EXHAUSTION AND PARALLEL IMPORTS IN THE INDIAN TRADEMARK LAW

Soumil Jhanwar[*]

Abstract

In the Kapil Wadhwa-Samsung judgment, a division bench of the Delhi High Court had held that India follows the "international exhaustion" of trademarks under Section 30(3)(b) of the Trade Marks Act, 1999. This article analyses the case law with respect to international exhaustion in India to outline the fault with the interpretation of Section 30(3)(b) in both the polarizing decisions by the single-judge and division bench of the Delhi High Court in Kapil Wadhwa-Samsung, to demonstrate that the principle governing exhaustion of trademarks ought to be legislatively resolved in India. Thereafter, the article analyses various policy considerations involved in the determination of the issue of exhaustion of trademarks to propose the applicability of "partial international exhaustion" in India. The article specifically uses the reduction of transaction cost as a means for analysis and as a justification for its conclusion.

Keywords: trademarks, exhaustion of IPR, Trade Marks Act, trademark policy, international exhaustion

DOI: https://doi.org/10.61238/ijipl.2023v1304

INTRODUCTION

In India, Section 30(3)(b) of the Trade Marks Act, 1999 deals with the issue of exhaustion of trademark rights. It exempts any lawfully

[*] Soumil Jhanwar is an Associate at Shardul Amarchand Mangaldas and Co. (Dispute Resolution), and is a gold medalist in IPR Law from the National Law School of India University, Bangalore/ Bengaluru. This paper was with the guidance and advice of Prof. T. Ramakrishna, who is the Professor of IPR Law at the National Law School of India University.

acquired goods from infringement, if such goods had been put on the market under the registered trademark by the proprietor or with his consent.[1] However, Section 30(3)(b) does not clarify whether the term "the market" includes foreign markets (making it "international exhaustion") or the Indian market (making it "national exhaustion"). This very issue had arisen in the *Kapil Wadhwa-Samsung* dispute, where a single judge of the Delhi High Court discerned the incorporated principle to be that of "national exhaustion", holding that "the market" evidently referred to the Indian market.[2] Overturning this, the Division Bench saw the Section as a manifestation of "international exhaustion", finding that the word "market" meant "any market" due to the absence of an explicit qualification.[3] This was subsequently appealed to the Supreme Court in Civil Appeal No. 8600/2013, which still stands undecided.

This article first outlines the rationalization in each of the aforesaid decisions, to demonstrate that the existing law is grossly indeterminate and the true solution to the problem only lies in a legitimate amendment rather than in a superficial interpretation. Second, the article identifies the factors that the legislature ought to consider while drafting the exhaustion rule. Third, it posits the best exhaustion regime should be the one that minimizes the transaction costs associated with alternative remedies in law. Finally, it proposes a new "partial international exhaustion" as the new rule that minimizes such transaction costs.

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1 Michael Sardina, 'Exhaustion and First Sale in Intellectual Property' (2011) 51 Santa Clara L. Rev. 1055, 1056.

2 Samsung Electronics Co Ltd & Anr v Kapil Wadhwa and Ors (2012) SCC Online Del 1004 ("Kapil Wadhwa (Single Judge)").

3 Kapil Wadhwa and Ors v Samsung Electronics and Anr (2012) SCC Online Del 5172 ("Kapil Wadhwa (Division Bench)").

SAYING NO TO A JUDICIAL SOLUTION

The only statutory interpretive aid to the determination of the exhaustion principle incorporated in the Trade Marks Act is the phrase "put on the market under the registered trade mark" in Section 30(3)(b).[4] Since this phrase does not evince a clear answer, the Single Judge and the Division Bench in the *Kapil Wadhwa-Samsung* dispute indulged in different methods of purposive interpretation.

A. The Single Judge – Objective Harmonious Interpretation

Conducting a harmonious interpretation, the Single Judge analysed the words "the registered trade mark" to conclude that the phrase is only indicative of "the" mark (singular and definite) registered in India in accordance with the Act.[5] He also interpreted "the market" (singular and definite) to construe "Indian market".[6] This interpretation was bolstered by the fact that the Act also mentions "the market" in Section 29(6)(b), which prohibits unauthorized offering for sale in the market.[7] Since the Act only governs infringements within India, "the market" inevitably means the Indian market in this section as well. Moreover, wherever the Act intends to describe markets in all jurisdictions, it uses the phrase "*any* market" (singular but indefinite), as it does in Sections 30(2)(b) and 76(1)(a).[8] Had "the market" been used to connote the global market as a unified market, even these sections would have used the phrase "the market", rather than "any market". Therefore, through a harmonious interpretation, the phrase

4 See Trade Marks Act 1999, s 30(3)(b).
5 Kapil Wadhwa (Single Judge) (n 2) at 82(b).
6 Ibid at 82(a).
7 Ibid at 68(e)(IV)-(V).
8 While the Single Judge did not expressly mention this distinction, they took pains to explain the difference between the concepts of "the market" and "any market", presumably addressing an argument on the aforesaid sections. See Kapil Wadhwa (Single Judge) (n 2) at 68(e)(II)-(III).

