.M.L.R. 1317; Joined Cases C-414-416/99, Zino Davidoff SA v. A & G Imports Ltd, Levi Strauss & Co. v. Tesco Stores Ltd., and Levi Strauss & Co. v. Costco Wholesale UK Ltd., 2001 E.C.R. I-8691; C-324/08, Makro Zelfbedieningsgroothandel CV, Metro Cash & Carry BV, Remo Zaandam BV v. Diesel SpA, 2009 E.C.R. I-10019. *But see* Case C-306/96, Javico Int'l & Javico AG v. Yves Saint Laurent Parfums SA, 1998 E.C.R. I-1983 (where the ECJ adopted a different position based upon the antitrust provisions of the TFEU); Mag Instrument Inc. v. California Trading Co., 29 I.I.C. 316 (EFTA 1998) (where the EFTA court stressed that courts or legislators in EFTA States should decide on the admissibility of products imported from outside the EEA).

128. Trademark Directive, *supra* note 121, art. 7(2).

129. *See* Joined Cases C-427, C-429 & C-436/93, Bristol-Myers Squibb v. Paranova A/S, 1996 E.C.R. I-3457, I-3536–45; Case C-379/97, Pharmacia &

exceptions of Article 7(2) do not extend to genuine goods of materially different quality when these differences are the result of trademark owners' marketing strategies and the unauthorized importers have not modified the products.[130] Likewise, the principle of mutual recognition continues to apply in the EU (EEA), and EU (EEA) members cannot prevent the importation of materially different goods from other members when those products comply with the requirements of the exporting countries.[131] Moreover, a "New Legislative Framework" has replaced the "New Approach to technical harmonization" and requires that EU (EEA) members take on an even larger role in increasing compliance with European standards to promote product uniformity and intra-EEA trade.[132]

## IV. LESSONS FROM A COMPARATIVE ANALYSIS OF NORTH AMERICA AND EUROPE

This Section compares the positions adopted by NAFTA

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Upjohn SA v. Paranova A/S, 1999 E.C.R. I-6927; Case C-349/95, Loendersloot v. Ballantine & Son Ltd., 1997 E.C.R. I-6227; Case C-337/95, Parfums Christian Dior SA v. Evora BV, 1997 E.C.R. I-6013; Case C-143/00, Boehringer Ingelheim KG v. Swingward Ltd., 2002 E.C.R. I-3759; Case C-348/04, Boehringer Ingelheim KG v. Swingward Ltd., 2007 E.C.R. I-03391; Case C- 276/05, Wellcome Found. Ltd. v. Paranova Parmazeutika Handels GmbH, 2008 E.C.R. I-10479; *see also* Irini A. Stamatoudi & Paul L.C. Torremans, *International Exhaustion in the European Union in the Light of "*Zino Davidoff*": Contract Versus Trade Mark Law?*, 31 I.I.C. 123, 137–38 (2000); Paul Torremans, *New Repackaging Under the Trade Mark Directive of Well-established Exhaustion Principles*, 11 E.I.P.R. 664 (1997). *But see* Case C-59/08, Copad SA v. Christian Dior Couture SA and Others, 2009 E.C.R. I-3421; Case C-558/08, Portakabin Ltd., Portakabin BV v. Primakabin BV, 2010 E.C.R. I-0000; Case C-127/09, Coty Prestige Lancaster Group GmbH v. Simex Trading AG, 2010 E.C.R. I-0000.

130. In *Loendersloot*, 1997 E.C.R. I-6227, the ECJ also said that importers could remove labels when these labels had been placed by trademark owners simply to control distribution and prevent parallel imports. In *Parfums Christian Dior*, 1997 E.C.R. I-6013, the ECJ went even further and applied trademark exhaustion to the use of trademarks in advertising. More recently, however, in *Copad*, 2009 E.C.R. I-3421 the ECJ stated that a trademark owner may oppose the unauthorized sale of luxury goods to discount stores by a licensee if the sale could damages the reputation of the mark.

