Exhaustion of rights: how to capitalise on UK's intellectual property rights and parallel imports, post-Brexit

While the **London Book Fair** is back in full swing at Olympia in London, which is a **pleasant sight** since the fair was cancelled in 2020 and only held online in 2021, I was reminded, yesterday, of the seminar I attended, on 10 March 2022, on "**exhaustion of rights and downstream uses**", organised by the **British Literary and Artistic Copyright Association ("BLACA")**. The presentations made by the speakers during this seminar, and in particular by Catriona Stevenson, general counsel of the

book publishing trade body Publishers Association, gave me cause for concern. While I could not pinpoint exactly why their arguments on the best United Kingdom ("UK")'s future regime on exhaustion of intellectual property rights ("IPRs") were troubling me, I decided to zero in and focus on analysing this topic, in the article below.

1. What is exhaustion of rights?

IPRs (i.e. patents, trademarks, designs and copyright) exist to incentivise innovation and creation of new technology, products or creative works. However, these IPRs need to be balanced against enabling competitive markets, consumer choice and fair access to IPRs-protected goods for the benefit of society.

Enters the concept of exhaustion of IPRs, also sometimes referred to as the "first sale doctrine" ("**Exhaustion of rights**").

It is one of the mechanisms to strike this balance, between incentivising creativity and innovation, and enabling more competition, consumers' choice and access to goods. While owners of IPRs can control distribution of their creation in terms of the first sale of their product, the principle of exhaustion of rights puts some limits on how far that control extends.

So the principle of exhaustion of rights essentially provides that, once goods have been placed on the market by a rights holder or with their consent, this rights holder cannot then assert their IPRs to prevent the onward sale of those goods into the territory. For example, once you have bought a book, the owner of the copyright in that book cannot then stop you from selling this book to another person, in the same territory.

Exhaustion of rights underpins parallel trade. Parallel trade is the cross-border movement of genuine (i.e. not counterfeited) physical goods that have already been put on the market. This is the import and export of IPRs-protected goods that have already been first sold in a specific market. As a result to exhaustion of rights, where the IPRs relating to goods have been exhausted, there will be an opportunity for others to engage in the parallel trade of those goods. For example, a distributor moves a good that had been sold in Germany, to import that good into the UK.

Prior to Brexit, when the UK was one of the 28 member-states of the European Union ("**EU**"), the regime of exhaustion of rights applying in the UK had been organised by Brussels' technocrats, via the European Commission and European Parliament legislative processes.

But post-Brexit, the UK is a free agent (allegedly), empowered to decide its own fate, and stance, on its future exhaustion regime and rules relating to the parallel trade of goods into the UK.

2. What was the deal, pre-Brexit, on exhaustion of rights?

Pre-Brexit, the UK was part of the EU, which operates a EU-wide regional exhaustion of rights regime, in compliance with the EU principle of free movement of goods.

Indeed, once goods have been put on the market, anywhere in the EU single market, these goods can flow freely in the then 28 (now 27) member-states of the EU, as well as in the European Economic Area ("**EEA**") (which, in addition to all EU member-states, is constituted by Iceland, Liechtenstein and Norway). Right holders cannot assert their IPRs to prevent this free movement of goods anywhere in the EEA. So, for example, a German right holder could not complain that his or her goods were being imported in the UK, pre-Brexit.

All this means that IPRs in goods first placed on the market anywhere in the EEA, by or with the right owners' consent, would be considered exhausted in the rest of the EEA. As a result, goods could be both parallel imported in the UK from the EEA, and parallel exported out of the UK to the EEA.

However, IPRs can be asserted to prevent goods from outside of the EEA entering the European market, without the rights holder's consent. This is because, for non-EEA goods, the IPRs are not considered "exhausted" when the goods are first put on the EEA market. Therefore, goods can move around within the EEA market, but not in respect of those goods put on the market by rights holders in non-EEA markets. So, for example, a US right holder could, and still can, complain that his or her goods were being imported in the UK, from Italy, without his or her consent.

On 31 December 2020, the UK left the EU, via its Brexit, therefore also leaving the EU's regional exhaustion of rights regime. Or did they?