"the market" can only be construed as the "Indian market", which indicates the application of "national exhaustion".

B. The Division Bench – Subjective Interpretation

Equally legitimate was the Division Bench's purposive construction of the statute, through legislative material. The Bench used committee reports[9] and India's statements at the WTO to demonstrate that the Indian government had favoured "international exhaustion".[10] Importantly, the Bench used a discarded draft of the objects and purposes of the Act, that had explicitly specified the incorporation of the international exhaustion principle.[11] The Bench finally concluded that the word "market" is indicative of any market across the globe.[12]

The Division Bench's decision was followed in various subsequent cases as well, but they are not pertinent for discussion,[13] given that they merely apply the *Kapil Wadhwa* Division Bench's decision as an authority, rather than making an independent assessment of the doctrine.[14]

C. The Need for a Legislative Intervention

Evidently, two contrasting but equally legitimate interpretations of Section 30(3)(b) can be justified, through different methods of purposive interpretation.[15] The objective harmonious interpretation

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9 Kapil Wadhwa (Division Bench) (n 3) at 62.

10 Ibid at 61.

11 Ibid at 56-60.

12 Ibid at 53-55.

13 Microsoft Corporation & Anr v Jayesh & Anr (2014) SCC Online Del 803 ("Microsoft Corp.") ; Philip Morris Products SA & Anr v Sameer & Ors (2014) SCC Online Del 1077 ("Philip Morris"); Hindustan Unilever Limited v Union of India & Ors, WP No. 22822 of 2012 (Mad HC, 20 Jul 2021) ("Hindustan Unilever"); Lifestyle Equities CV & Ors v Amazon Sellers Service, CS (COMM) 1015/2018 (Delhi HC, 14 Sep 2022) ("Lifestyle Equities").

14 Microsoft Corp. (n 13) at 14; Philip Morris (n 13) at 40; Hindustan Unilever (n 13) at 3-7; Lifestyle Equities (n 13) at 21.

15 Aharon Barak has laid out a thesis explaining how purposive interpretation can lead to multiple correct outcomes depending on the primacy attached to a particular method of

can be faulted for over-analysis of the statutory scheme, by contending that the draftspersons may not have paid heed to such harmonization.[16] The discernment of the subjective purpose of the Parliament can be controverted by arguing that sporadic statements by a couple of parliamentarians cannot constitute "Parliamentary purpose" and override the clearly harmonized use of the words "the market".[17] Consequently, the true legislative intent remains beclouded, and even the Supreme Court can only undertake a superficial analysis, using either of the aforementioned methods. However, since the choice of the method of exhaustion is a policy decision that has important ramifications for businesses and consumers,[18] the choice must not be left to an arbitrary and superficial interpretation. Therefore, the legislature must deliberate concerns associated with different forms of exhaustion to lay out a clear policy, that works the best for the Indian market.

Apart from concerns with the interpretive techniques, the principle laid down in *Kapil Wadhwa* Division Bench also results in a practical absurdity, that can be demonstrated from the most recent decision of *Lifestyle Equities CV & Ors v Amazon Sellers Service* by the Delhi High Court ("***Lifestyle Equities***").[19] In the said case, Lifestyle Equities (the Plaintiff) was the exclusive licensee for the trademark of Beverly Hills products in India.[20] Despite having acquired an exclusive license from Beverly Hills itself (situated in the US), Lifestyle Equities was naturally

interpretation or due to conflict in the values that the legal system incorporates. See Aharon Barak, *Purposive Interpretation in Law,* (Princeton Uni. Press 2005) 339-69.

16 Bennion highlights that judges often cite "inadvertent errors in drafting" to justify an interpretation reasonable through other means. See FAR Bennion, *Statutory Interpretation*, (3rd ed., Reed Elsevier 1997) 676.

17 This was in fact an argument specifically raised by the Single Judge Bench in Kapil Wadhwa (Single Judge) (n 2) at 137-38.

18 Ariel Katz, 'The First Sale Doctrine and the Economics of Post-Sale Restraints' (2014) BYU L. Rev. 55, 74-88.

19 Lifestyle Equities (n 13).

20 Ibid at 5.

under the impression that it won't face competition from the manufacturers of Beverly Hills product sellers. However, the Plaintiff soon discovered that Amazon was indulging in arbitrage, whereby, it was purchasing Beverly Hills products abroad at cheap prices and selling them on its platform in India, without the Plaintiff's permission.[21] Due to the sheer popularity of Amazon, the Plaintiff was naturally heavily losing out on revenue due to competition.

While in the order, the Plaintiff was successful in getting a temporary injunction over the sale of Beverly Hills products on Amazon, the Delhi High Court also categorically noted that this was merely an interim relief and that India follows international exhaustion otherwise.[22] Meaning thereby, eventually, the Plaintiff will face competition from other producers of Beverly Hills products overseas, despite having procured the exclusive rights to sell Beverly Hills products in India. This is outrightly unfair to an entity that has obviously paid a premium to be the exclusive licensee of a trademark across the whole of India.