131. *See* Council Resolution of 28 October 1999 on mutual recognition, 2000 O.J. (C 141) 2 (incorporated into the EEA Agreement); *see* Decision of the EEA Joint Committee No. 15/2002 of 1 March 2002 amending Annex II (technical regulations, standards, testing, and certifications) to the EEA Agreement, 2002 O.J. (L 110) 9.

132. European Parliament and Council Regulation (EC) No. 765/2008 of 9 July 2008, 2008 O.J. (L 218) 30.

and EU (EEA) members, and emphasizes the limitations of the principle of trademark first sale to guarantee free trade in free trade areas. In particular, this Section argues that effective free trade in free trade areas requires the adoption of a cumulative approach that combines uniform first sale rules, of at least regional exhaustion, with the prohibition against preventing the importation of materially different gray market products. This Section concludes that, in the long term, this can be achieved by the international harmonization of national product standards. In the immediate future, however, members of free trade areas can admit materially different gray market goods based on one of the following approaches: (1) mutually recognize national product characteristics of other members of free trade areas, or (2) allow the importation of materially different goods, so long as those products are properly labeled to avoid consumer confusion.

### *A. Trademark First Sale and Market Integration in North America and Europe*

As elaborated in Part II, the general purpose of the principle of trademark first sale is to prevent the use of marks as a tool for market segmentation and to promote the free movement of goods in the market.[133] The application of this principle across multiple jurisdictions, however, has created heated debate because of the impact of parallel imports on corporate profits and, in turn, national economies.[134] Still, countries have intensely pursued international free trade agreements in the past few decades because of their advantages for both corporations and national economies.[135] Hence, effective free trade can be secured only by limiting, *inter alia*, the domestic enforcement of national trademark rights when this enforcement can represent a barrier to legitimate trade.[136]

The above described approaches by NAFTA and EU (EEA) members regarding the admissibility of gray market

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133. *See* discussion *supra* Part II.
134. *See* discussion *supra* Part I.
135. *Id.*
136. *See generally* ABBOT ET AL., *supra* note 4, at 1 (introducing the relevance of international intellectual property in an increasingly integrated world economy).

goods in their territory directly reflect this tension between free trade and the exercise of trademark rights.[137] NAFTA and EU (EEA) members, however, have followed different models when pursuing the creation of their respective free trade areas.[138] Similar to TRIPS, NAFTA members have adopted primarily a *laissez faire* approach to domestic trademark first sale rules based on a strict interpretation of the principle of trademark territoriality and national sovereignty.[139] In contrast, EU (EEA) members have partially relinquished national sovereignty on the matter, and have harmonized their national laws to create a unified European market where the free movement of goods is a fundamental priority.[140]

Still, despite the fact that the harmonization of domestic rules on trademark first sale never constituted a national priority among NAFTA members,[141] all members of NAFTA individually practice international trademark exhaustion and permit the importation, and the circulation, of gray market goods within their respective territory when the marks affixed to the products share a common origin inside and outside their jurisdictions.[142] As a result, NAFTA members de facto promote the free movement of goods across the NAFTA territory.[143] NAFTA does not create, however, a fully

137. *Id.*

138. *See* discussion *supra* Part III.

139. *See, e.g.*, Curtis A. Bradley, *Territorial Intellectual Property Rights in an Age of Globalism*, 37 VA. J. INT'L L. 505, 549 n.223 (1997) (highlighting that NAFTA members only agreed upon the fact that NAFTA requires them to maintain the minimum standards described in the agreement); James A.R. Nafziger, *NAFTA's Regime for Intellectual Property: In the Mainstream of Public International Law*, 19 HOUS. J. INT'L L. 807, 815–16 (1997) (stressing that NAFTA members diverge on details regarding trademarks); *see also* NAFTA, *supra* note 19, art. 1701 (indicating that members must adhere to the standards set forth in NAFTA, but may create their own trademark registration systems).