3. What is the current deal, post-Brexit, on exhaustion of rights?

On 31 December 2020, the UK ceased to be part of the EEA and therefore, since then, IPRs relating to goods put on the UK market are not considered "exhausted" from the perspective of EEA countries.

Consequently, right holders can prevent the flow of goods they put on the UK market, into any EEA country.

However, the UK and the EU decided to maintain, for now, the "*status quo*". This means that, although the UK is no longer part of the EEA, the rights in goods put on the EEA market are considered exhausted in the UK. So, if a product protected by an IPR in the EEA is sold with the permission of the IPR owner anywhere in the UK or EEA, then the exclusive right of the IPR owner to control sale or commercial use of the product can no longer be asserted. For example, rights holders cannot prevent the flow of goods they put on the EEA market, into the UK. Additionally, UK rights holders cannot prevent the flow of goods from the EEA, into the UK.

Although parallel imports from the EEA to the UK remain freely importable (with the UK unilaterally participating in the EEA regional exhaustion regime for now), the same is not true of parallel imports from the UK into the EEA. IPRs in goods first placed on the market in the UK are not considered exhausted in the EEA. Consequently, right owners can stop the parallel export of these goods into the EEA, and UK businesses exporting IPRs-protected goods to the EEA need to ensure that they have requisite permission.

This is called the "UK+" EEA-wide exhaustion of rights regime.

As far as goods from outside the EEA are concerned, the case law of the Court of Justice of the European Union ("**CJEU**") which determined that, save for patents, international exhaustion of rights cannot apply in respect of goods put on the market outside of the EEA, still applies in the UK as retained EU law. Although the court of appeal in England & Wales and the UK supreme court may decide to diverge from such CJEU case law, it is likely that, in respect of goods put on the UK market both outside the EEA and within, the position on exhaustion of rights in the UK will remain as it is until the UK government directs a change of approach.

4. How may exhaustion of rights change, in the UK, post-Brexit?

Such moment for a new approach to exhaustion of rights is looming on the horizon.

The current UK+ exhaustion of rights regime may be a temporary solution until, following a consultation, a more permanent regime may be fixed by the UK government.

Therefore, further to a feasibility study commissioned to EY, the UK intellectual property office ("**UKIPO**") – the official UK government body responsible for IPRs – launched a consultation, which concluded on 31 August 2021, asking respondents whether the UK should keep the current exhaustion of rights regime on genuine (i.e. legitimate, not counterfeited) goods and materials (i.e. not services or digital goods), or change it (the "**Consultation**").

In the Consultation, four possible options were under consideration, as follows:

- **option one: UK+ to maintain the status quo**. This would be a continuation of the current unilateral application of an EEA-wide regional exhaustion regime, in the UK;
- **option two: national exhaustion**. This national exhaustion regime would imply that only goods put on the market in the UK can flow around the UK. Goods put on the market in any other country, European or otherwise, could be stopped from entering the UK market by relying upon UK IPRs;
- **option three: international exhaustion**. In an international exhaustion regime, goods put on the market in any country, anywhere in the world, could be automatically parallel imported in the UK, and IPRs could not be asserted to prevent the first sale of that

product in the UK; or

- **option four: mixed regime**. Under a mixed regime, certain IPRs, or certain types of goods, may have a different exhaustion regime applied to them. Switzerland, for example, which is neither part of the EU nor of the EEA, but is part of the European single market via bilateral agreements, has a mixed regime. Switzerland has adopted a unilateral EEA-wide regional exhaustion regime, with the exception of fixed price goods, primarily medicines, for which national exhaustion applies.

While the UKIPO sought views on the four above-mentioned regimes, in the Consultation, it also made it clear that it considered a national regime incompatible with the Northern Ireland protocol and, as such, ruled out adopting that option.

Hang on, what? The Northern Ireland protocol?

As with the rest of the UK, Northern Ireland adopted the same UK+ EEA-wide regional exhaustion of rights regime, from 31 December 2020 onwards. Goods can therefore flow freely from the EU member-state Ireland, or from anywhere else in the EEA for that matter, into Northern Ireland without IPRs holders being able to enforce their rights. This is one of the principles of the Northern Ireland protocol, along with the provision that certain EU legislation must be adopted in Northern Ireland to enable goods to flow around the geographical territory that is the island of Ireland; both in and out of Northern Ireland. However, as part of the EEA, the EU member-state Ireland cannot adopt a different exhaustion of rights regime to the other EEA territories. Therefore, notwithstanding the Northern Ireland protocol, rights holders in Ireland can still enforce their IPRs to stop their goods from being put on the market in Northern Ireland, flowing in the EU member-state Ireland.