The example of *Lifestyle Equities* evinces that, apart from concerns with the interpretive methods, the principle laid down in the *Kapil Wadhwa (Division Bench)* is also practically absurd and patently unfair. The next section analyses the various relevant considerations while drafting such a provision and argues for a "transaction cost"/ "legal efficiency" method to weigh these considerations.

NATIONAL OR INTERNATIONAL EXHAUSTION? A TRANSACTION COSTS APPROACH

The exhaustion debate is usually shaped by weighing the respective pros and cons of national exhaustion and international exhaustion, to

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21 Ibid.
22 Ibid at 21.

discern the more suitable regime. This part demonstrates that concerns with either of the approaches are largely resolvable through alternative legal solutions. Due to this, it concludes that the best solution is one that minimizes the transaction costs associated with such alternative legal solutions.

A. Common Factors

Price inflation under national exhaustion

From a consumer perspective, the major concern with national exhaustion is that it permits the proprietor to artificially increase prices in a country, without facing arbitrage from its cheaply sold products in other countries.[23] This not only hampers consumer choice but also reduces the real income of the consumer who is forced to unnecessarily pay a higher price.[24] The cross-border price arbitrage facilitated by international exhaustion limits the price differentiation permissible to a proprietor.[25]

However, the aforesaid problem is highly overstated for two reasons. First, since India is a third-world country, its customers are anyway usually the beneficiaries of international price differentiation, rather than its victims.[26] Consequently, even with a national exhaustion scheme, it is unlikely that the prices charged in the Indian market will be substantially higher than those in other markets.

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23 Irene Calboli, 'Trademark Exhaustion in the European Union: Community-Wide or International--The Saga Continues' (2002) 6 Marq. IP L. Rev. 47, 85.

24 Ibid.

25 Christopher B Conley, 'Parallel Imports: The Tired Debate of the Exhaustion of Intellectual Property Rights and Why the WTO Should Harmonize the Haphazard Laws of the International Community' (2007) 16 Tul. J. Int'l Comp. L. 189, 202.

26 In cases across jurisdictions, the exhaustion issue inevitably arises only in cases where the price in a third-world country was low, which facilitated arbitrage of the same against the manufacturer's high price listings in first-world countries. See *Sebago Inc et al v GB-Unic SA* (1999) Case C-173/98, 2 CMLR 1317 (ECJ) at 508 (Goods arbitraged from El Salvador to Belgium); *Kirtsaeng v John Wiley and Sons* (2013) 568 US 519, at 39 (Books arbitraged from Thailand to the US).

Second, a dominant proprietor can be prevented from charging unfairly excessive prices under Section 4(2)(a) of the Indian Competition Act.[27] Furthermore, the government can also use the Essential Commodities Act, to ensure price parity for essentials.[28] While the comprehensiveness and efficiency of these alternatives are highly doubtful, they theoretically provide some alternative legal solutions.

Proprietor interest and product availability under international exhaustion

A rationale at absolute loggerheads with "price inflation" is that of the proprietor's interest.[29] The differential pricing permitted by national exhaustion has categorical benefits for proprietors and even consumers. First, since the profit-maximizing equilibrium price vastly varies across countries due to varying patterns and elasticity of demand, price discrimination allows the producer to maximize its profits by tailoring its prices to the demand, supply, and consumer preferences in each jurisdiction.[30] Second, this ensures the cheap

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27 The section prohibits a dominant enterprise from charging unfair prices in the market. While usually dominance is unilateral, the Competition Commission has on instances provided relief against multiple entities in the same market charging excessive prices. One example is that of the unfair prices charged by car manufacturers on car parts and after sales services. See *Shamsher Kataria v Honda Siel and Others* (2014) Case No. 03/2011 (Competition Commission of India) at 2.5.86-2.5.99 <https://www.cci.gov.in/sites/default/files/032011_0.pdf>.

28 The Act empowers the Central Government to impose price ceilings for commodities like drugs, fertilizers, foodstuffs, petroleum, seeds, N-95 masks, amongst other things. See Essential Commodities Act 1955, s 3 read with Schedule I (India).

29 This argument is mostly the rationalization provided by EU for avoiding international exhaustion. See European Commission, 'Tiered Pricing for Medicines Exported to Developing Countries, Measures to Prevent their Re-importation into the EC Market and Tariffs in Developing Countries' (22 April 2002) s3.1 <https://trade.ec.europa.eu/doclib/docs/2005/april/tradoc_122196.pdf>.