140. *See* discussion *supra* Part III.B.

141. *See* Kenneth W. Abbott & Gregory W. Bowman, *Economic Integration in the Americas: A Work in Progress*, 14 NW. J. INT'L. L. & BUS. 493, 493–96 (1994) (discussing the 1990 initiation of NAFTA negotiations between the United States and Mexico); Richard Bernal, *Regional Trade Arrangements in the Western Hemisphere*, 8 AM. U. J. INT'L L. & POL'Y 683, 697 (1993) (discussing the proposal of NAFTA in the 1990s); Frank J. Garcia, *Protection of Intellectual Property Rights in the North American Free Trade Agreement: A Successful Case of Regional Trade Regulation*, 8 AM. U. J. INT'L L. & POL'Y 817, 821 (1993) (noting Mexico's desire to be a part of the NAFTA).

142. *See* discussion *supra* Part III.A.

143. *Id.*

integrated market because material differences in product quality can theoretically operate as a barrier to intra-NAFTA trade and ultimately undermine the scope of national rules on international trademark first sale.[144] Moreover, the harmonization of technical standards across NAFTA members only partially eliminates barriers to intra-NAFTA trade, such as existing differences in product standards or requirements.[145] NAFTA members also do not adopt a principle of mutual recognition as extensive as the principle developed by the ECJ and implemented in the EU (EEA).[146] Nevertheless, although still at the national level, all NAFTA members adopt domestic policies to reduce the impact of the materially different quality argument on international imports.[147] Specifically, appropriate labeling can cure material product differences and allow the importation of qualitatively different gray market goods into the Canadian and the U.S. markets while Mexican law does not seem to prevent the admissibility into Mexico of any products, also materially different, as long as the importers have not altered the products.[148] Furthermore, NAFTA members do not create a "fortress NAFTA" against parallel imports from outside their free trade area and apply the principle of international exhaustion to all products worldwide.[149] Still, the strong

144. For a similar conclusion, see Gonzalez, *supra* note 78, at 329 (comparing the NAFTA and EU trading blocks).

145. See NAFTA, *supra* note 19, Ch. 7B on sanitary and phytosanitary measures (SPS), and Ch. 9 on technical barriers to trade (TBT). *See also* Maureen Irish, *Regulatory Convergence, Security and Global Administrative Law in Canada-United States Trade*, 12 J. INT'L ECON. L. 333, 339 (2009) (providing a detailed analysis of these and other provisions related to NAFTA SPS and TBT measures).

146. *See* NAFTA, *supra* note 19, art. 714; *see also* Irish, *supra* note 145, at 339–40. "Both SPS and TBT provisions in NAFTA contain explicit obligations to recognize measures of other NAFTA Parties as equivalent." *Id.* at 339. "Neither go as far as the Cassis de Dijon decision . . . which interprets the ban on measures equivalent to quantitative restrictions . . . as requiring that any products lawfully produced or marketed in the Community must also have free access to the rest of the Community unless they would harm legitimate interests in the importing state . . . ." *Id.* at 339 n.28. For a position in favor of creating a full NAFTA common market, see WENDY DOBSON, C.D. HOWE INSTITUTE, THE BORDER PAPERS, NO. 162, SHAPING THE FUTURE OF THE NORTH AMERICAN ECONOMIC SPACE: A FRAMEWORK FOR ACTION (Toronto 2002), *available at* http://www.cdhowe.org/pdf/commentary_162.pdf.

147. *See* discussion *supra* Part III.A.

148. *Id.*

149. Gonzalez, *supra* note 78, at 330.

reliance on national rules by NAFTA members continues to characterize NAFTA as a fragile market integrated area, where national interest could easily prevail upon the principle of free movement of goods across NAFTA members and undermine the very purpose of the free trade area.