So, what was the outcome of the Consultation which, despite

mentioning the national exhaustion regime, as one of the four options, ruled out from the outset that such national exhaustion regime could ever be implemented in the UK, going forward?

Inconclusive, to say the least.

There were only 150 respondents to the Consultation, the majority of which came from the life sciences sector and creative industries.

As set out on the summary of responses to the Consultation:

- most respondents stated that there was parallel trade of goods (materials and products) in their respective sector;
- however, responses on the impact of parallel imports from the EEA on organisations, varied between those respondents whose livelihoods were dependent on commercialising parallel traded goods, and those who represent, or are, rights holders:
    - those respondents dependents on commercialising parallel traded goods, such as pharmaceutical distributors, commented that parallel imports from the EEA benefitted their organisation by contributing to (a) a greater choice of suppliers to source goods from that could in turn be made available to customers at different price points, (b) the availability, flexibility, and security of supply of goods to support market demand and alleviate supply shortages, (c) a competitive market especially intra-brand competition amongst suppliers of the same branded product (or substitutable products) encouraging price convergence;
    - those respondents representing, or being, rights holders, such as brand owners, replied that

> parallel imports (a) did not increase choice by providing a greater number of different goods because parallel imports tended to be products already available or approved in the UK, especially licenced branded goods such as branded toys and branded medicines, (b) weakened supply chain resilience due to fluctuations in supply and costs, making demand forecasting particularly difficult for brand owners, and (c) did not always drive competition for the benefit of the consumer but mainly benefitted distributors (through arbitrage opportunities) and resellers (incentivised to purchase lower priced parallel imports, rather than domestically sourced products to achieve higher profit margins).

The most favoured option by respondents was a continuation of the current UK+ regime, because of the difficulties with the national regime and the Northern Ireland protocol. So, if Northern Ireland was out of the picture, most respondents favoured the national exhaustion regime. But because the Northern Ireland protocol is a reality we all have to live with, they favoured the current UK+ EEA-wide regional exhaustion regime.

This is exactly what the two illustrious speakers at the BLACA seminar, Catriona Stevenson, general counsel of the trade body for the UK publishing industry Publishers Association, and David Harmsworth, general counsel of UK music neighbouring rights collecting society PPL, concluded, on 10 March 2022: let’s stick with the UK+ exhaustion regime because it is the least-damaging necessary evil.

More than 50 percent of the respondents to the Consultation opposed an international regime, citing concerns about stifling innovation, the environmental impact, domestic revenue losses, goods of inferior quality or different

standards hitting the UK market and the distortion of retail competition in favour of multinationals. Brand owners, manufacturers and those in the creative industries were most opposed to the international exhaustion regime.

More than 20 percent of respondents expressed opposition to a national exhaustion regime, with their primary concerns being isolating the UK market and prices being driven up. Distributors and those who depend upon the supply of goods from Europe – in particular, UK pharmaceutical stakeholders and the National Health Service ("**NHS**") – were most opposed to the national exhaustion regime.

A mixed regime, such as the one in place in Switzerland, was not favoured by respondents to the Consultation.

Further to the Consultation, and the publication of a summary of responses received, the UKIPO decided to do … nothing, merely setting out that it is "*analysing your feedback*" on its website.

Whilst an option on exhaustion of rights, which would reconcile the views of those whose livelihoods depend on commercialising parallel traded goods, and right holders, is nonexistent, the UKIPO invoked the lack of data available to understand the economic impact of any of the alternatives to the current UK+ regime, in order to shelve the Consultation for now.

Consequently, the UK will continue with the current regional UK+ regime for the time being, since "*further development of the policy framework must take place before the issue is reconsidered*" (sic).

5. Why something's gotta give, in order for the UK to keep its rank as a trade-

friendly, competitive and exports-focused nation

The UK government's decision to stay with the current UK+ EEA-wide exhaustion regime continues the strange asymmetry for IPRs holders in which a first sale in the EEA exhausts their rights in the UK, while a first sale in the UK does not exhaust their IPRs in the EEA.