30 Nicholas Petit, 'Parallel trade' in *Trade and Competition Law in the EU and Beyond* 332 (Elgar 2011) 336; Lazaros Grigoriadis, *Trade Marks and Free Trade* (Springer 2014) 5, 15-18. This has been explained through graphical method by Fisher and Syed. See William Fisher and Talha Syed, 'Differential Pricing' *Harvard Cyber Blog* (2 April 2012) 5-6 <https://cyber.harvard.edu/people/tfisher/Drugs_Chapter6.pdf>.

availability of a product in poorer countries, while also allowing the proprietors to recoup their investment from the pocket of the consumers in richer countries, who can afford it.[31] This also benefits the consumers in poorer countries, who may have had to pay a higher price in an internationally uniform price system, where the proprietor would be forced to raise prices across the board to ensure profitability.[32]

The benefits of national exhaustion are also overstated. Since India's prices are likely to be relatively lower, national exhaustion in India is irrelevant for the facilitation of international price differentiation. For instance, a drug sold at $1 in India is likely to be sold at $3 in the US. If the US allows international exhaustion, then irrespective of India's exhaustion policy, Indian wholesalers will be able to conduct arbitrage by reselling in the US. Similarly, if the US follows national exhaustion, then irrespective of India's exhaustion policy, Indian wholesalers will not be able to conduct arbitration by reselling in the US. Lastly, since India's prices are anyway lower, the American wholesalers will not be able to conduct arbitrage by reselling in India, irrespective of India's exhaustion regime. Consequently, only the exhaustion policies in the richer countries will determine whether price differentiation is possible or not.[33]

Having said that, even if the "lower-price" assumption is falsified in exceptional cases, the availability of essential products like pharmaceutical goods will be governed by the patent exhaustion

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31 This argument is especially sensitive for the Pharma Industry, where it is crucial for the drug to be available in another country. It is important to note that this is mostly done in the context of patent exhaustion and not trademark exhaustion. See Katz (n 18) 78-79. Posner says this also encourages investment. See Richard Posner, *Anti-trust Law* (2nd ed., University of Chicago Press 2001) 203-07.

32 Guy Rub, 'The Economies of Kirstaeng v. John Wiley & Sons Inc' (2013) 81 Res Gestae 41, 45-47.

33 Samuel Dobrin & Archil Chochia, 'The Concepts of Trademark Exhaustion and Parallel Imports' (2016) 6(2) Baltic J. Eur. Stu. 28, 43.

policy, and not the trademark exhaustion policy. Without trademark rights, the product can still be sold by change of branding.[34] However, without patent rights, the foreign-originated product itself cannot be sold.[35] Therefore, it is erroneous to bring in the perspective of the availability of pharmaceutical drugs to the trademark exhaustion debate.

Most importantly, a "regional resale clause" in any distribution contract can be an alternative solution to national exhaustion, which mitigates the risks of arbitrage.[36] While this solution may be incomprehensive and have distribution-chain-loopholes, the use of such loopholes by smaller entities down the distribution chain would make arbitrage so expensive as to only be viable in extremely high levels of price differentiation.[37] Therefore, while the proprietor and product-availability issues usually do not arise in India (especially when talking about trademark exhaustion), any issues that do arise can be substantially addressed through regional resale clauses.

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34 For example, AstraZeneca's COVID-19 vaccine is being sold under different trademarked names, such as Vaxzevria and Covishield in different countries. See 'Introducing Vaxzevria' (*RT*, 30 March 2021) <https://www.rt.com/news/519574-astrazeneca-name-change-vaccine-vaxzevria/> accessed 20 February 2023.

35 Daniel Hemel & Lisa Ouellette, 'Trade and Tradeoffs: The Case of International Patent Exhaustion' (2016) 116 Colum. L. Rev 17, 21

36 Such clauses mandate the wholesaler of the product to only resell the product in the country of original sale. Since their buyers are relatively small retailers with limited resources to export, this can prevent parallel exports. Moreover, even if there is a loophole through which entities down the chain indulge in arbitrage, it reduces the profit margin for resale in a foreign country by increasing the levels in the distribution chain. This is akin to the clause included by Levi Strauss with its wholesalers in Mexico, who were not permitted to sell outside of the country. See Joined Case C-414-416/99, *Zino Davidoff v A&G Imports, Levi Strauss v Costco Wholesale UK, Levi Strauss v Tesco Stores* (20 November 2001) at 25; Rub (n 27) 44-45; Amelia Smith Rinehard, 'Contracting Patents: A Modern Patent Exhaustion Doctrine' (2010) 23 Harv. J. L. Tech. 483, 484.

37 It is doubtful whether such excessive levels of price differentiation should at all be allowed. Therefore, not addressing the same cannot be called as a criticism of the contractual circumvention of parallel imports. A good criticism of price differentiations can be found in Kirtsaeng v John Wiley (n 26).

Product quality and uniformity in international exhaustion

Another major concern with international exhaustion is that different products or different versions of the same product may be sold under the same trademark in different jurisdictions, due to various possible reasons. First, the proprietor may design market-taste-specific products that are not intended to be sold in other markets.[38] Second, the proprietor may sell different versions of the same product in different markets, again due to differences in factors of demand and consumer preferences.[39] Lastly, a proprietor may have permitted unrelated entities to sell products under the trademark in different jurisdictions through territorial licenses and assignments.[40] Such products may have different qualities or attributes.