By contrast, the process of market integration in the European Union led EU (EEA) members to necessarily abandon their individual national policies and to harmonize national laws with respect to trademark exhaustion as well as technical standards to remove any disguised barriers to effective European trade.[150] EEA-wide trademark exhaustion has thus become the rule applicable to all EU (EEA) members.[151] To fill any remaining gap and avoid disguised restrictions to the free movement of goods in the EU (EEA), the ECJ developed the principle of mutual recognition and repeatedly ruled that products should be allowed in the market of any EU (EEA) country if they comply with the standards of the country where they were first marketed.[152] Only very serious concerns relating to health, security, or public policy in member countries can supersede this principle and prevent intra-EEA trade.[153] As a result, products can freely circulate within the European market without any barriers, even when they are materially different in quality.[154] Nevertheless, this integration does not extend beyond the territory of EEA members; goods are free to move within the EEA but genuine products coming from outside "fortress Europe" can be legally stopped at the will of trademark owners.[155] Ultimately, this solution reduces the scope of trademark exhaustion exclusively to European trade and permits market partitioning outside the EEA by the same multinational corporations that distribute goods under the principle of regional exhaustion within EU (EEA)

150. *See* discussion *supra* Part III.B.

151. *See* Case C-335/96, Silhouette International Schmied v. Hartlauer Handelsgesellschaft, 30 I.I.C. 920 (1998).

152. *Id.*

153. *See* TFEU, *supra* note 106, art. 36; Case 120/78, Rewe-Zentral AG v. Bundesmonopolverwaltung fur Branntwein, 1979 E.C.R. 649.

154. *See* discussion *supra* Part III.B.

155. *See, e.g.*, Carl Steele, *"Fortresse Europe" for Trademark Owners*, 1998 TRADEMARK WORLD 14 (Aug. 1998) (summarizing the relevance of the ECJ's decision in *Silhouette* in creating a closed trading block among member countries).

members.[156] At the regional level, however, the EU (EEA) solution constitutes a stronger and more definite approach than NAFTA to facilitate trade among members of a free trade area, although merely at the EU (EEA) level.

### *B. The Successful Recipe for Market Integration Beyond Trademark First Sale*

In light of the above, the following considerations can thus be derived with respect to the relationship between the exercise of trademark rights, free trade, and the principle of trademark first sale to promote effective market integration and the free movements of goods within the territory of free trade areas.

Generally, the comparative analysis of NAFTA and the EU directly demonstrates that effective free movement of goods in free trade areas cannot be achieved by relying exclusively on the principle of trademark first sale, even if countries nominally adopt national rules of international or regional trademark exhaustion. As this Article has highlighted, material product differences can jeopardize free trade in free trade areas when countries prevent the importation of gray market products because of these material quality differences. The adoption of uniform rules on either international or regional trademark first sale still remains, however, the primary condition that is necessary for creating an effective system of free movement of products across members of free trade areas.[157] In contrast, if members of free trade areas adopt domestic rules in favor only of national exhaustion, or practice non-uniform regimes of international and regional exhaustion, this would result in preventing regional trade altogether. In particular, if members of a free trade area practice only national trademark exhaustion, this would necessarily prevent any parallel trade among members. Similarly, if they adopt non-uniform exhaustion regimes, the goods lawfully imported from outside the free trade area into the territory of the

156. Critically, on this aspect of the principle of the EEA-wide exhaustion, see Calboli, *supra* note 2, at 87–90.

157. *See* Case C-335/96, Silhouette International Schmied v. Hartlauer Handelsgesellschaft, 30 I.I.C. 920 (1998). "This, moreover, is the only interpretation which is fully capable of . . . safeguard[ing] the functioning of the internal market." *Id.* at para. 27.

members practicing international trademark exhaustion would not be allowed into members practicing regional exhaustion, which would in turn jeopardize free trade within the whole free trade area.[158] As this Article has illustrated, both NAFTA and the EU adopt uniform national positions—international and EEA-wide exhaustion for NAFTA and EU (EEA) members, respectively.[159] Hence, the problem of non-uniform national rules was precisely at the heart of the discussions that ultimately led the ECJ to clarify that EEA-wide exhaustion is the only applicable rule for all members, even for those previously practicing international exhaustion.[160]