This may provide continued opportunities for IPRs holders in the EEA to assert those IPRs against parallel importers from the UK. So, anyone engaging in parallel importation of goods from the UK to the EEA must carefully considers whether those goods are protected by unexhausted IPRs in the EEA.

More concerning is that Brexit has left the UK with all the disadvantages of being tied to EU laws, but none of the advantages, as far as parallel imports, parallel exports and exhaustion of rights are concerned. EEA-based companies can easily export their goods to the UK, but UK businesses cannot reciprocate. Why is the UK accepting such unilateral deal? Because it is heavily dependant on exports coming from Europe, being a nation which manufacturing sector is weak. Moreover, a lot of UK businesses, and UK consumers, are reliant on the EEA for the supply of goods and raw materials.

So, as I predicted in 2016, many UK businesses either moved to the EEA or opened a manufacturing plan or facility in the EEA.

As a consumer, can you imagine living in London and only having access to UK-produced and manufactured goods, if a national exhaustion of rights regime was ever implemented in the UK? Not only would retail prices for non-UK manufactured products go through the roof, but basic necessities goods would be in scarce supply. The UK could kiss goodbye to all its rich London-based expatriates, unwilling to return to a 1970s' style shortage-stricken era.

Moreover, UK's borders controls are structurally weak and mismanaged, at best, and have been so for years. Indeed, the UK was recently sentenced by the CJEU to a potentially very heavy fine, after being found negligent in allowing criminal gangs to flood European markets with cheap Chinese-made clothes and shoes, while not collecting the correct amount of custom duties and VAT on these imported Chinese goods, from 2011 to 2017. In this context, how do, exactly, proponents of the national exhaustion of rights regime in the UK, such as the Publishers Association and PPL, intend to implement rigorous controls over IPRs-protected goods entering the UK, at UK borders, especially in respect of copyright which are not registered in any IPRs' database?

As far as goods from outside the EEA are concerned, IPRs owners have probably decided to forego the UK market as the place of first sale altogether, focusing their European sales on the EEA territory, which is a much more attractive proposition in terms of potential number of sales and diversity of customer-base. Then, these goods might enter the UK market via parallel imports, from the EEA, later on. But such convoluted distribution strategy has a cost, since all goods imported in the UK from the EEA are now subjected to trade tariffs and custom charges, as well as import duties.

No wonder every consumer is feeling particularly affected by the "supply chain crisis" and "inflation", in the UK.

Also, the resistance, from UK book publishers in particular, to let go of the distribution system territory-by-territory, on the pretense that "*territorial rights systems support diversity and competition in the publishing sector*" and that "*carving rights allows smaller publishers to compete and acquire sets of rights, in a way that might not be possible if global rights packages became the norm*", is just plain nationalistic and backward-looking protectionism. Compared to other creative industries, such as the music streaming sector, the book publishing business is a dinosaur, refusing to evolve

towards digital products such as e-books and digital comics, and towards global rights packages which would no doubt improve worldwide distribution of books at reasonable prices, in particular in emerging countries.

Already, the film industry – which used to be very monolithic itself – is finally forced to evolve towards global rights packages and more digital streaming, with COVID decimating the audience of local cinemas, and with the likes of Netflix and Amazon Prime only agreeing to "digital licenses", where they acquire all worldwide rights in perpetuity to a motion picture prior to production, for a fixed "buyout" payment with no additional net profits, royalties or other accountings, before billing it as a "*Netflix Original*" or "*Amazon Prime Video Original*".

The UK, and in particular its government, needs to master the ability to keep on looking inward, while, at the same time, adopting a much more realistic and pragmatic view and assessment of its own trade bargaining power, as well as strengths and weaknesses, *vis-à-vis* its main trading partners, worldwide. In particular, the UK government must push UK businesses towards leaner, more digitised and better streamlined worldwide distribution rights of their products and services, in order to keep their competitive edge. It is only at this cost of uncompromising realism and self-awareness, that the UK will keep a seat at the table of the most trade-friendly, competitive and exports-focused nations in the world.

Crefovi's live webinar: Exhaustion of rights – how can the UK coin the best trade deal? – 12 April 2022

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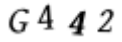

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