This market differentiation germinates three important objections to international exhaustion. First, the inferiority or difference in the quality of a foreign product may either dissatisfy or confuse consumers, defeating the fundamental purpose of uniform-quality-assurance associated with trademarks.[41] This may also be due to the increased risk of counterfeited products being mixed with such authentic products.[42] Second, the infrastructure for the after-sales-

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38 A simpler example of the same, is that manufacturers make different chargers for the US and Europe as the power outlets in the former country deliver only 110 volts whereas the power outlets in the latter deliver 220 volts. See Kyle Cattani *et al.*, 'Simultaneous Production of market-specific and global products: A two-stage stochastic program with additional demand after recourse' (2003) 50(5) Naval Research Logistics 438, 54.

39 The Economic & Social Committee of the EU emphasized this point by using the example of how people in the UK prefer mint flavoured toothpaste whereas those in Indonesia prefer Clove flavoured ones. See EU Economic and Social Committee, 'Opinion on the Exhaustion of Registered Trademark Rights' (2001) C-123 Official Journal 28, at 3.1.1 <eurlex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:52001IE0042:EN:HTML>.

40 For example, Schweppes had permitted Coca Cola to sell products under its trademark in the UK through assignment of its UK trademark to Coca Cola. Subsequent parallel imports from UK to Germany had led to a recent exhaustion dispute between Schweppes and Coca Cola. See *Schweppes SA v Red Paralela SL* (2017) ECLI:EU:C 990 (European Court of Justice) at 7.

41 Dobrin & Chochia (n 33) 37-39.

42 EU Economic & Social Committee (n 39) at 3.1.5.

services of such products may not be readily available in India, denting both consumer satisfaction and brand image.[43] Third, the Indian proprietor would not be able to honor the warranties on the product, due to logistical problems, especially when the foreign product was sold by a separately-functioning entity.[44] Similar concerns have also been raised in the *Kapil Wadhwa* Division Bench decision.[45]

The solutions to the latter two would be to develop unnecessarily broad after-sales infrastructure and complex mechanisms to honour warranties, which is certainly a highly onerous task that further causes detriment to the proprietor.[46] A solution to the first objection lies in a resort to Section 30(4) which has been broadly interpreted to prevent any parallel import that may cause a loss of reputation or consumer confusion.[47] The position on whether the inability to provide after-sales-services or honouring warranties prohibits parallel imports remains unclear.[48]

B. The Rule Utilitarianism Path

The above discussion demonstrates that all the concerns with international and national exhaustion are, at least to some extent, resolvable by resorting to alternative legal solutions. Having said that,

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43 The EU agrees with this argument of post-sale services in imposing a regional exhaustion. See EU Economic & Social Committee (n 39) at 3.1.4; Edward Iacobucci, 'The Case for Prohibiting Resale Price Maintenance' 19(2) World Competition 71.

44 The Canadian Supreme Court has recognized that differences in warranties may be of substantial importance in deciding whether to allow the sale of foreign goods. See *Consumer Distributing v Seiko Time Canada* (1984) 1 CPR 3d 1 (Canadian Supreme Court) 24-25.

45 Kapil Wadhwa (Division Bench) (n 3) at 66-68.

46 Ibid.

47 See Kapil Wadhwa (Division Bench) (n 3) at 68; *Amazon Seller Services v Amway India* (2020) SCC Online Del 454, at 119.

48 On the one hand, the Division Bench in *Kapil Wadhwa* cited various American judgements saying that such can be grounds for restriction of sale of other goods. On the other hand, it still allowed parallel imports of Samsung Korea products, despite the same objections. See Kapil Wadhwa (Division Bench) (n 3) at 68, 75.

these solutions (especially ones involving legal proceedings under other provisions) impose undue time and cost burdens, and also leave the resolution uncertain.[49] Meaning thereby, these solutions differ in their effectiveness/comprehensiveness and in their efficiency in addressing the concerns.[50] The exhaustion regime should be such that addresses the concerns that have no efficient or comprehensive alternative solutions, and leaves out only such concerns that can anyway be efficiently and comprehensively resolved through alternative means already available in the legal system. This is called the minimization of "transaction costs".[51] This solution is in pursuance of the theories of rule utilitarians, who argue that law should facilitate the most efficient resolutions to problems.[52] The next chapter proposes a suitable alteration of the exhaustion regime, that would maximize efficiency and minimize transaction costs according to the rule utilitarian formula.

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49 For example, a recent report has highlighted huge backlogs in processing of investigations and appeals in the Indian Competition regime. See Vedika Mittal *et al.*, 'Systemizing Fairplay, Key Issues in the Competition Law Regime', Vidhi Center for Legal Policy (November 2017) 12-13, 17-18.

50 For example, competition proceedings may not be a very effective or efficient solution for the need of price parity. However, proceedings under Section 30(4) may be quite effective in removal of sub-standard or different quality products.