Beyond requiring the adoption of uniform rules on trademark first sale, the comparison of NAFTA and the EU indicates, however, that effective market integration in free trade areas also requires the elimination of other barriers to trade so as to permit the parallel trade of all genuine products across members, even when those products carry differences in their material quality.[161] Generally, one of the primary objectives under international trade law and policy—the harmonization, or at least the approximation, of national product standards—can eventually eliminate these barriers and facilitate free trade.[162] Undoubtedly, the adoption of uniform standards would diminish the need for manufacturers to adapt their products to different national markets and it would impose compliance with certain common product standards across different jurisdictions.[163] Still, this harmonization would be a lengthy process that also requires compromises and changes in national standards, which in turn can increase the opposition against free trade and free trade agreements at the national level.[164] Furthermore, the harmonization of national standards will

158. *See* Calboli, *supra* note 2, at 60–66.

159. *See* discussion *supra* Part III.A–B.

160. *See* discussion *supra* Part III.B.

161. *Id.*

162. *See, e.g.*, Lori M. Wallach, *Accountable Governance in the Era of Globalization: The WTO, NAFTA, and International Harmonization of Standards*, 50 U. KAN. L. REV. 823, 823 (2002).

163. *Id.* at 824.

164. *See id.* at 823–24 (arguing in this context with respect to NAFTA and the WTO that "decades of popular political movements . . . have struggled to ensure that those who will live with the results are able to control the process and outcomes of important policy decisions").

not eliminate all product differences across separate jurisdictions. Trademark owners do not differentiate their goods merely to satisfy different national standards. As mentioned earlier, they often adapt products to domestic preferences and tastes, or simply use different ingredients based on local competition or basic costs.[165] These differences will continue to exist even in the ideal (and remote) situation where national requirements are fully harmonized, and trademark owners will continue to use these differences to try to prevent unauthorized channeling of their products across separate countries, and to segment the international market altogether.[166]

Ultimately, the comparative analysis of NAFTA and the EU demonstrates that effective market integration among members of free trade areas may be achieved only if, alongside the process of harmonization of national product standards, members adopt at least one of the following approaches. First, as exemplified by the position taken in the EU (EEA), members of free trade areas can promote free trade in their areas by implementing national principles of mutual recognition and by accepting into their territory gray market goods from other members as long as these goods comply with the product requirements of their country of origin.[167] Unlike the harmonization of national standards, the mutual recognition of the quality of goods coming from other members of free trade areas does not require changes in national standards. In contrast, mutual recognition only

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165. It is generally known, for example, that the traditional Coca-Cola beverage made in Mexico is different from the same beverage distributed in the U.S. market. *See* Louise Chu, *Is The Mexican Coke the Real Thing?*, SAN DIEGO UNION TRIBUNE, Nov. 9, 2004, *available at* http://www.signonsandiego.com/uniontrib/20041109/news_1b9mexcoke.html.

The Mexican Coca-Cola soda is made with sugar cane sweetener. *Id.* In the United States, the Coca-Cola Company stopped using cane sugar in the 1980s because of rising cost and started using corn syrup instead. *Id.* Still, numerous American consumers prefer the Mexican version of the Coca-Cola beverage over the U.S. version because of the sweeter taste and intentionally purchase the Mexican Coca-Cola precisely because of its material different quality when they see the Mexican products on the shelves of U.S. stores. *Id.* On the differences between Mexican and U.S. Coca-Cola and the reaction of U.S. consumers, see *id.*

166. *See id.*

167. Joel P. Trachtman, *Toward Open Recognition? Standardization and Regional Integration Under Article XXIV of GATT*, 6 J. INT'L ECON. L. 459 (2003).