51 Transactions are the monetary and temporal costs incurred by the subjects of the state, in achieving the same goal through alternative means, in the absence of legal intervention by state. When a state must choose between two conflicting policies with their own respective sets of advantages and disadvantages, it must choose the one with the minimal transaction costs, in order to ensure efficiency in the legal system. High transaction costs mandate state intervention. See Oliver Williamson, 'Transaction Cost Economics Meets Posnerian Law and Economics' (1993) 149(1) J. Insti. Theo. Eco. 99, 101

52 Despite their internal disagreements, rule utilitarians like Coase, Calabresi, Posner and Williamson agree that the purpose of law is to posit "the most efficient" solution to the problems of its subjects by minimizing "transaction costs". See ibid; Ronald Coase, 'The Institutional Structure of Production' (1992) 82 Am. Eco. Rev. 713, 716; Guido Calabresi & Douglas Melamed, 'Property Rules, Liability Rules, and Inalienability: One View of the Cathedral' (1972) 85(6) Har. L. Rev. 1089, 1097; Richard Posner, 'Transaction Costs and Antitrust Concerns in the Licensing of Intellectual Property' (2005) 4 John Marshall Rev. IP Law 325, 325.

MINIMIZING THE TRANSACTION COST

The preceding discussion culminates into an interesting dilemma of choice between the schemes of national exhaustion and international exhaustion, with both regimes having various policy and economic considerations favouring them. This Chapter proposes 'partial international exhaustion' as a solution to the dilemma, demonstrating how the same brings together the best of both worlds – national and international exhaustion. But before that, the Chapter brings another relevant consideration into the multi-dimensional debate – that of the territorial division of trademarks.

A. Proliferation of Territorial Divisions

Modern multinational corporations with recognizable trademarks often simultaneously operate in different jurisdictions to optimize profits. However, due to managerial headaches, such corporations often segregate regional operations through either of two solutions. Either they create subsidiaries in each region, all of whom have regional trademarks with exclusive rights to deal in such regions ["corporate-pyramid structure"].[53] Or they make region/country-specific exclusive licenses or assignments of the trademark to external entities alongside trade secrets, to cash-in on the brand name with minimal managerial hassles ["outsourcing structure"].[54]

Both these structures cause separate legal entities to function in contractually divided exclusive territories. The evident purpose behind this territorial division is to maximize profits by preventing intra-brand competition between the different entities selling the same brand.[55]

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[53] For example, Samsung operates with 14 different subsidiaries that have 285 worldwide operations, one of which is Samsung India. See Kapil Wadhwa (Division Bench) (n3) at 2.

[54] For example, Cadbury Schweppes had assigned its trademarks in certain regions to Coca Cola. See Schweppes v Red Paralela (n 40) at 7.

[55] Intra-brand competition reduces profitability, which in turn reduces incentive to sell and incentive to invest in improvement of product and related services. See Edoardo Fornani,

However, the first-sale doctrine poses a unique problem for such a structure, in that the subsequent wholesaler of such products is perfectly capable of undertaking international arbitrage of such products. This had been the scenario in the recent *Schweppes Case* and the *Levi Straus* cases.[56] Such arbitrage creates undesirable competition between the possessors of the same trademark in different jurisdictions.

These two kinds of structures are not directly addressed by the Trade Marks Act, which stipulates the ambiguous requirement of "consent" of the proprietor. Due to varying interpretations, this "consent" requirement has led to absurd and conflicting results.[57] For example, the products sold by one's unrelated assignee have been held to have been sold through the proprietor's consent by the Barcelona Civil Court in *Schweppes*, only to be overturned by the Court of Appeal, which had contrasting views on the matter.[58] Further, it's unclear whether two subsidiaries in a corporate-pyramid having no power over

'Effects of Intra-brand competition between private labels and manufacturer brands' (2011) 21(5) Int. Rev. Retail Distri. Con. Research 541, 544.

56 Despite strict territorial divisions, in the Schweppes case, the Coca Cola product "Red Paralela" still entered the Spanish and the German markets. See Schweppes v Red Paralela (n 40) at 7-8. In the Levi Strauss case, the Levi's jeans were being parallelly imported into the EU by wholesalers and subsequent sellers from the US, Canada, and Mexico. See Levi Strauss v Costco (n 36) at 24-26.

57 There are two kinds of absurd results this has caused. First, it has led to conflicting decisions by different authorities in the same cases, on whether the consent was actually there. Example of the conflict between the ECJ (broad interpretation) and Barcelona Court of Appeal (strict interpretation) in *Red Paralela*. See Schweppes v Red Paralela (n 40); Schweppes SA v Red Paralela, SAB B 9587/2019 <https://www.poderjudicial.es/search/documento/TS/8851962/derecho%20mercantil/20190801>. Second, the understanding of "consent" by the same entity (ECJ) has also changed and still remains unclear. This distinction is manifest between the narrow "unequivocal consent" approach in *Levi Strauss* and the broad "similar branding" approach in Schweppes. See Levi Strauss v Costco (n 36) at 45; Schweppes v Red Paralela (n 40) at 56-57.

58 Grau & Angulo, 'Exhaustion of trademark rights: Barcelona Court of Appeal rules in Schweppes Case' *Lexology* (2 December 2019) <lexology.com/library/detail.aspx?g=56c815d5-290e-43c3-a464-ad95eeb884b3>.

each other can exhaust each other's rights under this "consent" test.[59] Consequently, the Act also needs to alter its language to address the issue of territorial divisions.