requires the acceptance of the importation of those goods, even though they may be of materially different quality than the products distributed nationally, so long as they comply with fundamental national requirements, such as national security, safety, and public health related standards.[168] The acceptance of this principle, however, may prove controversial within national jurisdictions because it treats imported goods differently from the products distributed nationally.[169] As some authors have noted, this principle may even conflict with the non-discrimination and most-favored-nation principles that all WTO members are supposed to follow as part of their GATT, WTO, and TRIPS obligations.[170] Accordingly, although undoubtedly useful to promote free trade at the regional level, this solution seems less preferred for members of free trade areas.

Second, perhaps less controversial and immediately more effective is the approach of allowing the importation of qualitatively different gray market products into the territories of members of free trade areas so long as the products are properly labeled by the importers and comply with the fundamental requirements of national security, safety, and public health. Under this approach, which is currently applied by Canada and the United States, third party unauthorized importers of materially different gray market products are required to specify the different

168. *See* discussion *supra* Part III.B.

169. *See generally* Irish, *supra* note 145, at 350 (stating that "[f]or [mutual recognition] to work effectively, regulators from the involved countries must trust each other and accept that they have obligations extending beyond responsibilities to their own citizenries"). The tension between mutual recognition and national standards "is especially significant for mutual recognition of conformity assessments in which testing, inspection, verification or monitoring of compliance is done in one country and recognized in others." *Id.*

170. Because of its limited scope, this Article does not provide an exhaustive analysis of the tension between the principle of mutual recognition and the principle of non-discrimination, most-favored nation, and national treatment under GATT, the WTO, and TRIPS. Generally, it has been affirmed that the EU principle of mutual recognition is compatible with GATT and WTO principles, although some doubts in this respect have been raised during the recent enlargement of the EU. On these important aspects, see Lorand Bartels, *The Legality of the EC Mutual Recognition Clause Under WTO Law*, 8 J. INT'L. ECON. L. 691 (2005); Kalypso Nicolaidis, *Non-Discriminatory Mutual Recognition: An Oxymoron in the New WTO Lexicon?*, *in* REGULATORY BARRIERS AND THE PRINCIPLE OF NON-DISCRIMINATION IN WORLD TRADE LAW 267 (2000).

characteristics of the products and disclaim that their distribution is not authorized by trademark owners.[171] By using appropriate labels, unauthorized importers can thus easily dispel any likelihood of consumer confusion as to the quality of the imported products and prevent any alleged harm that the public could suffer because of the sale of these unauthorized gray market goods.[172] Notably, these labels allow consumers to clearly identify the differences among the products offered for sale, respectively, by trademark owners and by unauthorized importers under the same mark in the same national markets. Consumers can then base their purchases on an informed judgment about these respective products and their different qualities.[173] As stressed before, despite trademark owners' opposition to parallel imports, the sale of genuine products outside authorized channels of distribution do not alter or modify products *per se*—products remain in the same form as when the trademark owners originally distributed them, even if in a foreign market.[174] These sales also do not cause detriment to the traditional functions of the marks because the marks continue to indicate to consumers the commercial origin and the quality of the products as if they were distributed by trademark owners.[175] Although less controversial and immediately more effective, this solution remains nevertheless imperfect. In a completely integrated market, as currently in the EU (EEA), materially different genuine products should be able to move regardless of ad hoc labels disclosing their differences. Still, this solution clearly represents the easier solution, to date, to

171. *See* discussion *supra* Part III.A.

172. In Canada, see Consumers Distributing Co. Ltd. v. Seiko Time Canada Ltd. (1984), 1 C.P.R. 3d 1, 13–14 (Can. S.C.C.); Nestle Enterprises Ltd. v. Edan Sales Inc. (1991), 37 C.P.R. 3d 480 (Can. F.C.A.). In the United States, see MCCARTHY, *supra* note 10, § 29:50.50.

173. *See* Chu, *supra* note 165. "While the flavor of Mexican Coke provides a taste of nostalgia for immigrants hundreds of miles from home, its retro green-tinted contour glass bottles have also caught on among some baby boomers, who can recall a time when their cola was made with sugar." *Id.* "Coca-Cola downplays the appeal of the cane sugar version, insisting that 'there's not a perceivable taste difference between Mexican Coke and Coke bottled in the U.S.' . . . [b]ut fans of the import claim there's a world of a difference." *Id.* "Rob Boyce . . . discovered the drink while living for a time in Yuma, Ariz. . . . Now back in Georgia, Boyce savors the few Mexican Cokes that he comes across, sipping carefully rather than guzzling what he considers a treat." *Id.*

174. *See* MCCARTHY, *supra* note 10, § 29:50.50.

175. *Id.*

achieve effective market integration in free trade areas compatible with the principles of trademark territoriality and national sovereignty.

In summary, although fiercely opposed by multinational corporations because of the additional pressure that gray market goods create for their business, "the territorial approach of trademark law and the interests of international trade do not form irreconcilable contradictions."[176] As this Article has reiterated, trademark rights do not permit trademark owners to control the distribution of products after their first sale in the market.[177] To grant this control to trademark owners would create an unjustified monopoly against the rights of purchasers to dispose of their lawfully acquired products and resell them as they see convenient. Accordingly, when national interests prompt individual countries to enter free trade agreements to take advantage of the benefits of free trade, this principle needs to extend to the whole territory of the regional block of countries that are members of these agreements. Consequently, the national exercise of trademark rights should not interfere with the free movement of goods across this territory so long as products are genuine and importers have not altered their quality. Likewise, multinational corporations should not object to the free movement of genuine products across this territory by relying on (often minimal) differences in the quality of their products, particularly when labels or other notices can properly inform consumers about these product differences. To the contrary, the proper functioning of free trade in free trade areas would be jeopardized and trademark protection would wrongfully exceed its scope to the detriment of competition and consumers.[178]

## V. CONCLUSION

The relationship between international trade and trademark rights is a complex one. Despite trademark owners' desires to control the future distribution of the products that they have introduced into the market, trademark law was never intended to grant trademark

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176. Beier, *supra* note 1, at 71.
177. *See* discussion *supra* Part II.A.
178. Beier, *supra* note 1, at 71–72.

owners this control. Although generally accepted at the national level, this principle has been fiercely debated internationally due to the strong interests of multinational corporations in preventing arbitrage in consumer goods from low-cost to high-cost countries and maximizing profits across separate jurisdictions. Hence, free trade is a fundamental component of the modern economy and the free movement of goods is a fundamental component of free trade, which requires the limitation of the exercise of national trademark rights when these rights act as barriers to free trade.

Different trade areas in the world have adopted different solutions with respect to the application of the principle of trademark first sale, or trademark exhaustion, to promote regional market integration. The analysis of the market integration achieved, respectively, by NAFTA and EU (EEA) members indicates that regional market integration requires, at a minimum, the adoption of uniform national rules providing for the exhaustion of trademark rights internationally or, at least, within the territory of members of a free trade area. Effective integration in free trade areas may be jeopardized, however, when material differences in product quality operate as barriers to trade among members, even if members uniformly practice international or regional trademark exhaustion. The harmonization, or at least the approximation, of national standards alongside the mutual recognition of product characteristics, or the acceptance into national markets of materially different gray market products from other members with appropriate labels disclosing these differences, can nevertheless overcome these barriers. Ultimately, to invoke trademark protection to segment the market against the parallel trade of genuine goods across members not only undermines the purpose of free trade areas; it also goes against the general scope of trademark protection, which protects consumers against confusion and trademark owners against illegitimate actions that could take unfair advantage of, or damage, the reputation of the marks, and does not prohibit the resale of genuine goods that trademark owners themselves have introduced into the market, even if in the territory of another member of a free trade area.