B. The Partial International Exhaustion Approach: An American Solution

As discussed, India needs to follow an exhaustion regime that minimizes the transaction costs of alternative solutions that are the most effective. The paper first examines the concerns of proprietor interest, product availability, and price inflation in the general context, as for these concerns it is irrelevant who originally sold the parallel imports. Then the debate is complicated by analysing the concerns of market differentiation and product uniformity/quality, by differentiating between scenarios where the same economic entity sells the product and where different entities sell products in different countries.

General Context

This sub-part analyzes the concerns of proprietor interest, product availability, and price inflation in the general context.

Proprietor Interest and Product Availability: As discussed, since India is anyway likely to have lower prices for a product, the nationality or internationality of exhaustion in India is likely to be irrelevant for the facilitation of price differentiation.[60] Even if international exhaustion exists, the arbitrage problem can be dealt with efficiently by regional resale clauses in contracts, mitigating the risk of price arbitrage.[61] While

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[59] For example, there may be two subsidiaries of the same company who cannot control each other (like Samsung has subsidiaries in India and the UK). While sale by Samsung India and Samsung UK can be said to be with consent of Samsung Korea, it is unclear whether sale by Samsung UK can also be said to be through consent of Samsung India, which does not have independent control over Samsung UK.

[60] See text to n 27.

[61] See text to n 30.

this alternative may still have loopholes when the price differentiation is excessively high, such loopholes are desirable to ensure that price differentiation does not exceed its limits.[62] Most importantly, the availability of essential products depends more on patent exhaustion than trademark exhaustion.[63] Consequently, proprietor interest and product availability concerns have comprehensive and efficient solutions, outside of mere imposition of a national exhaustion scheme.

Price Inflation: National exhaustion may lead to undesirable levels of price inflation. While the alternative solution to this is the competition regime, the same only deals with cases of extremely unfair prices (and that too only in cases of dominance),[64] rather than general price differentiation.[65] Moreover, competition proceedings are highly unpredictable and mount immense monetary and temporal costs.[66] Therefore, unlike national exhaustion, international exhaustion is not substitutable with alternative remedies, as such remedies are extremely inefficient and uncertain.

Admittedly, both the aforesaid concerns are overstated in the Indian context as India is a low-price country.[67] Having said that, the aforesaid analysis demonstrates international exhaustion to be a better solution, as national exhaustion is easily substitutable with alternative contractual schemes, that provide protection against arbitrage within desirable limitations. Now the paper brings another dimension to the debate by assessing the effect of the identity of the original seller of

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62 See text to n 31.

63 See text to n 28-29.

64 For example, in *Shamsher Kataria* the price was unfair as it the automobile manufacturers were earning 5000% profits over car parts. See *Shamsher Kataria* (n 27) at 2.5.86-2.5.99.

65 Katz mentions that competition law is a highly imperfect solution to price differentiation as antitrust law does not prohibit price discrimination by itself. It merely deals with certain kinds of price discrimination that may be egregiously unfair. See Katz (n 18) 83-84.

66 The unpredictability arises out of the infancy of the competition regime in India, especially in context of assessment of unfairness of prices. Investigation and appellate delays have also been major concerns. See Vedika Mittal *et al.* (n 49) 12-13, 17-18.

67 See text to n 20-22, 27-29.

parallelly imported products in the context of territorial divisions and product quality/uniformity issues.

C. Territorial divisions and Product Quality/Uniformity: The American Way

As highlighted, the current exhaustion regime leaves ambiguity in scenarios with conscious territorial trademark divisions. This allows exhaustion of rights in product sold by another entity in another territory goes against the fundamental purpose behind contractual territorial divisions.[68] A straightforward solution to this problem is to introduce a regime of national exhaustion.[69] However, the previous analysis shows that international exhaustion is a more efficient solution to the general concerns, although such concerns are less relevant to the Indian exhaustion regime. This is because product availability and price differentiation in poor countries like India in fact rather depends on exhaustion regimes in richer countries.[70] Since product quality/uniformity and territorial divisions are more legitimate concerns that can directly be affected by the Indian exhaustion regime, the presumption in favour of international exhaustion is rebuttable. To conclusively resolve the issue, the author differentiates scenarios where the two entities with territorial divisions are *de facto* controlled by the same group or company ("**same economic unit**"),[71] from one where the two entities do not have a common controlling source ("**separate economic entities**"), as often found in the outsourcing structure of territorial division.

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68 See text to n 48-49.

69 This is because national exhaustion will by default disallow parallel imports, no matter what the entity.

70 See text to n 27.

71 This may also be in a scenario where two entities do not control each other but are controlled by the same parent entity. This structure is usually prevalent in larger corporate pyramids. See Y Chauhan *et al.*, 'Board Structure, Controlling Ownership and Business Groups' (2016) 27 Emerging Markets Rev. 63, 63-65.

The author proposes that the solution found in the US is a viable solution in such a scenario. In the US, international exhaustion is followed if the original product had been sold by the same economic unit,[72] i.e., entities controlled by a common proprietor. As against this, national exhaustion applies to the products sold by a separate economic entity under the same trademark, though it may have been through consent or permission of the main proprietor in the USA.[73]

The twofold economic rationale behind this differentiation is impeccable. *First*, parallel imports of products first sold by separate legal entities impose higher transaction costs. This is primarily because, products sold/manufactured by separate entities are naturally likely to differ in attributes and quality,[74] which may spur a higher number of Section 30(4) proceedings by the Indian proprietors. As against this, when an entity in the same economic unit sells the product, there is higher product uniformity,[75] and are also other internal contractual mechanisms of preventing parallel imports (that can be compelled by the common controller),[76] which reduces the need to resort to Section 30(4).

Moreover, it is highly unfair for a separate entity to honor warranties or develop after-sales-services to suit products sold by an unrelated company.[77] Contrastingly, it is reasonable for the same ultimate

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72 Dobrin & Chochia (n 33) 37-38.

73 Ibid; *K Mart Corporation v Cartier* (1988) 486 US 281 (Supreme Court, US) 291.

74 Irene Calboli, 'Trademark Exhaustion in the European Union: Community-Wide or International--The Saga Continues' (2002) 6 Marqee IP L. Rev. 47, 58.

75 Ibid. This is of course more likely as the manufacturer would be the same and uniformized production methods would be used. Even if the product itself differs, the quality will be according to the general quality assurances of the brand.

76 The previously discussed solution of "regional resale clauses" can be used as a policy to prevent parallel imports by the same economic unit. This solution does not work when different entities function in different markets, as neither of them will have incentive to cut their market short by including such clauses. For discussion on regional resale clauses, See text to n 30-31.

77 See text to n 37-38.

controller to bear the loss of honoring a warranty,[78] and to globally uniformize after-sales-services for its products.[79]

Since, parallel imports of products by separate economic entities inflict high transaction costs, in such a context, the presumption in favour of international exhaustion gets overturned in favour of more efficient national exhaustion. However, since parallel imports of products by entities within the same economic unit impose almost no transaction costs, the presumption in favour of international exhaustion stands in that context.

This conclusion is bolstered by the ***second*** rationale regarding the enforcement of contractual market delineations. When separate economic entities (say licensor and licensee) divide exclusive territories for the use of the same trademark, the same is to avoid such intra-brand competition that causes loss to both of them.[80] However, when both entities form part of a single economic unit, then the unfair detriment and unfair gain through international movement of goods is only superficial, because, at the end of the day, they have the same controller/owner.

While it is true that this regime leaves the legislature and the courts with the arduous task of determining whether two entities form part of a "single economic unit", the same is not a substantial transaction cost as this is a comparatively simpler legal issue, which has fairly settled positions in Indian corporate law.[81] These standards can be

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78 This is perhaps the reason why the Division Bench in Kapil Wadhwa was inclined on discarding the "warranties and after-sales services" concern, by saying that the Indian subsidiary can provide the same instead and put up a notice clarifying that it is the Indian entity doing so and not the Korean one. See Kapil Wadhwa (Division Bench) (n 3) at 74-75.

79 Ibid.

80 See text to n 48.

81 The well-established test of control in *Subhkam Ventures* was recently upheld by the Supreme Court in *Arcelormittal. See Arcelormittal India. v Satish Kumar Gupta* (2019) 2 SCC 1, at 48-57; *Subhkam Ventures v SEBI* (2010) SCC Online SAT 35, at 6.

further fossilized by legislative guidance and through judge-made law over time, gradually making the partial international exhaustion regime even more efficient. Further, treating goods from a single economic entity as the same would be in compliance with the "*one mark, one source, one proprietor*" rule endorsed by the Supreme Court of India.[82]

Summing up, the legislature must adopt the American approach (i.e., the "partial international exhaustion" approach) through a legislative amendment, imposing national exhaustion on parallel imports by unrelated entities and international exhaustion on those by the same legal entity.

CONCLUSION

The paper has demonstrated that Section 30(3)(b) of the Trade Marks Act is inherently indeterminate, which leaves the question of exhaustion completely ambiguous, the answer to which depends on the means of interpretation preferred by the interpreter. To avoid such arbitrary determination of a policy with vast possible ramifications, the legislature must intervene to redraft the exhaustion principle in the Act.

The paper has also compared the schemes of international exhaustion and national exhaustion, demonstrating that international exhaustion is a preferable scheme when the foreign seller forms part of a single economic unit as the Indian proprietor, irrespective of whether the Indian proprietor itself "consented" to such sale or not. Contrarily, national exhaustion is preferable as a more efficient scheme when the original seller was a separate economic entity, even though such an entity may have acquired its right to sell by the "consent" of the Indian proprietor. Therefore, the paper implores the legislature to remove the "consent" test, to introduce an "ownership and control" test, as is prevalent in the competition and takeover regimes.

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82 *Power Control Appliances vs Sumeet Machines Pvt. Ltd.* (1994) SCC 2 448, at 41.